ANNUAL REPORT 2016

Mercator

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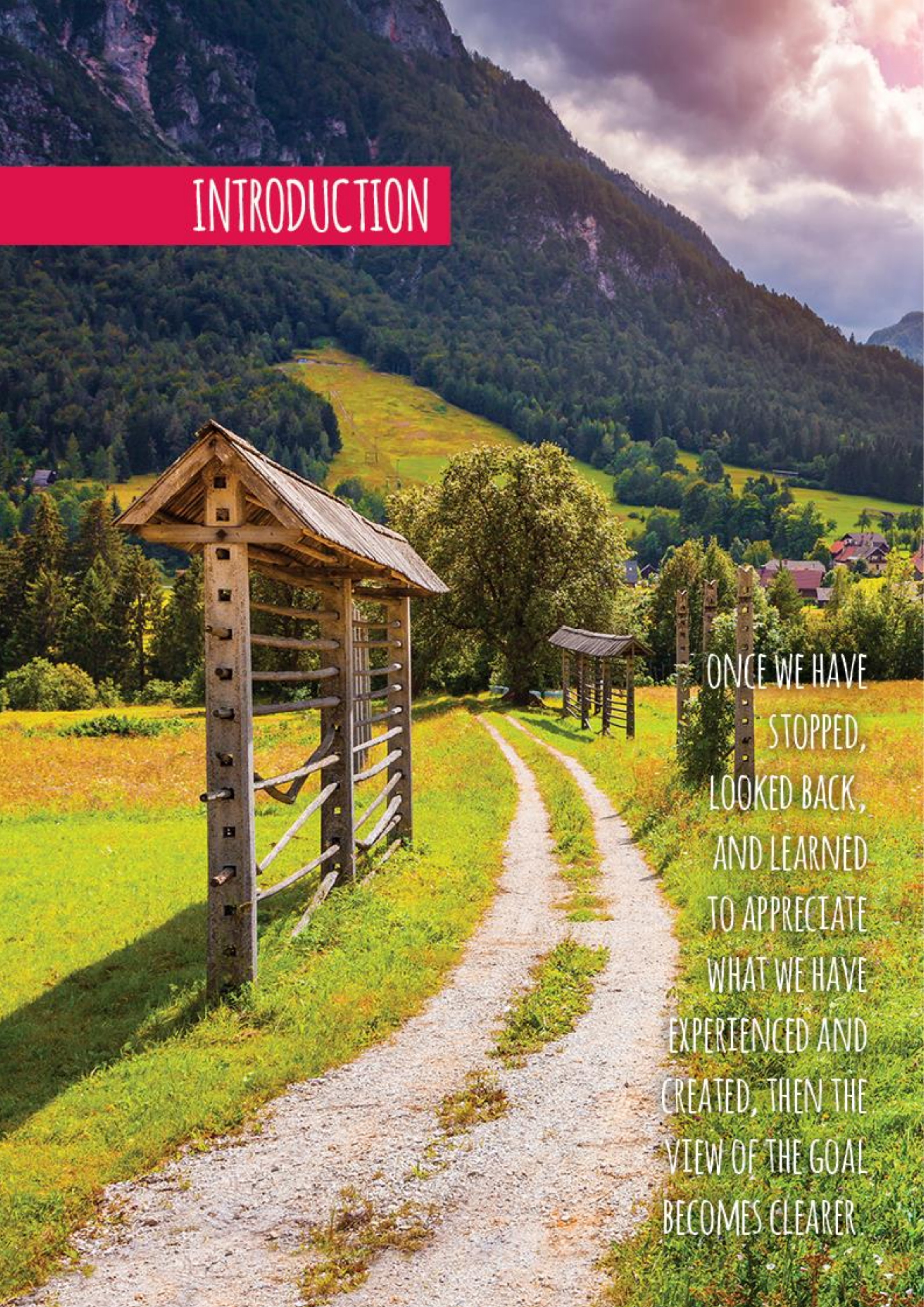


ONCE WE HAVE STOPPED, LOOKED BACK, AND LEARNED TO APPRECIATE WHAT WE HAVE EXPERIENCED AND CREATED, THEN THE VIEW OF THE GOAL BECOMES CLEARER.

REPORT BY THE PRESIDENT OF MANAGEMENT BOARD

2016 – A year of strategic transformation

Mercator's operations and performance in 2016 were determined especially by the strategic decision that stabilization of operations, improvement in competition of offer, and especially the establishment of foundations for long-term success and efficiency requires considerably higher investment into competitiveness of Mercator's offer. Relative to the years before, Mercator had to step up its efforts to improve its competitiveness. Only competitive offer, based in particular on sourcing within respective markets of the Group's operations, is the only foundation for long-term development and pursuit of individual stakeholders' goals. This applies in particular to the key market – Slovenia, which is one of the most competitive markets in the region and beyond. Major investments into competitiveness, however, also resulted in lower profitability. Nevertheless, growth of market share, especially in the Slovenian market, proves that Mercator is on the right track. With its competitiveness boosting measures, Mercator succeeded in stopping the stagnation of its market share which has been growing steadily since the end of the first quarter.

In 2016, Mercator Group revenue amounted to EUR 2,493.8 million, which is 4.5% less than in 2015. The figures are not directly comparable as Mercator was executing its strategy of focusing on its core activity. In 2016, the measures in this regard were intensified, which included divestment of Modiana and Intersport operations. This, in turn, affected operations in markets outside Slovenia.

Revenue development differed across markets. Slovenia and Serbia remain the most important markets for the Mercator Group. In Slovenia, revenue dropped by 4.0% in 2016. The cause for lower revenue includes divestments completed in 2015 (divestment of the Santana and Loka brands, divestment of Grosuplje Bakery at the end of the third quarter, divestment of tourist services M Holidays at the end of the year), divestment of Modiana at the end of the third quarter of 2016, divestment of the company Intersport ISI d.o.o. in December 2016, and divestment of other non-core operations or non-operating assets. Lower revenue is also a result of temporary closure of stores for refurbishments. Revenue was also lower in Serbia (by 6.5%), which is partly a result of divestment of Modiana and Intersport in 2016, and closing down of some stores based on a decision of the country's regulator. We also saw lower revenue in the markets of Croatia (by 9.3%) and Bosnia and Herzegovina (by 3.7%) where the companies, after successfully completed sales processes of Modiana and Intersport in 2016, only conduct real estate operations. In the market of Montenegro where we opened new neighbourhood stores in 2016, revenue in 2016 was higher than in 2015 by 6.8%.

Annual Report and performance was also affected considerably by the events and developments regarding the owner. As a result of a law adopted by the Republic of Croatia, and especially due to compliance with the International Accounting Standards, the Group had to recognize additional impairments for receivables from the companies within the owner's system. This had a material negative effect on the Group's key performance indicators. Another fact should be pointed out in particular: the Annual Report pursuant to the International Accounting Standards also records the effect of discontinued operations of the Modiana and Intersport operations on the income statement.

Regardless of Mercator's performance in 2016 and the owner's problems, Mercator Group is independent in all its key business decisions. Immediately upon commencing its term of office, the new Management Board made it a key priority to reach an agreement with its creditor banks, approaching the negotiations in a highly proactive manner. In a matter of days, the new management succeeded in restoring the confidence and striking an agreement according to which Mercator's liabilities, despite the outstanding maturing liabilities of Agrokor as the owner, shall not fall due for immediate repayment. We firmly believe this is a highly important fact confirming that Mercator's operations are stable and not directly connected to the owner's predicament.

The key takeaway is that Mercator succeeded in restoring the growth of its market share in 2016. Major investments, especially into refurbishments and updates of the retail network and capital expenditures that increased by as much as 16.9% in 2016 relative to the year 2015, have yielded results: Mercator is increasing its market share; sales are rising in particular in all refurbished and updated stores.

In the future, Mercator operations will remain stable and independent. Moreover, Mercator will do everything necessary to remain a solid business partner. On the other hand, it will seek to make use of the circumstances that are beyond Mercator's direct influence to the benefit of the employees, suppliers, creditor banks, and respective countries in which the Group is conducting its operations.

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

Ljubljana, April, 25, 2017

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 2016 by a Supervisory Board which met at five regular sessions in the course of the year. In addition, five correspondence sessions were held in 2016.

Composition of the Supervisory Board was as follows: Ante Todorić (Supervisory Board chairman), Matej Lahovnik (deputy chairman), Damir Kuštrak, Ivan Crnjac, Darko Knez, and Ivica Mudrinić as shareholder representatives; and Matjaž Grošelj, Vesna Stojanović, and Veljko Tatić as worker representatives.

Major Supervisory Board resolutions

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

- approved the Business Plan of the Mercator Group and the company Poslovni sistem Mercator, d.d., and the strategy for the years 2016 and 2017;
- the Supervisory Board discussed and adopted the Annual Report for the Mercator Group and the company Mercator, d.d., for the year 2015, and confirmed the wording of the Supervisory Board Report on the 2015 Annual Report audit;
- approved the signing of the sales agreement for the purchase of real property near the freight railway station Ljubljana–Moste (BTC Letališka) for the construction of a Mercator logistics and distribution centre;
- appointed Igor Mamuza as Senior vice president of the company Poslovni sistem Mercator, d.d., as of April 1, 2016, for the term of office lasting until September 19, 2019;
- received a presentation of the Mercator Group Internal Audit Annual Report for the year 2015;
- confirmed the revision of the investment plan for 2016;
- adopted the resolution on the signing of the agreement to divest the subsidiary Investment Internacional, d.o.o.e.l., in Macedonia;
- received information about the divestment of the activities Modiana and Beautique in the markets of Slovenia, Croatia, Bosnia and Herzegovina, and Serbia to the buyer Montecristo SL d.o.o., Slovenia;
- approved the sale of 100% shareholding in the company Intersport ISI, d.o.o., to the investor Enterprise Fund VII, Poland;
- approved the signing of the General Term Sheet between the company Poslovni sistem Mercator, d.d., and the company Numerica partnerji, družba za upravljanje, d.o.o., which pertains to real property monetization;
- adopted the proposal for appointment of the 2016 company auditor;
- approved the agenda for the 23rd Shareholders Assembly (AGM) of the company Poslovni sistem Mercator, d.d.;
- received a presentation of the results of the company Poslovni sistem Mercator, d.d., and the Mercator Group for the periods 1–3, 2016, 1–6, 2016, and 1–9, 2016;
- received information about the results of Supervisory Board and Audit Committee performance assessment, and the new Code.

Activities of the Audit Committee

The Audit Committee consisting of Ivan Crnjac, chairman (Poslovni sistem Mercator, d.d., Supervisory Board member); Damir Kuštrak, member (Poslovni sistem Mercator, d.d., Supervisory Board member); and Sergeja Slapničar, member (independent expert on accounting and auditing); held five sessions in 2016.

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

- the Audit Committee approved the 2016 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 2015;
- 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 2015;

- 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 2016 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, 2016; 1–6, 2016; and 1–9, 2016.
- the Audit Committee supervised the work of Internal Audit in the period 1–12, 2016, and submitted proposals for improvements;
- discussed the 2017 Business Plan and provided their comments;
- discussed the risks to which the Mercator Group may be exposed.

Semiannual and Annual Report for 2016

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, 2016, at their session held on August 30, 2016. 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 session held on April 25, 2017, the Supervisory Board discussed the audited non-consolidated and consolidated Annual Report for the year 2016, as audited by the auditing company Deloitte revizija, d.o.o., Ljubljana. The Annual Report had previously been discussed on the same day by the Audit Committee of company Poslovni sistem Mercator, d.d. Also present at this Audit Committee session was the certified auditor who provided any additional explanations required. On April 25, 2017, 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 2016, and confirmed it unanimously at the session held on April 25, 2017.

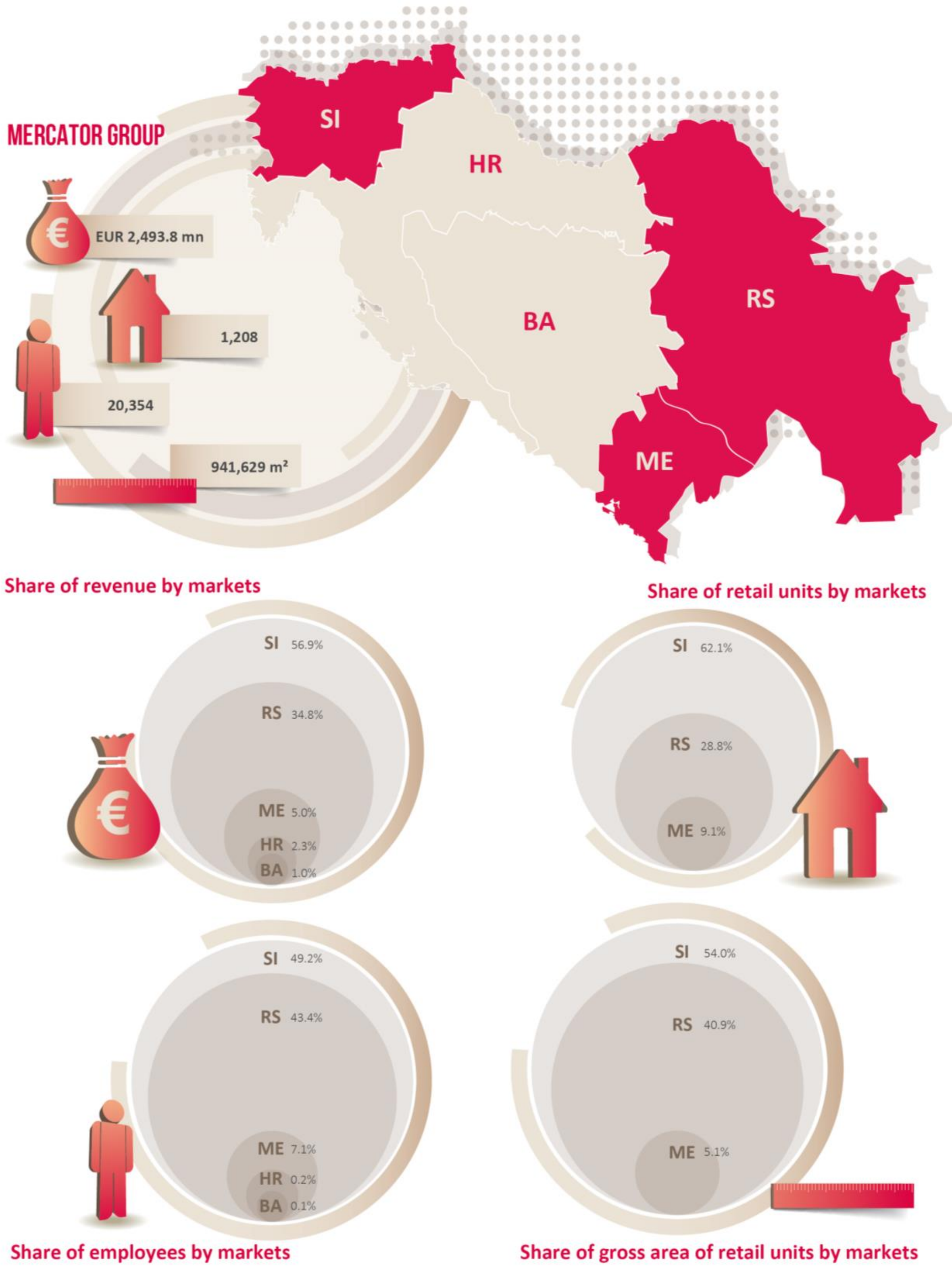
In 2016, Mercator Group generated net loss in the amount of EUR 72,735 thousand.

The company Poslovni sistem Mercator, d.d., wrapped up the year 2016 with a net loss of EUR 77,447 thousand. The company proposes that the balance sheet (distributable) loss in the amount of EUR 79,249 thousand be covered to the debit of reversal of revaluation adjustment to equity.

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 sistemi Mercator, d.d.
Matej Lahovnik
Ljubljana, April 25, 2017

2016 HIGLIGHTS BY MARKETS



PERFORMANCE HIGHLIGHTS FOR THE PERIOD 2013-2016

		Mercator Group business with discontinued operations					Mercator Group continued operations*		
		2013	2014	2015	2016	Index 2016/ 2015	2015	2016	Index 2016/ 2015
INCOME STATEMENT	Revenue (in EUR 000)	2,765,868	2,653,735	2,612,418	**2,493,802**	95.5	2,467,430	**2,374,538**	96.2
	Results from operating activities (in EUR 000)	29,121	3,946	61,510	**-39,875**	-	51,194	**-46,009**	-
	Profit (loss) before income tax (in EUR 000)	-16,945	-48,595	26,797	**-76,990**	-	16,398	**-82,997**	-
	Profit (loss) for the year (in EUR 000)	-16,929	-44,547	20,154	**-72,735**	-	10,153	**-78,063**	-
	Gross cash flow from operating activites (EBITDA) (in EUR 000)	102,857	91,993	140,322	**41,037**	29.2	128,271	**33,319**	26.0
	Gross cash flow from operating activites before rental expenses (EBITDAR) (in EUR 000)	159,255	149,952	217,758	**115,088**	52.9	201,428	**104,139**	51.7
BALANCE SHEET	Total assets (in EUR 000)	2,303,841	2,237,373	2,225,723	**2,122,836**	95.4			
	Equity (in EUR 000)	514,294	621,677	634,433	**557,375**	87.9			
	Net financial debt (in EUR 000)	977,326	785,974	849,241	**805,320**	94.8			
PRODUCTIVITY AND ABILITY TO GENERATE CASH FLOW	Productivity (in EUR 000)	124.4	127.6	127.8	**125.4**	98.1			
	Value added per employee per hours worked (in EUR 000)	20.0	20.3	23.2	**18.2**	78.3			
	Return on sales	-0.6%	-1.7%	0.8%	**-2.9%**	-	0.4%	**-3.3%**	-
	Return on equity	-3.2%	-7.5%	3.3%	**-11.5%**	-	1.6%	**-14.0%**	-
	Net financial debt / equity	1.90	1.26	1.34	**1.44**	107.9			
	Net financial debt / gross cash flow from operating activities (EBITDA)	9.5	8.5	6.1	**19.6**	324.3	6.6	**24.2**	365.1
	Gross cash flow from operating activites (EBITDA) / revenue	3.7%	3.5%	5.4%	**1.6%**	30.6	5.2%	**1.4%**	27.0
	Gross cash flow from operating activites before rental expenses (EBITDAR) / revenue	5.8%	5.7%	8.3%	**4.6%**	55.4	8.2%	**4.4%**	53.7
INVESTMENT ACTIVITIES	Capital expenditure (in EUR 000)	29,499	85,722	77,363	**90,426**	116.9			
EMPLOYEES	Number of employees as at the end of the period	22,922	22,643	21,459	**20,354**	94.9			
	Number of employees based on hours worked	22,239	20,803	20,440	**19,893**	97.3			
SHARE	Market value per share as at the end of the period (in EUR)	82.0	72.0	82.0	**68.0**	82.9			
	Earnings per share (in EUR)	-4.5	-7.3	-0.6	**-12.8**	2,038.3	-0.8	**-13.0**	-
	Number of companies in the group as at the end of the period	17	12	20	**16**	80.0			

* the impact of discontinued business activities of Modiana and Intersport is displayed in the Income statement

MERCATOR GROUP PROFILE AND ORGANIZATION

Mercator Group Profile

Mercator Group is one of the largest corporate groups in Slovenia and in the entire Southeastern European region. As at December 31, 2016, the company was present with ten companies in Slovenia and with six subsidiaries in other markets of the Southeastern Europe. Poslovni sistem Mercator, d.d., headquartered in Slovenia, is the parent company of the Mercator Group.

Poslovni sistem Mercator, d.d.	
Telephone	+386 1 560 10 00
Email adress	info@mercator.si
Website	www.mercatorgroup.si
Company head office	Dunajska cesta 107, 1113 Ljubljana
Activity	Retail in non-specialized food retail outlets (G 47.110)
Registration number	5300231
VAT tax code	45884595
LEI[1]	549300X47J0FW574JN34
Company share capital as at December 31, 2015	EUR 254,175,051.39
Number of shares issued and paid-up as at December 31, 2015	6,090,943
Share listing	Ljubljanska borza, d.d., official market, prime market, symbol MELR

1 Legal entitiy identifier

Mercator Group organization as at December 31, 2016

The Management Board represents the company. It manages its business independently and at own responsibility. As at December 31, 2016, the Management Board of the company Mercator, d.d., consisted of three members: Management Board president, and two members.

Pursuant to the Mercator, d.d., Management Board Act, the Management Board president and members were, respectively, in charge of the following fields in 2016:

- **Toni Balažič** for coordinating the work of Management Board of the company Poslovni sistem Mercator, d.d., and the Mercator Group; coordination of relations between Mercator Group and the Agrokor Group; coordination of trade operations in Serbia and Montenegro; coordination of non-core operations; corporate communication, strategic investment, and real estate management; strategic human resource management, organization, legal affairs, and wholesale, on April 4, 2017, his term of office was terminated, without any fault-based grounds or liability on his part, and he was replaced by Tomislav Čizmić;
- **Igor Mamuza** for managing trade operations in Slovenia;
- **Drago Kavšek** for finance, controlling, accounting and internal audit, IT and telecommunications, and coordination of activities of the subsidiaries Mercator - H, d.o.o., and Mercator - BH, d.o.o. On December 21, 2016, Mr Kavšek filed his statement of resignation from the post of Management Board member at the company Poslovni sistem Mercator, d.d. He stepped down from his position as of December 31, 2016.

As of December 31, 2016, the term of office of Management Board member Drago Kavšek was terminated; as of April 6, 2017, the term of office of the President of the Management Board Toni Balažič was terminated and he was replaced by Tomislav Čizmić. As of April 18, 2017, the Management Board again includes three members as Draga Cukjati was appointed Management Board member in charge of finance and IT. All 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.

Brief presentation of new members of the Management Board

- **Tomislav Čizmić**

Tomislav Čizmić holds a Master's degree in economics and has nearly 20 years of experience in executive positions in business, management, and corporate restructuring.

He joined the Mercator Group in 2013, initially as a Management Board member, and later as the Management Board president at Mercator Croatia.

In September 2014, he took over the management of the Group's most challenging project, i.e. integration and reaping of synergies between Mercator and Agrokor in five markets. Along with third-party international advisers, he has been in charge of 50 different teams that included over 1,000 people, and integration and reaping of synergies in the key business functions of 11 different fields.

Early in 2016, he managed the development of the new Mercator - S, d.o.o., business model as the assistant to the managing director of Mercator Serbia. He continued his career at Mercator as the Senior Executive Director and director of business support in Slovenia where he was in charge of all projects at the level of Poslovni sistem Mercator, d.d.

- **Draga Cukjati**

Draga Cukjati graduated in economics and has over 20 years of managerial and executive experience in international financial institutions.

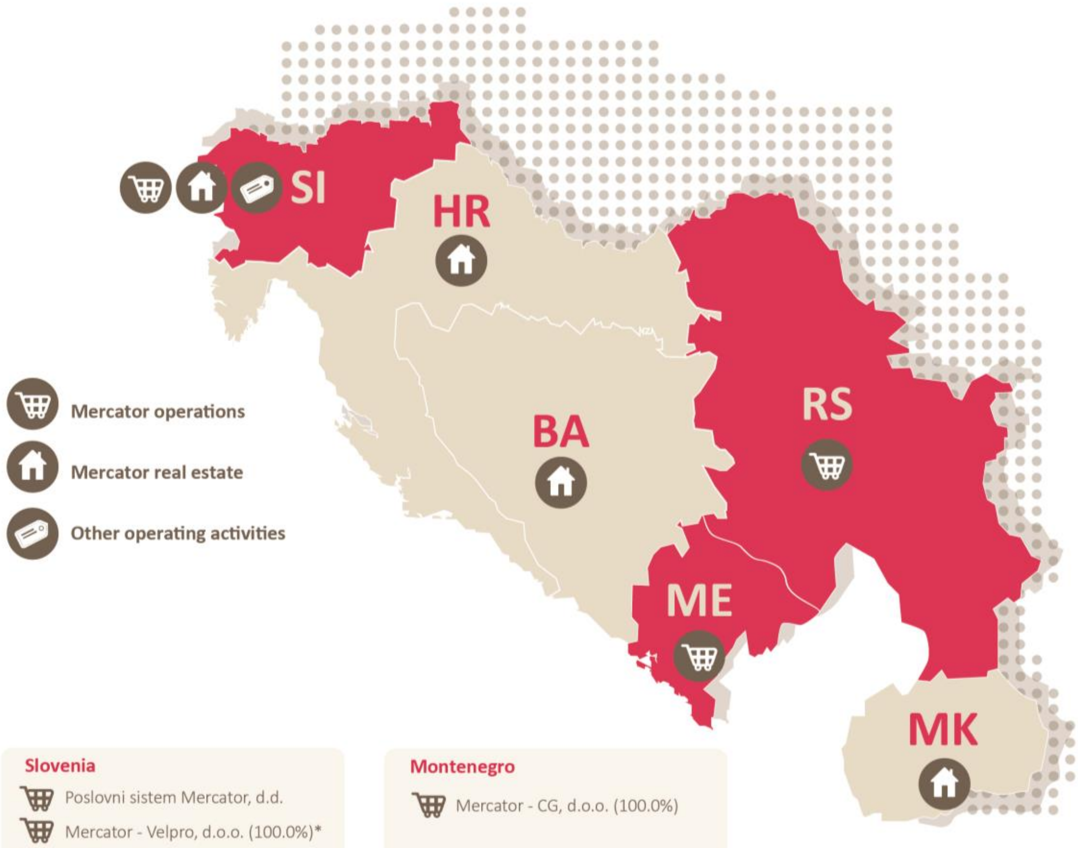
Throughout her career, Draga Cukjati worked in managerial and executive positions within the UniCredit Group in Zagreb, Vienna, and Ljubljana. She specializes in structured financing, investment banking, enterprise valuation, and mergers and acquisitions.

Her key tasks in the role of the Chief Financial Officer (Management Board member in charge of finance) will include meeting all agreed liabilities and commitments to all partners, continuation of constructive cooperation with all banks, improvement of performance and profitability, and deleveraging.

Assistants to the Management Board president as at December 31, 2016, were in charge of the following fields:

- **Vera Aljančič Falež** of human resource development, organization, and legal issues;
- **Luka Jurkovič** of real estate;
- **Igor Maroša** of wholesale development within the Agrokor Group;
- **Iztok Verdnik** for corporate communication.

Mercator Group compositions as at December 31, 2016



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 Hercegovina
- Mercator - BH, d.o.o. (100.0%)

Croatia
- Mercator - H, d.o.o. (99.3%)

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

* The company does not conduct business operations in 2016.

Branch Offices
As at December 31, 2016, Mercator Group companies did not have any branch offices.

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

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

MERCATOR GROUP ACTIVITIES

Mercator Group's core activity is **fast-moving consumer goods retail**, in a dense and extensive retail network in Slovenia, Serbia, and Montenegro. In 2016, Mercator Group continued to pursue its strategy of divesting its non-core operations. In July, we signed an agreement on the divestment of Modiana which includes apparel and other textile products, as well as body care products and other decorative cosmetics of renowned brands, offered at the Beautique drugstores. In September, we signed an agreement on the divestment of Intersport operations which include sale of sports equipment and sportswear.

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

Fast-moving consumer goods

With a dense and extensive retail network of fast-moving consumer goods stores, Mercator Group is present in Slovenia, Serbia, and Montenegro. Looking to meet all desires, tastes, and needs of our customers, we are offering over **40,000 different FMCG products**. Our sales assortment is further upgraded with private label lines such as Lumpi, Bio Zone, Mila, Dax, Nature, Special Moments. Total number of private label products on our shelves is over 3,000.

In 2016, we generated 88.2% of our revenue with sale of fast-moving consumer goods.

In the digital age, consumers start shopping before they enter the store, and the focus is on improvement of shopping experience. Thus, we are looking to adapt to the customers as much as possible by diversifying our store formats in the greatest possible number of locations. Broad market coverage is provided with **different store formats**. The largest share – 67.6% of all our FMCG stores – is accounted for by **neighbourhood stores**. In recent years, we focused mainly on refurbishments of smaller neighbourhood stores, continuing the tradition of coming closer to our customers in the local environment. Diversity of store formats is rounded off with hypermarkets, supermarkets, a comfort store, a convenience store, and wholesale units.

Particular attention is paid to freshness and Slovenian origin. Thus, our FMCG assortment includes regular offer under the slogan **Radi imamo domače (We like homemade)**. The project includes over 2,000 Slovenian growers and suppliers, and 20 cooperatives.

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 10,000 well-priced products, with option of payment in instalments and free delivery for all orders above EUR 200.

Mercator Real Estate

Real estate is a separate 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 continuous improvement. Within this field, we seek to reach the optimum in managing our buildings, developing our retail network, and improving the attractiveness of our shopping centers.

Service activities and manufacturing

Mercator Group also offers its customers other service activities like self-service petrol stations **Maxen**. 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., operates according to a modern concept of employment of persons with disabilities, to whom Mercator Group dedicates particular attention.

Maxi

Mercator's offer at the Maxi department store fosters quality development of shopping culture and successfully satisfies the fastidious tastes of even the most demanding consumers. Offer at the Maxi department store is comprehensive and it includes apparel, cosmetics, footwear, fast-moving consumer goods, culinary service, and supplementary offer.

Apparel and cosmetics

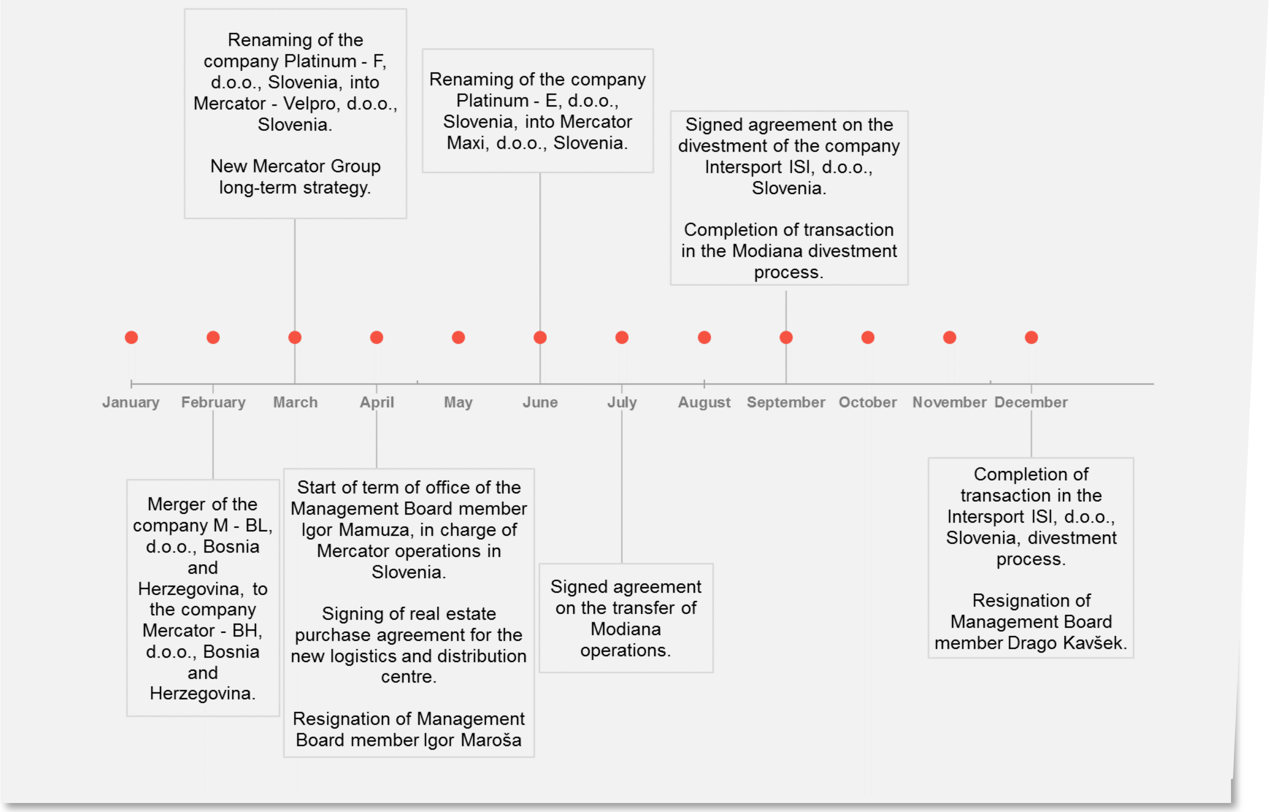
Modiana stores offer apparel of renowned fashion brands, while Beautique stores offer cosmetic products. These two programs were divested in 2016.

Sportswear and equipment

Intersport stores offer the customers the latest sportswear and sports equipment. The sportswear and equipment program was divested in 2016.

KEY EVENTS

Brief summary of key events in 2016



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

Senior vice president in charge or category management, purchasing, wholesale, and marketing of the company Poslovni sistem Mercator, d.d., **Igor Maroša**, filed on April 18, 2016, his statement of resignation from the position of Senior vice president. Based on the statement, his term of office as Management Board member was terminated as of April 30, 2016. At the Supervisory Board session held in March, the Supervisory Board approved, upon proposal by the President of the Management Board Toni Balažič, the appointment of **Igor Mamuza**, previously a Assistant to management Board, as the new Senior vice president in charge of Mercator operations in Slovenia. He started his term of office on April 1, 2016.

On December 21, 2016, Senior vice president at Poslovni sistem Mercator, d.d., **Drago Kavšek** filed his statement of resignation from the position of Senior vice president in charge of finance, IT, accounting, and the markets of Croatia and Bosnia and Herzegovina. As of January 1, 2017, the Management Board of the company Poslovni sistem Mercator, d.d., thus consists of: Toni Balažič, president of the Management Board; and Igor Mamuza, Senior vice president.

Changes in Mercator Group composition and other changes related to the Group's operations

Two companies were founded at the end of 2015: **Intersport H, d.o.o.**, Croatia; and **Intersport BH, d.o.o.**, Bosnia and Herzegovina. Both are subsidiaries of the Slovenian company Intersport ISI, d.o.o. The companies launched their activities in 2016 – Intersport BH, d.o.o., at the start of the calendar year, and Intersport H, d.o.o., in March 2016.

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

In March 2016, a change in the company name was entered into the court register, from **Platinum - F, d.o.o.**, to **Mercator - Velpro, d.o.o**. The new company was founded with the primary purpose of independent development of the wholesale segment and boosting the wholesale and logistics operations. The company does not yet conduct any business activity.

In late April 2016, the company Intersport S trgovina, d.o.o., was founded, headquartered in Serbia; it commenced its business activities in July. The newly founded company is a subsidiary of the Slovenian company Intersport ISI, d.o.o.

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

On July 14, 2016, the companies **Poslovni sistem Mercator, d.d.**, and **Montecristo SL, d.o.o.**, successfully signed an agreement on the **divestment of Modiana operations**. The subject of the sales process at hand includes apparel stores and Beautique drugstores in all markets of Mercator operations (Slovenia, Croatia, Serbia, and Bosnia and Herzegovina). The agreement includes takeover of activities at all locations, as well as transfer of assets and all employees. Sales procedure was formally completed on September 30, 2016.

We are pursuing a strategy of focusing on the core activity.

In August 2016, the company **Intersport CG, d.o.o.**, headquartered in Montenegro, was entered into the court register. It commenced its operations on September 1, 2016. The newly founded company is a subsidiary of the Slovenian company Intersport ISI, d.o.o.

The company **Poslovni sistem Mercator, d.d.,** and the company **Enterprise Fund VII** of Poland, a private investment fund managed by Enterprise Investors, signed on September 13, 2016, a sale and purchase agreement for the company **Intersport ISI, d.o.o.**, the parent company of the Intersport Group which in turn is the 100% shareholder of the following subsidiaries: Intersport BH d.o.o., Bosnia and Herzegovina; Intersport CG d.o.o., Montenegro; Intersport H d.o.o., Croatia; and Intersport S trgovina d.o.o., Serbia.

Real estate purchase agreement for the new logistics and distribution centre

In April 2016, the companies **Poslovni sistem Mercator, d.d., and Slovenian Railways** (Slovenske železnice d.o.o.) signed a real estate purchase agreement for the property on which a new Mercator logistics and distribution centre (LDC) is to be built. The property is located at the freight railway station Ljubljana–Moste (BTC Letališka). The value of the transaction was EUR 17 million, and the value of the entire investment is estimated at approximately EUR 100 million. The purpose of construction of the logistics centre is to centralize the warehousing activity, optimize the operating costs, successfully compete with other retailers, and to modernize operations.

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

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

Opening of the refurbished centre Mercator Šiška

On July 21, 2016, the updated **Mercator Šiška** shopping centre was reopened. After the refurbishment, it is Mercator's flagship centre offering an all-around shopping experience on an area of 6,618 m^2.

Awards and other achievements

1.


3.


2.


4.


Mercator IP, d.o.o., received three medals of quality at the 54th agriculture and food industry fair AGRA. Chefs Danilo and Marija and their team prepare quality spreads made of select ingredients, marketed under the **Danilo & Marija** brand. The bronze medal was won by the spread **Tatarc resna delikatesa**; silver medal was won by tuna spread **Modro dož´vetje**; and gold medal was won by cod spread **Bakalar Morske sanje**.

The QUDAL – Quality Medal survey, conducted in Slovenia in June of 2016 by the international organization Icertias of Zurich, has shown that in terms of quality when shopping for hand soap bars, Slovenians see the **Dvorec Trebnik soap** as the choice of the highest quality. Another recipient of the QUDAL – Quality Medal accolade is the **Idea store format** in Serbia, for 2016/2017, which received the QUDAL for the retailer with the highest quality level in the country of its operation. We are also a medal recipient in the category of **cured meat products among private labels.** The QUDAL award was also presented to our **Mercator Call Centre** and the **M Tehnika web store**. (3.)

Working with the Ministry of Labour, Family, Social Affairs and Equal Opportunities, the Ekvilib Institute presented the basic and full certificates **Family-Friendly Company**. Festive award ceremony was held at the Poligon Creative Centre in Ljubljana. They also presented special awards for spreading the culture of family friendly company, which was received by the companies Poslovni sistem Mercator, d.d., and Mercator IP, d.o.o., social enterprise. (2.)

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

In November 2016, the 5th Shopper's Mind E-Commerce Day conference took place. **Mercator online store** won The Shopper's Mind Committee Award which is a special award for the greatest improvement and web store revision. (4.)

IGD, the leading professional global organization in the trade industry, released a list of 15 stores in the world to visit in 2017. The list of the best stores, which includes stores from Sydney to Toronto and from Buenos Aires to Shanghai, also features the **Mercator Šiška hypermarket**.

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

Our campaign **Jump to Mercator, support our ski jumpers** was short-listed for the finals of the **SPORTO contest** for the best projects in sports marketing.

We received the **Superbrands** certificate in 2016.

In March 2016, Pika card was recognized as the **best customer loyalty card** in an independent survey conducted by the company Valicon.

Mercator's humanitarian activities

Working with the Slovenian Red Cross organization, Mercator donated bread in the international campaign **Breadcrumb** for aid to families in financial distress across Slovenia. We donated a total of 5 tons of bread within the project.

Mercator's holiday caravan worked with volunteers to collect, prepare, and wrap presents, surprising 2,017 children in 17 Slovenian towns in a single day. The children were also visited by Santa Claus with his entourage.

Major events following the end of period at hand

As of January 1, 2017, Dean Čerin was appointed Assistant to Management Board president in charge of financial, accounting and controlling.

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%. The share of their voting rights remains unchanged.

In April 2016, the Agrokor restructuring program was launched. The goal of restructuring is to provide stability to Agrokor. It should be noted that Mercator Group companies have small number of business operations and financial transactions with the company Agrokor d.d. and its subsidiaries which are not a part of the Mercator Group. Mercator Group's operational risks related to Agrokor Group are described in more detail in the financial part of the Annual Report, under the note Financial Instruments.

As of April 5, 2017, the term of office of Management Board president Anton Balažič was terminated. 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. Thus, the Management Board of Poslovni sistem Mercator, d.d., is operating in the following composition: Tomislav

Čizmić, president of the Management Board; Draga Cukjati, Management Board member, and Igor Mamuza, Management Board member.

As of April 15, 2017, Krešimir Ležaić was appointed Assistant to Management Board president in charge of IT and telecommunications.

In 2016, receivables payable by the Agrokor Group companies that are not a part of the Mercator Group were impaired at the companies Poslovni sistem Mercator d.d., Mercator–H d.o.o., and Mercator–BH d.o.o. At its extraordinary session held on April 14, 2017, the Supervisory Board instructed the Management Board to immediately examine all possibilities of settling or offsetting all mutual receivables and liabilities between the Mercator Group companies and Agrokor Group companies that are not a part of the Mercator Group. If such offsetting is possible, this will result in a reversal of impairments and additional revenue for the Mercator Group in the amount of such receivables impairment.

CORPORATE GOVERNANCE STATEMENT

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. The Corporate Governance Code (Official Journal RS No. 118/2005, dated December 17, 2005, changed and amended on February 5, 2007, revised and adopted on December 8, 2009) – hereinafter referred to as the Code – is available in Slovenian and English at the Ljubljana Stock Exchange website at www.ljse.si. The company's decision to commit to the provisions of the Code is voluntary. On October 27, 2016, a new Corporate Governance Code was adopted to come into effect as of January 1, 2017. Thus, the company Poslovni sistem Mercator, d.d., still refers to the Code revision from 2009 which was in effect until the start of this year.

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 2016 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., have in 2016 reviewed 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:

- Relations with shareholders

Recommendation 4.2: Given the fact that majority shareholder communicates their investment plans on their own initiative, the company did not invite them separately to publicly disclose their management policies with regard to their investment in this publicly traded stock corporation.

Recommendation 5.2: 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); records are kept internally.

Recommendation 5.10: The company publicly released identification of the three largest shareholders present or represented at the Shareholders Assembly, rather than the five largest shareholders, because the three largest shareholders account for over 90% of total voting rights. The company specified the number of shares and voting rights for each such shareholder.

- Supervisory Board

Recommendation 6.2: Considering the current ownership structure of the company Poslovni sistem Mercator, d.d., in which two Agrokor Group companies hold over 88% of total company shares, the Supervisory Board therefore includes more than one half of the members with close economic ties to the said shareholders.

Recommendation 7.1: Some Supervisory Board members have not produced documentation to prove their specialized professional or expert competencies for Supervisory Board membership. Nevertheless, they qualify for such engagement due to professional competencies or experience.

Recommendation 8: All Supervisory Board members have signed a special statement specifying their position on meeting each of the independence criteria. However, the company did not announce the signed statements on its website; the statements are deposited at the company headquarters.

Recommendation 10.1: Considering the highly concentrated ownership structure of the company Poslovni sistem Mercator, d.d., explained under section 6.2, a Management Board member at the company's largest shareholder was appointed Supervisory Board chairman.

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

Legal transactions between the company Mercator, d.d., and the parent company of the Agrokor Group

The company Poslovni sistem Mercator, d.d., as a subsidiary, did not enter or execute any legal transaction with its parent company in 2016, which would result in damage or negative consequences for the subsidiary's operations and performance. Moreover, there was no legal transaction between the parent company and the subsidiaries in this period based on any obligatory instruction. Pursuant to Articles 545 and 546 of the Companies Act, 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.

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 Group companies; also important is appropriate delineation of powers and responsibilities.

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 at the Group 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 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 audit 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, a lot of care is devoted to their regular education. We provide both internal and third-party professional education, as well as training to acquire the "soft" skills.

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 23rd regular Shareholders Assembly, the shareholders appointed the auditing company Deloitte revizija, d.o.o., Slovenia, as the auditor for the company Poslovni sistem Mercator, d.d. The auditing company Deloitte is also in charge of auditing the Group and most of the subsidiaries.

Auditing company Deloitte revizija, d.o.o., employs the most recent audit methodology which is developed to comply with the latest national and international auditing standards, as well as to support and improve the quality of the audit and contribute to its efficiency.

Internal audit

In addition to the Management Board, Supervisory Board, and independent auditor, internal audit is one of the pillars of corporate governance. Internal audit reports to the Management Board and to the Audit Committee of the company Poslovni sistem Mercator, d.d., Supervisory Board. Activities of Mercator Group internal audit are compliant 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. The subject of Mercator Group internal audit are especially the fields with a higher degree of risk and the fundamental, key processes. 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.

Internal audit conducts regular and extraordinary audits. In 2016, 5 regular and two extraordinary internal audits were carried out. The audits were conducted in purchasing and category management, retail, wholesale, and logistics.

Corporate social responsibility is viewed by Mercator Group as a cornerstone of future success of our society and the Group and company Poslovni sistem Mercator, d.d. 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.

Rules in this respect were laid down in the document titled "Policy of Motivating Responsibility and Integrity". Instructions were also published on the website[2]. 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 2016, internal audit discussed 14 reports.

Audit Committee

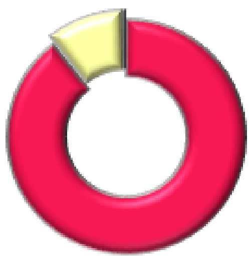
Audit Committee of the Supervisory Board of the company Poslovni sistem Mercator, d.d., has been in operation with varying membership since 2008. It plays an important role in the total corporate governance structure of the company Poslovni sistem Mercator, d.d., and the Mercator Group. It aids the Supervisory 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.

Cooperation with the Financial Administration of the Republic of Slovenia

In March 2016, the company Poslovni sistem Mercator, d.d., was awarded a special status by the Financial Administration of the Republic of Slovenia, within the program for encouragement of voluntary fulfilment of obligations and settlement of liabilities, and resulting decrease in administrative load of financial regulation and supervision; this program is a form of continuation of the horizontal monitoring pilot project. Thus, the company continues to work with the Financial Administration, and this cooperation is based on transparency, understanding, and mutual trust.

Composition of major holders of company securities as at December 31, 2016

		Country	Number of shares	Share
1	Agrokor d.d.	Croatia	3,621,992	59.47%
2	Agrokor Investments B.V.	Netherlands	1,744,187	28.64%
3	Societe Generale - Splitska Banka d.d.	Croatia	393,792	6.47%
4	Addiko bank d. d.	Croatia	173,264	2.84%
5	Zagrebačka Banka d.d.	Croatia	35,393	0.58%
6	Galić Josip	Croatia	21,525	0.35%
7	Erste Group Bank AG	Austria	6,148	0.10%
8	Raiffeisen bank international AG	Austria	1,891	0.03%
9	Clearstream Banking SA	Luxembourg	1,875	0.03%
10	Banque Pictet and CIE SA	Switzerland	1,107	0.02%
	Total		**6,001,174**	**98.53%**



Ten largest shareholders hold a combined share of 98.53% of the company Poslovni sistem Mercator, d.d.

2 http://www.mercatorgroup.si/sl/druzbena-odgovornost/

Company rules on appointment of members of managerial and supervisory bodies and changes to the Articles of Association

As at December 31, 2016, the company Poslovni sistem Mercator, d.d., was represented by a three-member Management Board. 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. All 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. As of January 1, 2017, the Management Board of the company Poslovni sistem Mercator, d.d., thus consist od two members.

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 interest of the shareholders, and the 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

Shareholders Assembly is the superior body of governance through which the shareholders assert their rights with regard to the company affairs. The company Poslovni sistem Mercator, d.d., is committed to full compliance with the principle of equal treatment of shareholders, allowing them to exercise their legal or statutory rights. All shareholders shall have equal voting rights.

As a rule, Company Management Board shall convene the Shareholders Assembly of Poslovni sistem Mercator, d.d., once per year. The convocation shall be announced at least 30 days before the Assembly meeting. The convocation of the Assembly shall be announced in the Delo daily paper, and in the electronic information dissemination system of the Ljubljana Stock Exchange called SEOnet, 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. A shareholder or a proxy may assert the voting right at the Assembly by presenting a written authorization. Convocation of the Assembly, agenda, proposed resolutions with the relevant explanations, and the Assembly resolutions, are also announced on the company website at www.mercatorgroup.si.

On May 10, 2016, the 23rd regular Shareholders Assembly took place with 94.34% of total shares with voting rights present. The Shareholders Assembly included a presentation of the 2015 Annual Report and the Supervisory Board Report on the audit results for the 2015 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 2016. The Shareholders Assembly appointed the auditing company Deloitte revizija, d.o.o., as the company auditor for 2016.

Managerial and supervisory bodies

MANAGEMENT BOARD MEMBERS:

President of the Management Board – Toni Balažič (until April 5, 2017)

Education:

- MBA, BA Economics

Fields of responsibility:

- coordination of relations between the Mercator Group and the Agrokor Group
- coordination of the work of the Management Board of Poslovni sistem Mercator, d.d., and the Mercator Group;
- coordination of trade operations in Serbia and Montenegro
- coordination of activities of the social enterprise Mercator IP, d.o.o., and M - Energija, d.o.o.
- coordination of activities of the Intersport Group
- coordination of activities of the Technical Consumer Goods Division
- coordination of activities of the Modiana Division
- corporate communication
- strategic investment and real estate management
- strategic human resources, organization, and legal affairs
- wholesale

Management Board member / senior vice president in charge of finance, IT, and the markets of Croatia and Bosnia and Herzegovina – Drago Kavšek (until December 31, 2016)

Education:

- BA Economics

Fields of responsibility:

- finance, controlling, accounting, and internal audit
- IT and telecommunication
- coordination of the activities Mercator - H, d.o.o., and Mercator - BH, d.o.o.
- managing other fields subject to authorization by the President of the Management Board

Management Board member / senior vice president in charge of operations in Slovenia – Igor Mamuza

Education:

- BA Economics

Fields of responsibility:

- category management and procurement of trade goods
- retail and supply chains
- logistics
- marketing
- business support to Mercator operations Slovenia
- maintenance and refurbishments
- store format development and standardization
- managing other fields subject to authorization by the President of the Management Board

SUPERVISORY BOARD MEMBERS:

Supervisory Board Chairman – Ante Todorić

- Education: BA economics, MA finance
- Employment: Agrokor, d.d., vice president of the Agrokor Group

Supervisory Board Members Representing Shareholders

Matej Lahovnik, deputy chairman

- Education: PhD in management and organization
- Employment: Faculty of Economics, University of Ljubljana; professor

Damir Kuštrak

- Education: BS construction engineer, MS agronomy
- Employment: Agrokor, d.d., advisor to the president of the Agrokor Group

Ivan Crnjac

- Education: BA Economics
- Employment: Agrokor, d.d., Management Board member in charge of strategy and capital markets

Darko Knez

- Education: BS mechanical engineering and shipbuilding, MA economics
- Employment: Konzum, d.d., Management Board president; Labud, d.d., Management Board president

Ivica Mudrinić

- Education: BS electrical engineering
- Employment: Mudrinic Management Consulting d.o.o.

Supervisory Board Members Representing Employees

Matjaž Grošelj

- Education: sales manager, VI level of education
- Employment: Head of distribution system I at the company Poslovni sistem Mercator, d.d.

Vesna Stojanović

- Education: administration clerk
- Employment: senior independent expert in HRM and general affairs at Poslovni sistem Mercator, d.d.

Veljko Tatić

- Education: sales manager, VI level of education
- Employment: senior business consultant in retail channels at Poslovni sistem Mercator, d.d.

Observing the diversity policy

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 mostly consists of male employees and the Supervisory Board only includes one female employee. In terms of other aspects of the diversity policy, the managerial and supervisory bodies have suitable composition.

Information on activities and composition of the Audit Committee

Operations of the Audit Committee of the Supervisory Board of the company Poslovni sistem Mercator, d.d., are consistent with the provisions of the Companies Act (ZGD-1). As of September 19, 2014, its members include: Sergeja Slapničar, independent expert; and Ivan Crnjac and Damir Kuštrak, Supervisory Board members at Mercator, d.d. The activities of the Audit Committee are aimed at further improvement of performance of the supervisory function at the company.

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 company of the Mercator Group, operates by the principles of improving business performance in each subsidiary and the Mercator Group as a whole, common harmonized development of the Mercator Group, optimum supply of fast-moving consumer goods and services in all markets of Mercator Group's operations, improving competitiveness, efficient allocation and coordination of material flows, harmonized and coordinated procurement and sales at home and abroad, financing current operations and development with common funds, and security, risk and liquidity management, and maximum returns in financial management within the legal framework provided by the restructuring agreements.

In Slovenian and foreign subsidiaries incorporated as limited liability companies (d.o.o.), the parent company Management Board members performs the function of company Assembly; alternatively, the parent company Management Board, either entirely or partially (with involvement of only some of its members), takes part in the work of the Supervisory Boards of these companies. The employees present in the bodies of governance at these companies do not receive any additional compensation for the performance of such functions

MERCATOR GROUP BUSINESS STRATEGY

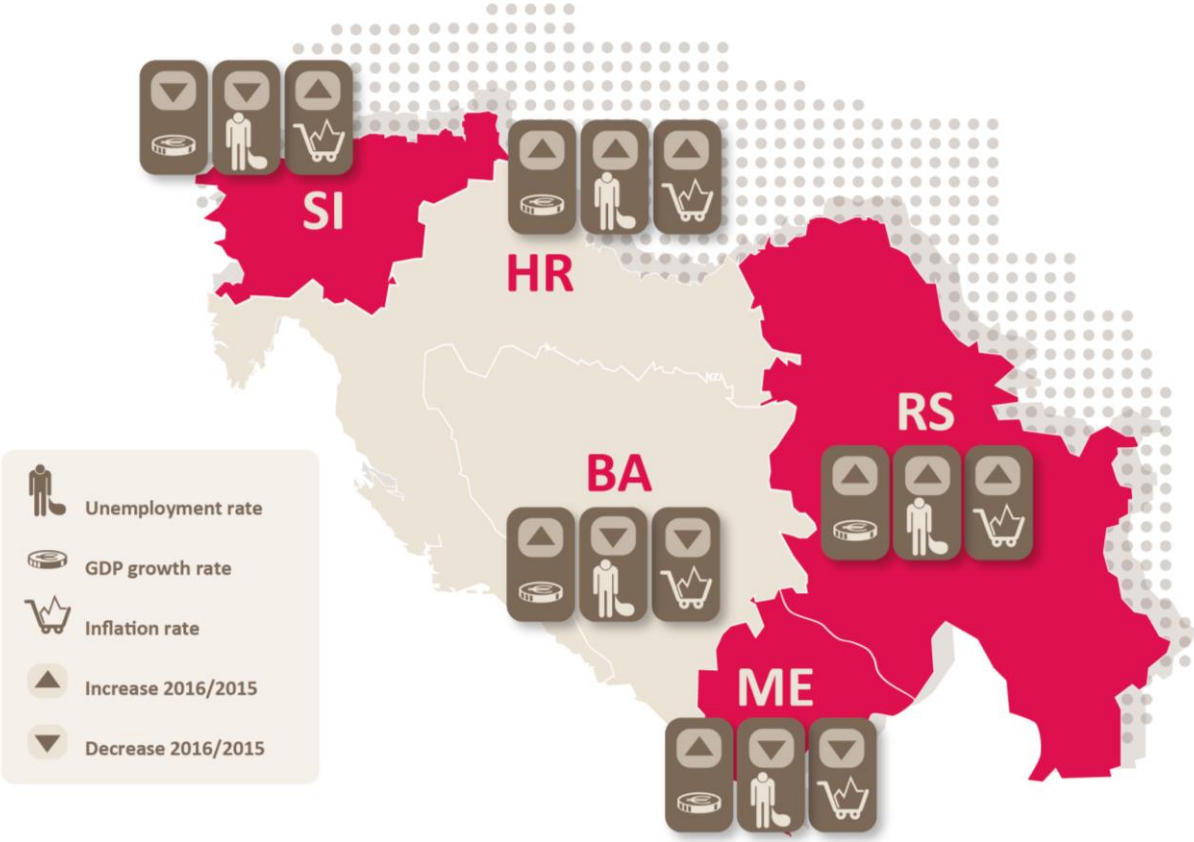
Vision	**Mercator will be the biggest, the most successful, and the most efficient retailer in the markets of Slovenia, Serbia, and Montenegro.**
Mission	Happy customers recognize Mercator as the best retailer.
	We enjoy trust from all stakeholders.
	Motivated employees are the key competitive advantage.
Strategy	VALUE FOR MONEY Day in, day out, Mercator fulfils the needs and expectations of its customers, and offers the best value for their money with innovative offer.
	LOCAL Mercator works closely with its environment and continues its local initiatives which are reflected in the most extensive network of stores that are closest to the customers.
	THE BEST OFFER In addition to the offer of renowned brands, Mercator's private label products offer customers solid quality and competitive pricing. Mercator introduces innovative products and adjusts the offer in each of its stores to customer needs.
	THE ULTIMATE FRESHNESS Mercator offers its customers the broadest choice of innovative products that are relevant to them, with stable partnership with local and regional suppliers.
	THE BEST SERVICE With a friendly and amiable approach, Mercator employees are focused on the customers. With intensified refurbishment of its stores, Mercator offers its customers improved shopping experience in a pleasant ambiance.

BUSINESS REPORT

WE ARE NOT LOOKING FOR THE SHORTEST AND EASIEST WAYS, BUT ALWAYS THE BEST ONES.

EFFECT OF ECONOMIC CONDITIONS AND COMPETITION ON MERCATOR GROUP OPERATIONS IN 2016[3]

Economic conditions in 2016



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

Key macroeconomic indicators in the markets of Mercator's operations

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

		2013	2014	2015	2016	Index 2016/ 2015	Estimate 2017
Gross domestic product growth (in %)	Slovenia	-1.1%	3.0%	2.6%	**2.3%**	88.5	2.0%
	Serbia	2.6%	-1.0%	0.7%	**1.8%**	257.1	2.3%
	Monetenegro	3.5%	2.0%	4.0%	**4.7%**	117.5	2.5%
	Croatia	-0.9%	-0.7%	1.1%	**1.9%**	172.7	2.1%
	Bosnia and Hercegovina	2.5%	2.3%	1.9%	**3.0%**	157.9	3.2%
Inflation rate (in %)	Slovenia	1.9%	0.4%	-0.6%	**0.1%**	-	1.5%
	Serbia	7.8%	2.2%	1.6%	**1.7%**	106.3	4.0%
	Monetenegro	1.8%	-0.2%	1.6%	**0.9%**	56.3	1.3%
	Croatia	2.3%	0.2%	-0.1%	**0.4%**	-	1.4%
	Bosnia and Hercegovina	-0.3%	1.5%	0.5%	**-0.7%**	-	1.2%
Unemployment rate (in %)	Slovenia	10.1%	13.1%	12.3%	**11.2%**	91.1	7.7%
	Serbia	22.1%	20.0%	17.7%	**18.7%**	105.6	22.4%
	Monetenegro	19.5%	19.3%	17.7%	**17.3%**	97.7	19.0%
	Croatia	17.3%	17.7%	16.2%	**16.4%**	101.2	16.4%
	Bosnia and Hercegovina	27.5%	27.5%	27.0%	**26.5%**	98.1	26.0%

Economic conditions in the period 1 - 12, 2016

Relatively favourable economic developments continued in the euro zone at the start of the last quarter of 2016. With strengthening of private spending which had contributed the most to economic growth in the euro zone in the first three quarters of 2016, revenues in retail saw the highest increase. Other forecasts remain positive as well at the start of 2017 as confidence indicators in the economy and among consumers continue to improve. Also contributing to the increase of household consumption was the improvement in conditions in the euro zone labour market. Unemployment rate, in decline since 2013, hit the lowest value after 2009 in October 2016.

> Private spending was increasing in 2016.

In December, prices of crude oil Brent reached the peak for 2016, and prices of other raw materials started to recover as well. At the end of 2016, the European Central Bank kept the interest rate unchanged and extended the quantitative easing program to ensure price stability. The current program, expiring in March, will remain in place, with lower monthly purchases (from EUR 80 billion to EUR 60 billion), until the end of 2017 or until inflation rate approaches the medium-term target. At the end of 2016, inflation in the euro zone amounted to 1.1%.

SLOVENIA

Increase in activity continued in most industries in the last months of 2016. With stronger international demand and favourable export competitiveness, growth of exports and processing manufacturing output increased further relative to the year before. With further growth of private consumption, revenue in retail has also increased in recent months, especially in the segment of durables and semi-durables, and in leisure services, which is also related to solid revenue from international tourists. Lower government investments in particular have kept the activity low in the construction industry. Real exports and imports of goods remained high early in the fourth quarter. Exports of services increased further, while imports remained at the same level as in the third quarter of 2016. Manufacturing output in processing industries also remained high. With further relatively high sales, prices of residential real estate increased further in the third quarter, topping the figure from a year ago by 5%. With further improvement of conditions in the labour market, consumer confidence improved further at the end of the year, which was reflected in further growth of household spending.

The number of registered unemployed decreased (by 8.5%) in 2016 with increased hiring. The number of unemployed was close to the level from the years of stable economic growth. Growth of average gross salary in the first ten months of 2016 was the highest in the last five years, although it still lags considerably behind the growth from the time before the economic crisis. Consumer prices at the end of 2016 were higher year-on-year (by 0.5%), especially on account of an increase of raw material and service prices. The drop in energy prices which contributed the most to the deflation in 2015 started to decrease in the second half of 2016. At the end of the year, energy prices were on a par with the figures from a year earlier.

In the first eleven months of 2016, real sales revenue in retail was 3.2% higher than in the same period of the year before. Relative to the equivalent period of previous year, it increased the most in non-food retail, by 6.8%. It also increased in specialized stores with motor fuels, while in food retail it was still somewhat lower than sales in 2015.

Credit rating by markets

Market	Rating in 2016	Outlook	
Slovenia	A-	positive trend	↑
Serbia	BB-	positive trend	↑
Croatia	BB	stable trend	≈
Bosnia and Herzegovina	B	stable trend	≈
Montenegro	BB+	negative trend	↓

Competitive conditions in the markets of Mercator's operations

SLOVENIA

Effect of market situation on consumption

Consumer confidence[4] in Slovenia in 2016 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 regarding savings had a negative effect on the annual change. According to Nielsen[4] data, consumer confidence in Slovenia in the third quarter of 2016 was slightly higher than in the second quarter of 2016, but still below the European average.

The share of respondents believing the country is in recession decreased by 3 percentage points and it stood at 71% for 2016, while in 2015 it was at 74%. Just over 70% of respondents believe that the country will not recover from the recession in the next 12 months. Their primary concerns are security of employment, own health, and rising costs.

Competition

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 86% of the market[5]).

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4 Nielsen: Consumer Confidence Index, Q2 2016, Slovenia

5 Valicon, market share survey

SERBIA

Effect of market situation on consumption

Consumer confidence in **Serbia** is slowly but constantly improving;[6] however, it remains below the European average. A high share of respondents – 82% – believe the country is in a recession. Nearly three quarters of respondents in believe that the country will not recover from the recession in the next 12 months. Consumers are the most concerned about security of employment, health, work-life balance, and their own health. As many as 54% will save on out-of-home entertainment, and slightly 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.

GDP growth in Serbia was at 1.8%; therefore, better or at least the same economic conditions are expected based on the forecasts. Household consumption will increase. Security of employment is the primary concern of the population.

Competition

Trade is relatively less consolidated (top 10 retailers account for 36% of the market[7]) as traditional retail (smaller independent retailers) is still predominant. Mercator's competition includes international retailers (Delhaize, Metro) and domestic retail chains (DIS, Univerexport, Aman and Gomex).

MONTENEGRO

Effect of market situation on consumption

In 2016, Montenegro's GDP rose by 4.7%. Unemployment rate remains high at 17.3%. Average salary and income of retirees remain unchanged, persisting at the 2010 level.

Competition

The Montenegrin market is the least consolidated compared to other markets of the region; traditional retail continues to account for a considerable share. In 2016, most retailers expanded their sales network: Mercator, Voli Trade, Domaća trgovina, Laković, and Mesopromet Franca.

6 Nielsen: Consumer Confidence Index, Q3 2016, Adriatic

7 FMCG vrijednosno panel kucanstava GfK 2016

SALES AND MARKETING [8]

Sales

The euro zone saw positive business growth in 2016. Increase in private consumption could also be perceived. Private spending contributed the most to the euro zone economic growth. Forecasts for next year are optimistic as well. Unemployment rate, hit the lowest value after 2009 in October 2016.

Slovenia saw positive economic growth in 2016, largely fuelled by rising exports and stronger household consumption.

Economic growth was also positive in other countries of Mercator's presence in 2016. High unemployment rate remains one of the biggest problems in all markets, especially in Bosnia and Herzegovina.

Global economic crisis had a strong impact on the fast moving consumer goods retail industry. Rising prices of food products, weak growth of personal income, and low consumer confidence rate have led to a drop in consumer confidence in Europe in recent years, and this has affected even the essential product categories of food and beverages.

Mercator Group revenue in 2016 amounted to EUR 2.5 billion.

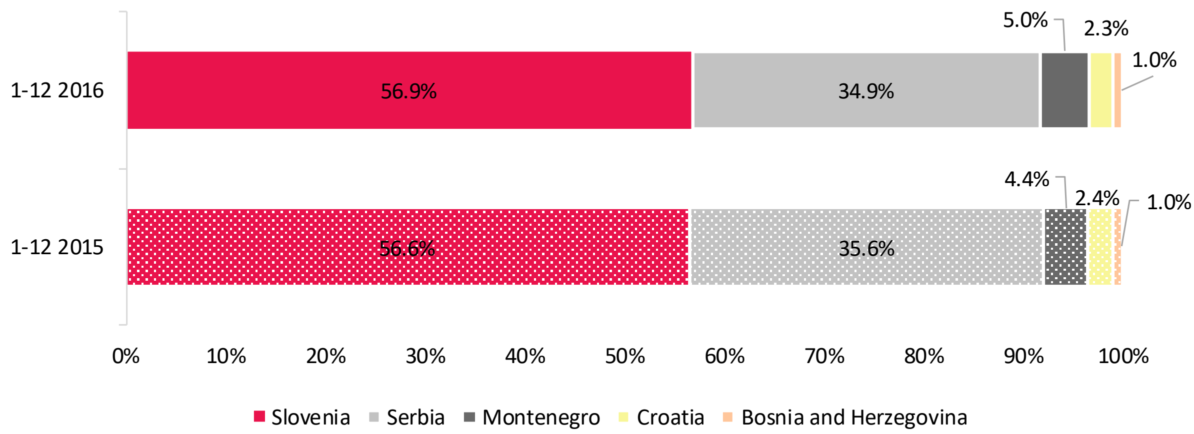
In 2016, Mercator Group revenue amounted to **EUR 2,493.8 million**, which is 4.5% less than in 2015. Revenue development differed across markets. Slovenia and Serbia remain the most important markets for the Mercator Group.

In **Slovenia**, revenue dropped by 4.0% in 2016. The cause for lower revenue includes divestments completed in 2015 (divestment of the Santana and Loka brands, divestment of Grosuplje Bakery at the end of the third quarter, divestment of tourist services M Holidays at the end of the year), divestment of Modiana at the end of the third quarter of 2016, divestment of the company Intersport ISI, d.o.o., in December 2016, and divestment of other non-core operations or non-operating assets. Revenue was also lower in **Serbia** (by 6.5%), which is partly a result of divestment of Modiana and Intersport in 2016. We also saw lower revenue in the markets of **Croatia** (by 9.3%) and **Bosnia and Herzegovina** (by 3.7%) where the companies, after successfully completed sales processes of Modiana and Intersport in 2016, only conduct real estate operations.

In the market of **Montenegro** where we opened new neighbourhood stores in 2016, revenue in 2016 was higher than in 2015 by 6.8%.

8 Following is a comprehensive view of the Mercator Group sales activities in 2015 and 2016, which means it also includes sales operations of Modiana and Intersport in the periods when these two activities were still a part of the Mercator Group.

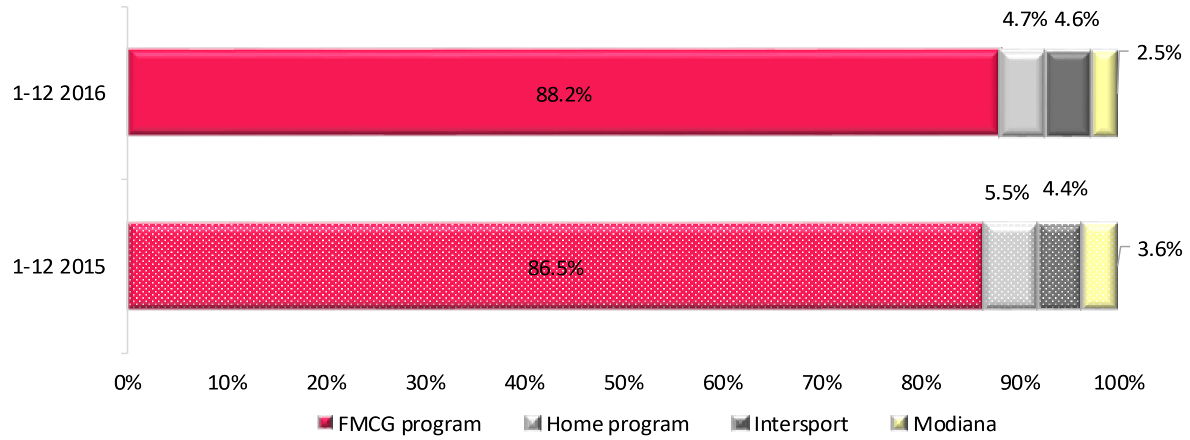
Mercator Group revenue by geographical segments:



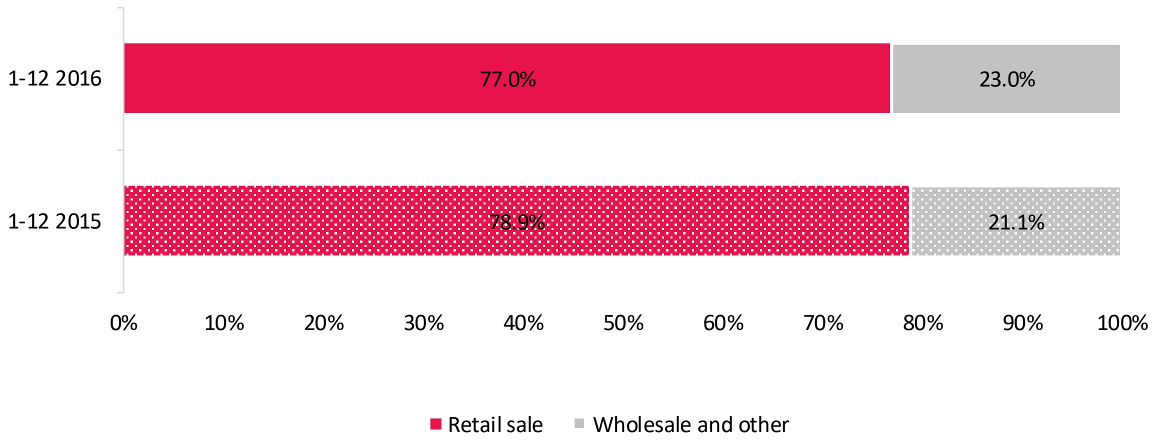
Mercator Group revenue from trade operations by programs:

> The Group generates the largest share of its total revenue in Slovenia with the fast moving consumer goods program.

In 2016, the majority of Mercator Group revenue resulted from sales of fast-moving consumer goods as they accounted for 88.2 percent of total revenue; revenue from other specialized programs amounted to 11.8 percent. Relative to the year before, Mercator Group saw the highest drop in revenue in the apparel program (Modiana), as a result of the completion of the sales process and transfer of Modiana activities to the new owner as of September 30, 2016. Moreover, revenue is lower in the sportswear equipment program due to the completion of the divestment process for Intersport operations in early December of 2016. Lower revenue was also seen within the home product program since this program was discontinued in 2016 in the markets of Serbia and Montenegro, and the number of retail units in Slovenia decreased by 3. Lower revenue within the fast-moving consumer goods program is partly a consequence of final discontinuation of this program in Croatia as of June 30, 2015.



Mercator Group revenue by type of sale:



In 2016, Mercator Group generated 77.0% of the Group's revenue from retail, while the remaining 23.0% was generated in wholesale and other activities.

Store formats, customer segments, and category management

Store formats

Composition of sales units as at December 31, 2016

COUNTRY	SLOVENIA	SERBIA			MONTENEGRO		MERCATOR GROUP		
STORE FORMATS	Mercator Number of units	Mercator Number of units	Roda Number of units	Idea Number of units	Mercator Number of units	Roda Number of units	Number of units	Gross area	Net sales area
Hypermarkets	22	2	30	4	-	2	60	268,344	182,516
Supermarkets	109	-	3	90	-	13	215	227,171	149,150
Neighbour stores	338	-	-	207	-	92	637	248,108	148,167
Comfort stores	1	-	-	1	-	-	2	6,296	3,776
Mini stores	1	-	-	-	-	-	1	159	83
Cash & Carry / VELPRO	13	-	-	11	-	3	27	80,615	36,644
Total FMCG program	484	2	33	313	-	110	942	830,693	520,337
Restaurants	8	-	-	-	-	-	8	2,070	1,379
Technical consumer goods	44	-	-	-	-	-	44	61,401	37,730
Total specialised programs	52	-	-	-	-	-	52	63,471	39,109
Total retail units under management	**536**	**2**	**33**	**313**	**-**	**110**	**994**	**894,164**	**559,446**
Franchise stores	214	-	-	-	-	-	214	47,465	31,919
TOTAL	**750**	**2**	**33**	**313**	**-**	**110**	**1,208**	**941,629**	**591,365**

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

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

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

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

Major refurbishments of Mercator stores took place in 2016. In total, we completed in 2016 comprehensive refurbishments of 15 stores spanning a combined total gross area of 31,090 m^2; partial refurbishments of 13 stores spanning a combined total gross area of 4,638 m^2; and we updated the refurbishments of 36 stores with a total gross area of 29,734 m^2. Before the summer season, our offer was improved and a facelift was carried out at several tourist-oriented units, both at the seaside (Portorož, Piran, Lucija), and in the Gorenjska region (Bled, Bohinj, Bohinjska Bistrica). In September, the fully refurbished store at Slovenska cesta 55 in Ljubljana was opened. The store's product mix was further adjusted to cater to the shopping needs of passers-by looking to quickly shop for a snack or lunch, and to daily shoppers residing in the vicinity of the store. At the end of November, we completed comprehensive update of the Koseze supermarket. The supermarket was renovated in accordance with the new concept that places more emphasis on offer of fresh program, a larger fruit and vegetables department, a new bakery etc.

Mercator hypermarket Šiška was ranked among the 15 best stores in the world.

After the refurbishment in July, **Mercator hypermarket Šiška** in Ljubljana became **the most modern** hypermarket in Slovenia and the broader region. IGD, the leading global professional organization in the trade industry, included **Hypermarket Šiška on the list of 15 best stores in the world** to visit in 2017. This is additional proof that Mercator is setting new trends in retail on a global scale.

With its unique ambiance and many new features in its offer and services, Hypermarket Šiška delivers a modern shopping experience and offers unique culinary experiences. The offer includes over 35,000 types of products, including 5,000 entirely new ones in 2016. There are many new features, in particular:

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

Store formats by country and store brands

Country	Fast moving consumer goods	Home products, textile and cosmetics and other non-core activities
SLOVENIA	Mercator	MAXEN MAXIMALNA ENERGIJA M Tehnika INTERSPORT MODIANA BEAUTIQUE
SERBIA	Mercator IDEA RODA	INTERSPORT MODIANA BEAUTIQUE
MONTENEGRO	IDEA	M Tehnika INTERSPORT
CROATIA		INTERSPORT MODIANA
BOSNIA AND HERCEGOVINA		INTERSPORT MODIANA BEAUTIQUE

The following programs were divested in 2016:

- Modiana and Beautique in all markets of our operations (September),
- Intersport in all markets of our operations (December),
- M Tehnika in the market of Montenegro (December).

Customer segments

The needs and desires of our customers are highly diverse. We learn about them by analyzing their shopping behaviour, either through market research or shopping data analysis. Upon this basis, we can adjust the offer and the retail area accordingly, and plan our marketing activities. All major activities are approached with a three-dimensional mindset: offer, store (place), and customer.

In 2016, we stepped up the scope of our activities to adjust the offer to different customer segments.

In 2016, 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.

Category managemet

In category management, we pursue the following goals:
- to build a quality multi-level offer of both branded and private label products,
- to provide competitive prices for branded and private label products, to include appealing offer in our sales promotion activities,
- to efficiently manage our store area at the level of each product or category and store as a whole,
- to provide adequate in-store sales service.

Marketing

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

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

1. We provide well-priced shopping
2. With Pika, our customers save more
3. We Love Local
4. We provide a pleasant shopping experience
5. New shopping technology
6. Offer of private label products

We provide well-priced shopping

We are constantly adapting to customer needs and demand, but we also create new opportunities and services that make everyday easier for our customers. Convenience, rationality, and quality are important factors affecting the consumers' choices. Our **key policy is to focus on satisfying the needs of modern consumers and to offer well-priced shopping.** 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.

We are focused on actual customer needs. Our offer is adjusted to customer demand, and we are introducing increasingly more Slovenian offer in the fresh departments. We prepare regular and seasonal special offers and campaigns, and various short-term activities that involve well-priced offer. More special campaigns are dedicated to Mercator Pika card holders as we wish to offer more to our most loyal customers.

The company Poslovni sistem Mercator, d.d., is continuously pursuing the goal of the most effective favourable pricing for the customers. Each week, we offer appealing discounts in our special campaign catalogue for products from a variety of categories. Every day, consumers can shop at our stores for products with discounted prices in all key 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. 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. Such prices are set based on an analysis of prices for similar or same products in Slovenian retail. In the shelf, the discounted price for such product is labelled along with the new price and the percentage of discount.

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.

We wish to make sure that our basket of products represents the best value to our customer, both in terms of pricing and quality. Therefore, we are constantly adjusting our marketing mix and we hold campaigns that include favourable shopping, as well as new ways to win discounts or savings.

Quality offer of fresh produce, competitive pricing, the most widespread store network, and the broadest offer of Slovenian products and produce are a permanent feature, a standard expected from the company Poslovni sistem Mercator, d.d., by our customers, and which we are happy to deliver. In addition to the pleasant shopping environment and excellent trade service, they also expect new features that cannot be seen elsewhere.

With Pika, our customers save more

Advantages of the Pika Card customer loyalty system are now known to virtually every household in Slovenia. Customers can win and use the Pika bonus points on the entire offer, and they are offered immediate Pika discounts on select products. The card also allows deferred payment and payments in up to 24 instalments at a zero interest rate. Pika card affords the customers a number of benefits when shopping in Mercator's sales network and at partner companies.

In 2016, the Pika card was recognized as the best customer loyalty card.

For the segment of customers keen on shopping in the web store, we will continue to allow the functionality of online payment for alimentary products and technical consumer goods using the Mercator Pika card. We will continue to upgrade and develop our unique Pika card loyalty system in the future.

In addition to the Pika discounts on select products from the flyers, and double and triple Pika card bonus points which are available to all Pika card holders, additional discounts are offered to all retirees who show their retiree card at the check-out counter.

We are also preparing custom tailored offer for customers who allowed us to track their shopping behaviour. Thus, we are looking to meet their wishes and needs as well as we can. In the future, we will continue to develop activities dealing with the wishes and needs of our customers.

We Love Local

The **Locally Grown** ("Iz domačih krajev") project has been focused in recent years on Slovenian offer of fresh produce. We were the first in the market to offer our customers seasonal fruit in vegetables. The project also emphasizes our other advantages, such as: meat 100% raised in Slovenia; milk and dairy products from 100% Slovenian milk; and bread made of 100% Slovenian wheat.

Homemade is the best. Therefore, the Locally Grown project has been upgraded since May 2016 at over 300 Mercator stores across Slovenia to include special stands and shelves offering exclusively authentic local produce. As we want your nearest Mercator store to be stocked with the best offer of local produce in a single place, we label with a red heart, on dedicated shelves, the **We Love Local** ("Radi imamo domače") products. This includes offer of authentic products and products from local farms, growers, and producers. Our broad family of partners, currently comprising over 2,000 Slovenian growers, processing operations, and suppliers, has been further extended with new local suppliers, the farmers. Our offer of Slovenian products, already broader than anywhere, was extended with a varied offer of over 900 new types of genuine products from local farms.

We provide a pleasant shopping experience

In spring this year, 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, guerilla advertising, local advertising, labelling, and an opening event.

In May and June 2016, some of our **Mercator centres** celebrated their anniversaries which included a lot of entertainment for the visitors and bonuses for the shoppers. The weekend of June 17 to 19 was the **Crazy Discount Weekend** at all Mercator centres and trade centres. In addition to exclusive discounts by our tenants, we also prepared promotional campaigns and supplier samplings or tastings, promotion of BMW automobiles, an event for the children, and a party with a DJ.

In December, we treated our visitors at major centres to free gift wrapping service for the customers, and a visit by the Santa Claus.

In 2016, more precisely in July, we **completely transformed our largest hypermarket Šiška**. There was a major clearance sale in the week before the closing. Store refurbishment was accompanied by a prominent re-opening ceremony at which our customers were treated to snacks at culinary islands offering a unique and interactive shopping experience, and children were offered a weekend of

unforgettable fun and outdoor experiences. Also celebrating the opening was a major contest that involved giving away a recreational vehicle (a camper home) 10 electric bicycles, and 100 weekend getaways in Slovenia. The second wave of similar opening activities took place in late August when most people returned from holidays. In September, we celebrated the Mercator centre Šiška birthday when we again prepared a number of activities for our customers, and again we did not leave out the youngest among them. They were entertained by the band Čuki, unleashed their creativity at workshops, and finally helped us cut the birthday cake. Happening went on late into the night with night-time shopping. In autumn months, we held the We Love Local contest which included taking 40 people to St. Martin's Day festivities at the Brda wine region, and we celebrated the feast of wine when a wine road was opened in Šiška. At the end of the year, we again held many activities for our customers. In the days of holiday warmth, we offered them free gift wrapping service, tasting of holiday delicacies in special cooking demonstrations held by our suppliers, we served sparkling wine, held a concert by the singer Alya, and more. We devoted particular attention in this festive time to our youngest visitors. Each weekend, they had fun at the Santa Claus Dream Factory, saw a play, or met with Santa and told him their wishes – many of which actually came true. In the last half of the year, we also issued 4 special flyers for Šiška, distributed to 150 thousand households in Ljubljana and surroundings in order to show our customers the special features of this store.

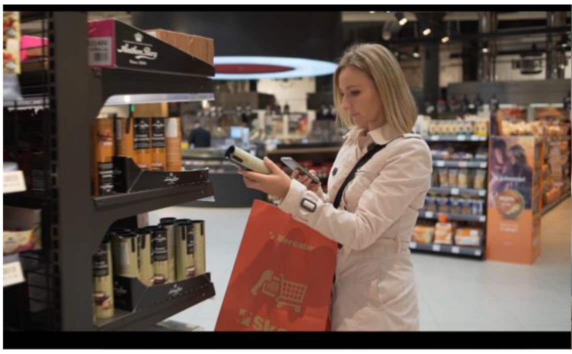
New shopping technologies

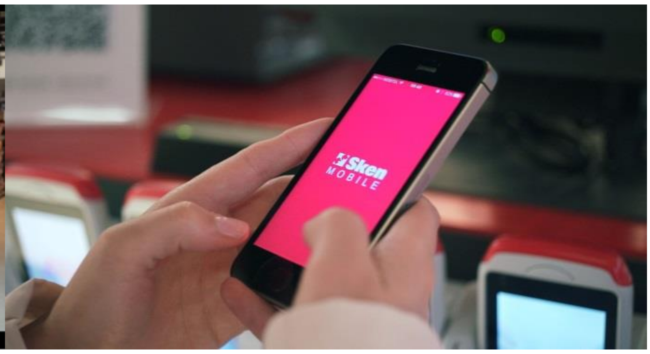
M sken (self-scan shopping service) is a new technological feature that changes the way we shop. The customers use a phone-sized scanner which they get at the entrance to the store to scan the product bar codes. Products are then paid for at the rapid check-out counter without having to place them on the conveyor belt, as they have already been scanned during shopping.

In 2016, we expanded the M sken project to new stores.

Implementation of the M sken service already took place in late 2015 at the Mercator Šmartinska hypermarket. In 2016, project implementation expanded to refurbished stores (in March to hypermarket Rudnik Supernova, and in July to hypermarket Celje and Mercator Šiška).

Upon opening of the refurbished Mercator Šiška store, we brought the service even closer to the customers, as they can now shop with the M sken service without a portable scanner, using their smart phones (Android and iOS) instead.





Offer of private label products

Mercator private label lines offer a variety of products for all occasions, at all price segments. In 2016, we continued to offer communication support to our **new private label lines**: dairy products **Mila**, new line of tissue paper products **Natur**, and the **Dax** line for home and household. Also launched were the body care products **Olea and Man Extreme**, and new sunbathing cosmetic products. In March, before Easter, we presented the products of our new **Special Moments premium line**. The products include small treats for special moments, especially during holiday seasons. Therefore, they were also communicated in during the Christmas and New Year holiday season. Revision of product appearance in the **central Mercator private label line** continued. Flyers and activities of the project **Jump to Mercator, support our jumpers!** promoted the sales of key alimentary categories of the Mercator line. This project also included the presentation of the organic products with a new name **Bio Zone**, and the redesigned **Lumpi diapers**. Broad communication support across a variety of media outlets and at the stores was provided for the **Lumpi** label. **Bio Zone line** was finally launched in late June to enrich our offer of organic products with quality new additions. We also developed appealing communication with our brand ambassador Alenka Košir who prepared tips and recipes throughout the year, showing our customers how an organic diet is more natural and simpler. The key purpose of the line is to bring these products closer to young families, thus coming closer to this segment of customers as a retailer.

Upon the launch of the revised line of the Bio products and introduction of the Bio Zone line, we prepared an SMS competition Choose BIO, travel to Rio. In the summer, we ran a strong campaign to successfully launch the **new Mercator beer**, with a new flavour and new packaging. In 2016, the beer was the best-selling private label product.

In the second and third quarter, we supported the Mercator private label communication with two catalogues that presented in a comprehensive way our private label lines and singled out the new additions to the offer. This was supported with the umbrella slogan "Thank you for trusting our private label products" as research has shown that Mercator customers have great confidence in our private label products. The campaign also included emphasizing the key advantages of our private labels, and in particular the predominantly Slovenian product origin. It is still the case that among the private label products, over 70% of products sold are of Slovenian origin. This includes over 2,000 products by more than 140 Slovenian producers. The support also took the form of a TV ad, as well as billboards at the start of the campaign. As a part of the 2016 edition of the increasingly popular Ljubljana Marathon, we successfully carried out the promotion of our Lumpi brand. On the day of the Lumpi Run event we literally took the centre of Ljubljana and provided joy for the children with additional activities and "healthy" Bio Zone pancakes according to the recipe by Alenka Košir. We wrapped up the year with preparations for the Lumpi diaper donation for babies born on January 1, 2017.

REAL ESTATE MANAGEMENT [9]

In 2016, Mercator Group's priority in investment activities, consistently with the investment plan, was refurbishment of retail units and setting up new stores acquired through operating lease. We opened 51 new units: 36 FMCG units, 9 Intersport stores, one Benetton apparel unit, one home product unit, three Cash & Carry units, and one distribution centre. We also sought and assessed new potential locations to expand our retail network for all Mercator programs, including a new logistics and distribution centre in Slovenia. The result of the latter process is the acquisition of the site in Ljubljana, based on the purchase agreement signed in April 2016.

Our investments in 2016 amounted to EUR 90.4 million. Majority of this figure (64.0%) pertains to projects carried out in Slovenia.

Except for the Trade Centre Bled, the construction of which is in progress, we did not construct any own units in 2016. Investment funds were mostly used for renovation and investment maintenance of the existing retail network, and for investment into new leased stores. Major acquisitions in Slovenia include the refurbished hypermarket in Rudnik, Ljubljana, hypermarket in Ptuj, and hypermarket and Intersport at the Mercator Center Celje. We also renovated the hypermarket at Mercator Center in Šiška, Ljubljana, which now allows shopping according to the latest shopping trends, and brings new trends to Slovenia and the broader region. This hypermarket was listed among 15 best stores in the world by the leading global research and education organization in retail, the IGD.

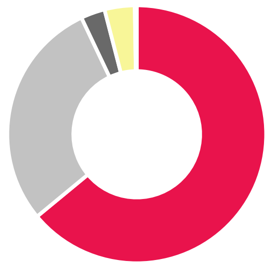
Following are Mercator's key goals in real estate management:

9 Following is a comprehensive view of the Mercator Group real estate management activities in 2015 and 2016, which means it also includes real estate operations of Modiana and Intersport in the periods when these two activities were still a part of the Mercator Group.

Investment and Divestment

In 2016, Mercator Group investment into property, plant, and equipment (CAPEX) amounted to EUR 90.4 million. Of this amount, 64.0% was used for investments in Slovenia and 36.0% was used for investments in foreign markets.

	Capital expenditure in 2016 (in EUR 000)	Structure (in %)
Slovenia	57,868	64.0%
Serbia	26,202	29.0%
Montenegro	2,725	3.0%
Croatia	3,408	3.8%
Bosnia and Herzegovina	223	0.2%
TOTAL	**90,426**	**100.00%**

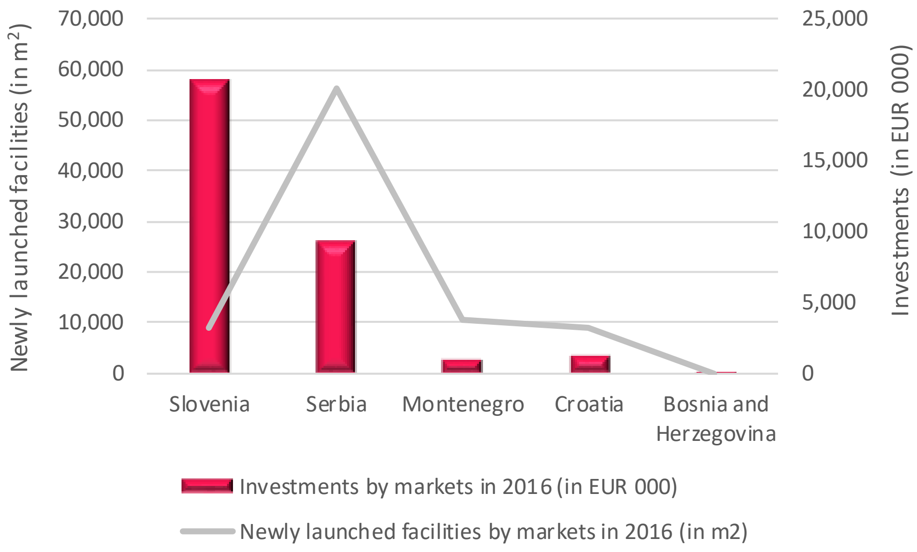


Investments into expansion of retail capacity accounts for 14.2% of total investments; refurbishments, renovations and updates account for 45.3%; investments into IT 13.8%; investments into logistics 24.7% (of which 84.9% pertains to the new logistics and distribution centre in Ljubljana – acquisition of land, plans etc.); while the remaining 2% were invested into non-trade activities.

In 2016, Mercator Group acquired 30,151.99 m^2 of gross store area. All new gross areas, except for technical consumer goods store Nove Jarše which is a part of an already operating Mercator's own shopping centre (of which Mercator is the owner), and the expansion of Intersport Celje, were acquired through operating lease.

In 2016, Mercator Group divested property, plant, and equipment worth EUR 18.6 million, of which EUR 14.2 million pertains to the divestment of property (real estate) and EUR 4.4 million pertains to plant and equipment.

Newly opened sales area and investments by markets in 2016:



Summary of total gross retail area as at December 31, 2016 (in square meters):

	Used for own operations	Leased out-Konzum	Leased out-third parties	Total at December 31, 2016
Owned retail area	516,822	108,562	313,147	938,531
Leased retail area	377,342	74,905	141,951	594,198
Total retail area	**894,164**	**183,467**	**455,098**	**1,532,729**
Owned warehouse capacity	130,878	661	15,772	147,311
Leased warehouse capacity	55,667	25,982	6,658	88,307
Total warehouse capacity	**186,545**	**26,643**	**22,430**	**235,618**
Owned commercial facilities	17,310	0	2,309	19,619
Leased commercial facilities	7,788	0	0	7,788
Total commercial facilities	**25,098**	**0**	**2,309**	**27,407**
Gross area under management	**1,105,807**	**210,110**	**479,837**	**1,795,754**
- of which owned	665,010	109,223	331,228	1,105,461
- of which leased	440,797	100,887	148,609	690,293

SUMMARY OF RETAIL UNITS LAUNCHES BY MARKETS IN 2016

SLOVENIA

Area of new facilities: 3,210m^2

Number of new units: 2

Openings: Tehnika (technical consumer goods) Nove Jarše, Ljubljana; Intersport Outlet, Ljubljana

Expansions: Intersport MC Celje

Refurbishments:

Number of refurbished units: 18 (15 FMCG stores, 1 Intersport, 1 technical consumer goods store, 1 C&C)

CROATIA

Area of new facilities: 3,118m^2

Number of new units: 5

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

SERBIA

Area of new facilities: 20,086m^2

Number of new units: 31

Openings: Market Sivac; Market Karađorđeva, Šabac; Market Irig; Market Strahinića bana, Belgrade; Supermarket London, Belgrade; Supermarket Retail park, Subotica; Market Kneza Miloša, Kragujevac; Market Sarajevska, Belgrade; Supermarket Medijana, Niš; Supermarket Dragana Rakića, Belgrade; Supermarket Novi Banovci; Market Bogatić; Market Vojvode Stepe, Belgrade; Market Titel; Market Bujanovac; Market Makenzijeva, Belgrade; Market Ćirila i Metodija, Stara Pazova; Market Vuka Karadžića, Loznica; Market Jagodina; Market Braničevska, Belgrade; Market Zlatibor; Market Trg Oslobobođenja, Požarecac; Market Braće Jugovića, Belgrade; Supermarket Kanjiđa; Supermarket Trg Đ. Stanijevića, Negotin; Market Đure Salaja, Negotin; Market Karapandžina, Negotin; Diskont pića (C&C), Cara Nikolaja, Belgrade; C&C Belgrade; Intesport Pančevo; distribution centre Novi Banovci

Refurbishments:

Number of refurbished units: 9 FMCG stores

BOSNIA AND HERZEGOVINA

Refurbishments:

Number of refurbished units: 1 shopping centre, 1 Intersport

MONTENEGRO

Area of new facilities: 3,739m^2

Number of new units: 13

Openings: Market Cetinje; Market Budva 2; Market City 2, Podgorica; Market Rijeka Crnojevića, Cetinje; Market Totoši, Ulcinj; Market Igalo 2; Market Zaljevo, Ulcinj; Market Dobre vode, Ulcinj; Market Podgorica 3; C&C Zelenika 1; Intersport Bar; Intersport Zelenika; Intersport Ulcinj





PERFORMANCE ANALYSIS IN 2016

Following is a performance analysis for 2016 for the Mercator Group, the parent company Poslovni sistem Mercator, d.d., and respective markets of Mercator Group's operations. 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.

MERCATOR GROUP OPERATIONS AND PERFORMANCE ANALYSIS

Following is an analysis of Mercator Group operations in 2015 and 2016, which means it includes sales of Modiana and Intersport operations in the periods when these two businesses were still a part of the Mercator Group. The effect of results of their operation is evident from Note No. 7 Discontinued operation (financial report of the Mercator Group and the company Poslovni sistem Mercator d.d.).

Review of write-offs, revaluation adjustments, and impairments

Mercator Group
In 2015, Mercator Group did not report any major write-offs or impairments in its financial statements.

In 2016, receivables payable by Agrokor 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. Impairments of receivables by Agrokor Group companies that are not a part of the Mercator Group amounted to EUR 46,012 thousand.

Poslovni sistem Mercator, d. d.
Impairment of long-term financial investments had an effect of EUR 34,169 thousand on the income statement in 2015. Of this amount, investment by the company Mercator - H, d.o.o., was impaired by EUR 33,086 thousand, and investment in the company M - Energija, d.o.o., was impaired by EUR 1,083 thousand.

In 2016, impairment of financial investments had an effect of EUR 69,287 thousand on the net profit or loss; of this amount, impairments at the company Mercator - H, d.o.o. amounted to EUR 59,408 thousand; impairments at the company M - Energija, d.o.o., amounted to EUR 949 thousand, and impairments at the company Mercator - BH, d.o.o., amounted to EUR 8,930 thousand.

At the company Poslovni sistem Mercator, d.d., receivables from Agrokor Group companies that are not a part of the Mercator Group were impaired by EUR 6,782 thousand in 2016.

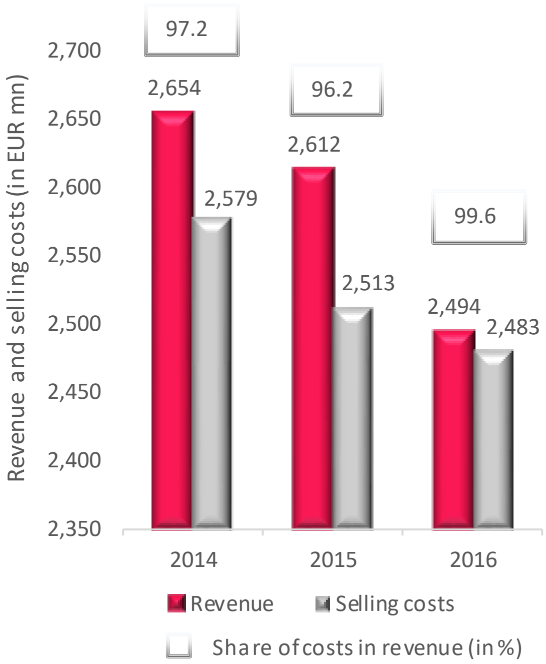
Revenue and productivity

Mercator Group revenue dropped by 4.5% in 2016 relative to the year before, reaching a total of EUR 2,493,802 thousand.

One of the reasons for the drop in revenue for the entire Mercator Group was still the change in consumer behaviour due to the economic crisis and harsher market conditions. In addition, the drop was a result of activities related to intensified refurbishments of our stores and divestment of the Modiana and Intersport operations.

Relative drop was the largest at Mercator - H, d.o.o., by 26.4%. Namely, the company only generated revenue with real estate operations at the end of 2016. Revenue was lower especially on account of discontinuation of the entire FMCG program as of June 2015 following the transfer of retail operations to Konzum, d.d. In 2016, revenue also dropped on account of divestment of the non-core operations of Intersport and Modiana.

Decline in revenue was also recorded for the company Poslovni sistem Mercator, d.d., (revenue lower by 3.9%) and Mercator - S, d.o.o. (revenue lower by 6.3%). A part of the decrease in revenue is a result of lower number of units, and divestment of non-core operations.



2014
- Agrokor, d.d., becomes the majority owner of the company Poslovnega sistema Mercator, d.d.

2015
- divestment of activities Pekarna Grosuplje
- divestment of brands Santana, Loka
- divestment of activities M Holidays

2016
- divestment of activities Modiana
- divestment of activities Intersport

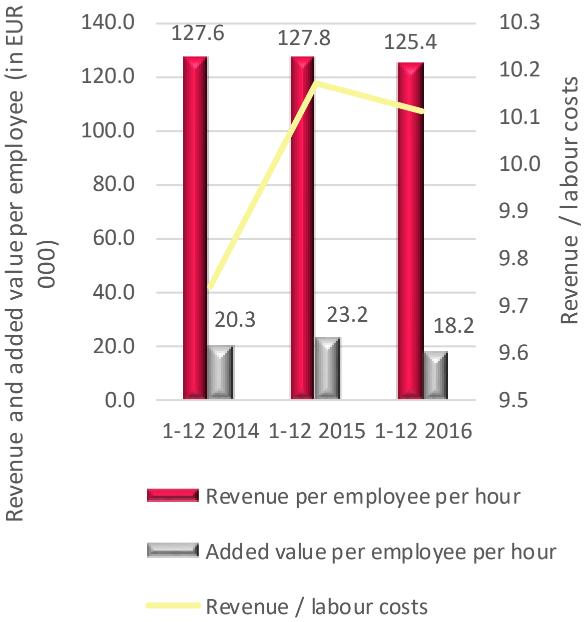
Majority of revenue is generated in the fast-moving consumer goods program.

On the other hand, revenue increased in the company Mercator - BH, d.o.o. (by 12.9%), Mercator - CG, d.o.o., (by 7.6%), and Mercator IP, d.o.o. (by 15.4%).

Structure of revenue by respective programs did not change considerably. Core activity of fast-moving consumer goods sale still accounts for the largest share of total revenue with 88.2%. Relative to the year before, the share in comparison to other programs increased by 1.7 percentage points.

The structure of revenue by countries did not change significantly either compared to 2015. Slovenia is still the largest market with 56.9% of total revenue, followed by Serbia with 34.8%. The share of revenue decreased in Serbia relative to the year before, on account of higher share of revenue in Montenegro.

Productivity, calculated as revenue per FTE (i.e. employee based on working hours) decreased relative to 2015 by 1.9%.



Operating costs

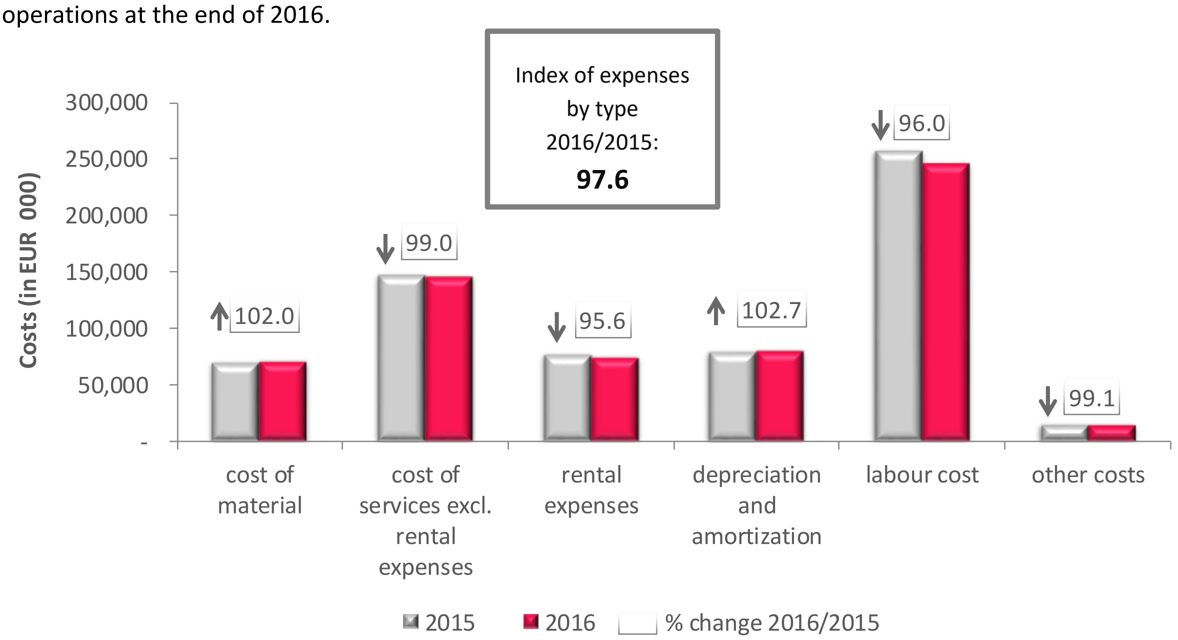
Total costs, including cost (purchase value) of goods sold, revaluation adjustments, and other Mercator Group operating expenses, decrease in 2016 relative to 2015 by 1.3%, or by EUR 32,510 thousand, and they amounted to EUR 2,567,157 thousand. All costs except for material costs,provisions, amortization and depriciation for other liabilities and charges decreased in 2016 compared to the year before.

In 2015, funds for the monetization project were reallocated from non-current assets to current assets, as assets for disposal. Based on the analysis of economic justification which found that the project was not economically justifiable, the monetization project was suspended. As a result, the assets for disposal were reclassified back to non-current assets.

Mercator Group cost of sales and selling and marketing costs, which include the purchase value (cost) of goods sold, production costs, selling and marketing costs, and other expenses, amounted to EUR 2,482,650 thousand in 2016, which is 1.2% less than in 2015. At the companies Poslovni sistem Mercator, d.d., Mercator - H, d.o.o., and Mercator - BH, d.o.o., we impaired in 2016 receivables from Agrokor Group companies that are not a part of the Mercator Group.

Administrative expenses in 2016 amounted to EUR 84,508 thousand, which is 2.4% less than in 2015.

The decrease relative to the year before was also seen in labour costs, by 4.0%; thus, they amounted to EUR 246,613 thousand in 2016. One of the reasons for lower labour costs is the lower number of employees as a result of divestment of Modiana and Intersport operations. In relative terms, the number of employees decreased the most in Croatia and Bosnia and Herzegovina where Mercator only conducted real estate operations at the end of 2016.



Results from operating activities

Mercator Group wrapped up the year 2016 with a negative result from operating activities at EUR 39,875 thousand, which is a decrease of EUR 101,385 thousand compared to the year before. The lower result from operating activities is not entirely comparable to the year before due to divestment of non-core activities and their elimination from the financial statements:

- Pekarna Grosuplje, operating until and including September 2015;
- Santana and Loka brands divested in the first half of 2015;
- M Holidays operations which operated until the end of 2015;
- Modiana which operated until and including September 2016;
- Intersport which operated until the start of December 2016.

At the same time, profits from divestment of Pekarna Grosuplje, Santana and Loka, and M Holidays, had a positive effect on the results from operating activities in 2015. In 2016, gains from divestment of Modiana had a positive effect on results from operating activities.

In 2016, negative result from operating activities was also affected by impairments of receivables from Agrokor Group companies that are not a part of the Mercator Group, in the total amount of EUR 46,012 thousand.

Net finance expenses

In 2016, net finance expenses amounted to EUR 37,115 thousand, which is 6.9% more than in the year before. The largest share of finance expenses pertains to net regular interest expenses at EUR 33,032 thousand, which is EUR 144 thousand or 0.4% more than in the year before. Unlike the previous year when Mercator Group recorded net currency translation differences, the Group's currency translation differences in 2016 were positive at EUR 936 thousand.

Review of key exchange rates for the Mercator Group[10]

		December 31, 2015	December 31, 2016	annual average in 2016	index 2016/2015
HRK	Croatian kune	7.64	7.56	7.53	0.99
BAM	Bosnian convertible marka	1.96	1.96	1.96	1.00
RSD	Serbian dinar	121.23	123.60	122.90	1.02

In 2015, net financial result was affected by the divestment of some financial investments; in 2016, it was affected by divestment of Intersport.

Profit or loss for the year

In 2016, Mercator Group generated a net loss of EUR 72,735 thousand. Mercator Group's result for the year 2015 was a loss of EUR 20,154 thousand. One of the reasons for decrease in net profit or loss is, as noted, the focus on the core activity, and impairments to receivables from Agrokor Group companies that are not a part of the Mercator Group.

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

Gross cash flow from operating activities (EBITDA) amounted to EUR 41,037 thousand in 2016, which is EUR 99,286 thousand less than in 2015. Changes in EBITDA resulted from business events described in the notes to the results from operating activities.

Gross cash flow from operating activities before rental expenses (EBITDAR) in 2016, amounting to EUR 115,088 thousand, was lower than in preceding year by 47.1%.

10 Source: Mercator Group

Below is presented normalized EBITDA in 2016 in comparison to 2015:

		1-12, 2015	1-12, 2016
	NORMALIZED EBITDA	**EUR 89.6 mn**	**EUR 62.4 mn**
+	The impact of the sale of brands Santana and Loka, Grosuplje Bakery	EUR 25.9 mn	
+	The impact of Intersport and Modiana operations and cost of sales processes	EUR 14.4 mn	EUR 11.7 mn[1]
-	Impairment of receivables by Agrokor Group		EUR -46.0 mn
+	Extraordinary revenue of Mercator - S, d.o.o.	EUR 10.4 mn	EUR 13.0 mn
	REPORTED EBITDA	**EUR 140.3 mn**	**EUR 41.0 mn**

[1] Intersport (1-11, 2016) and Modiana (1-9, 2016) operations

Assets

Mercator Group's assets as at December 31, 2016, amounted to EUR 2,122,836 thousand, which is 4.6% less than at the end of 2015.

Non-current assets as at December 31, 2016, amounted to EUR 1,657,143 thousand, which is 14.8% more than at the end of 2015, mostly due to higher value of property, plant, and equipment. The value of property and equipment accounts for the highest share of non-current assets, at 94.7%. Total fixed assets (property, plant, and equipment) account for 95.3% of total non-current assets.

Mercator Group's current assets as at December 31, 2016 amounted to EUR 465,693 thousand, which is EUR 316,550 thousand less than at the end of 2015. Decrease in current assets is a result of the changes in bookkeeping policy on recording of assets earmarked for monetization, which were transferred in 2016 from current assets to non-current assets, and the decrease in inventory by EUR 56,525 thousand. The highest increase was seen in cash and cash equivalents, by EUR 7,320 thousand, or 38.5% relative to the year before.

in EUR 000	December 31, 2014	December 31, 2015	December 31, 2016	Index 2016/2015	Share in total assets 2016
Tangible and intangible assets	1,639,097	1,394,295	1,601,767	114.9	75.5%
Loans and depozits	25,015	30,604	31,385	102.6	1.5%
Deffered tax assets and available-for sale financial assets	23,479	18,581	23,991	129.1	1.1%
Non-current assets	**1,687,591**	**1,443,480**	**1,657,143**	114.8	78.1%
Assets for disposal	-	217,482	-	-	0.0%
Inventories	257,323	280,853	224,328	79.9	10.6%
Receivables	254,988	256,845	206,937	80.6	9.7%
Loans and depozits	3,247	8,065	8,110	100.6	0.4%
Cash and cash equivalents	34,224	18,998	26,318	138.5	1.2%
Current assets	**549,782**	**782,243**	**465,693**	59.5	21.9%
Total assets	**2,237,373**	**2,225,723**	**2,122,836**	**95.4**	**100.0%**

Equity and liabilities

Changes in equity in 2016 pertain to the following: negative net result in the amount of EUR 72,735 thousand; actuarial losses on recognition of provisions for retirement benefits in the amount of EUR 294 thousand; currency translation differences pertaining to international subsidiaries in the amount of EUR 2,047 thousand; decrease due to other changes in the amount of EUR 772 thousand; decrease due to deferred tax in the amount of EUR 1,208 thousand.

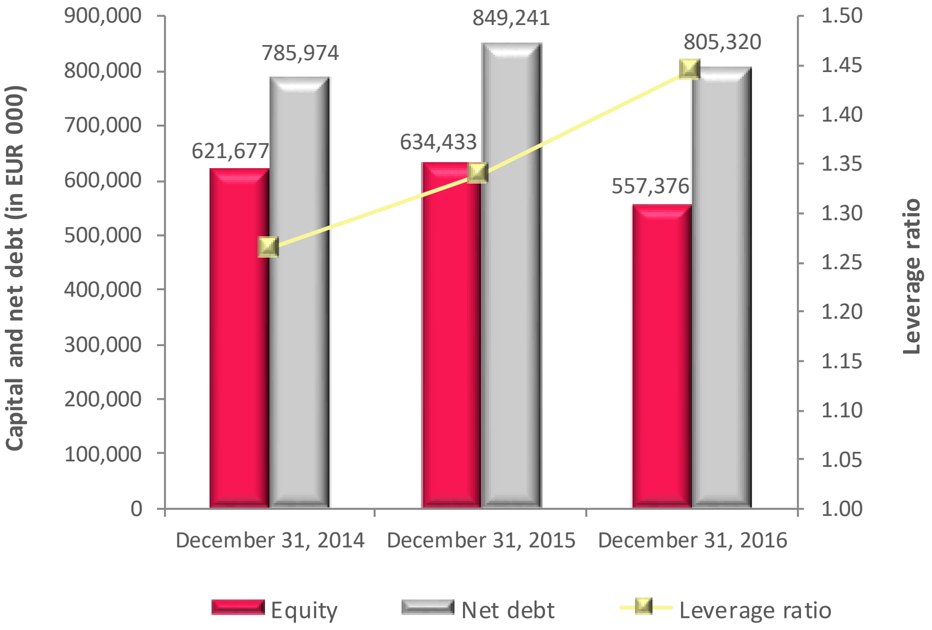
in EUR 000	December 31, 2014	December 31, 2015	December 31, 2016	Index 2016/2015	Share in total equity and liabilities 2016
Equity	**621,677**	**634,433**	**557,376**	**87.9**	**26.3%**
Trade, other payables and deferred tax liabilities	37,157	68,299	76,539	112.1	3.6%
Financial liabilities	806,640	758,208	738,354	97.4	34.8%
Provisions	20,706	25,918	26,818	103.5	1.3%
Non-current liabilities	**864,503**	**852,425**	**841,711**	**98.7**	**39.7%**
Trade, other payables and deferred tax liabilities	708,195	589,641	590,509	100.1	27.8%
Financial liabilities	42,998	149,224	133,241	89.3	6.3%
Current liabilities	**751,193**	**738,865**	**723,750**	**98.0**	**34.1%**
Total liabilities	**1,615,696**	**1,591,290**	**1,565,460**	**98.4**	**73.7%**
Total equity and liabilities	**2,237,373**	**2,225,723**	**2,122,836**	**95.4**	**100.0%**

Mercator Group's borrowings and other financial liabilities as at December 31, 2016, amounted to EUR 871,595 thousand, which is EUR 35,837 thousand less than at the end of 2015. The decrease in financial liabilities is a result of lower long-term liabilities by EUR 19,854 thousand, while short-term financial liabilities decreased by EUR 15,983 thousand. Net financial debt of the Mercator Group as at December 31, 2016, amounted to EUR 805,320 thousand, which is EUR 43,921 thousand lower than a year earlier.

Trade and other payables as at December 31, 2016, amounted to EUR 635,204 thousand, which is 1.4% more than at the end of 2015.

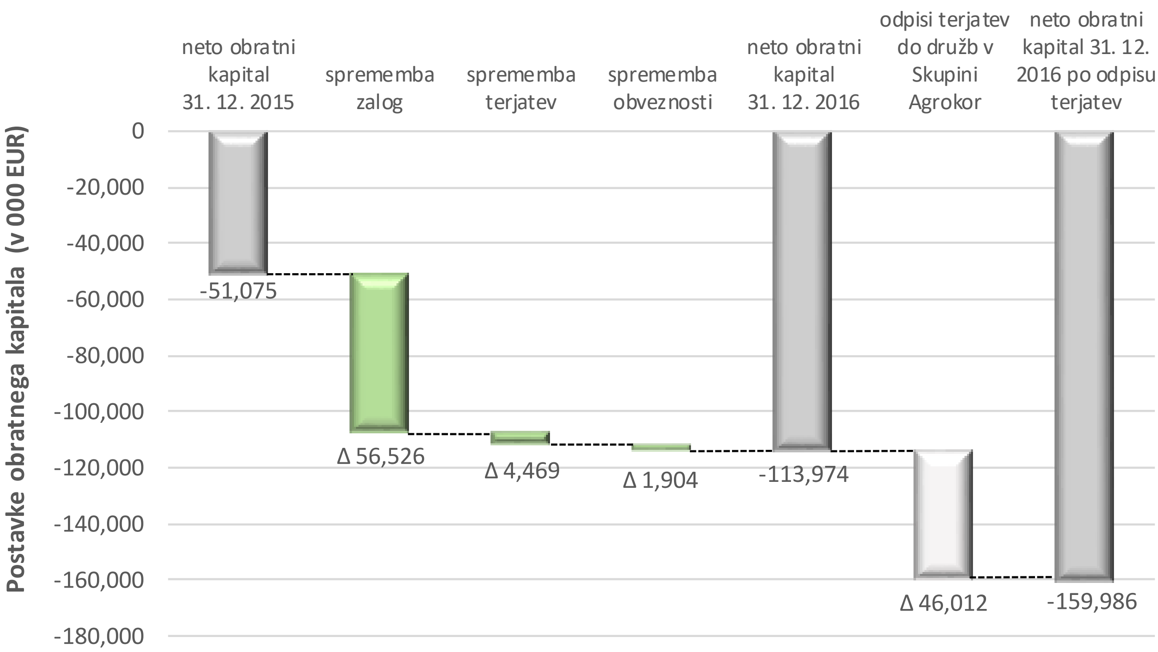
Provisions as at December 31, 2016, amounted to EUR 26,818 thousand, which is 3.5% more than at the end of 2015.

As at December 31, 2016, long-term coverage of non-current assets with non-current liabilities at the Mercator Group amounted to 84.4%, which is 18.6 percentage points less than as at the end of 2015.

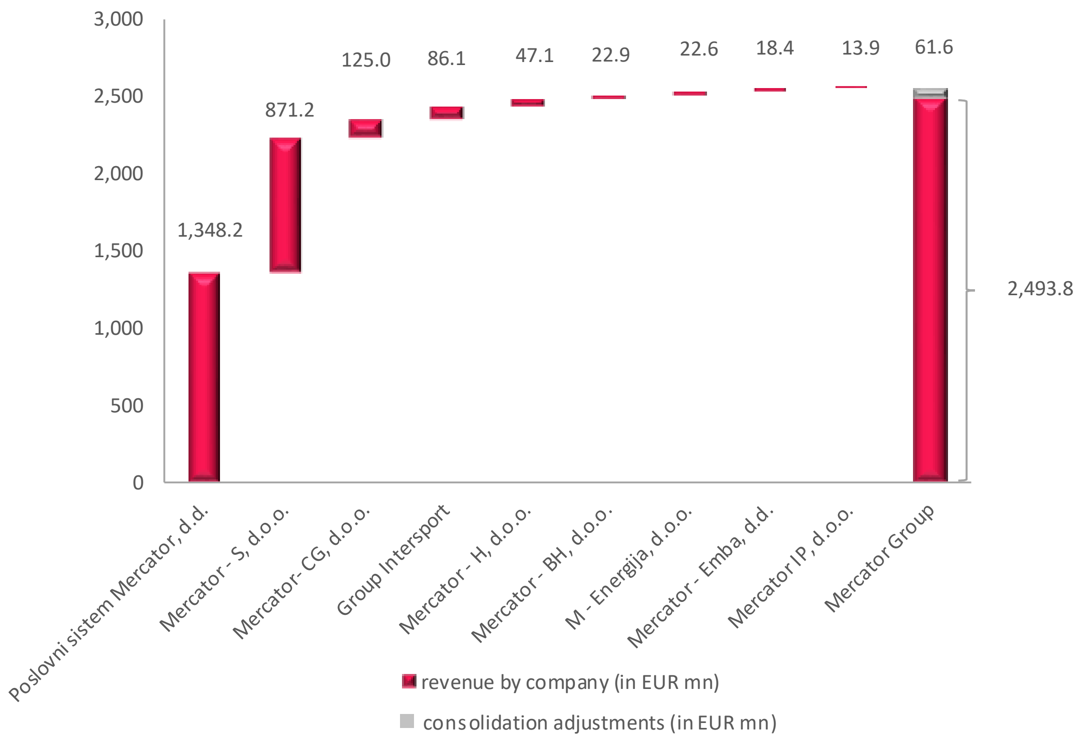


Changes in working capital

At the end of 2016, the Group's working capital structure was more favourable than a year earlier. Working capital was positively affected by changes in all items.



PERFORMANCE ANALYSIS BY MARKETS



Slovenia

Total sales revenue from Slovenian market in 2016 amounted to EUR 1,418,545 thousand, which is 4.1% less than in the year before. One of the reasons for the decrease is our focus on the core activity and divestment of the Modiana and Intersport operations. In 2016, the following companies operated in the Slovenian market: Poslovni sistem Mercator, d.d.; Mercator - Emba, d.d.; Mercator IP d.o.o.; M - Energija d.o.o.; and in the period 1–11, 2016, the company Intersport ISI d.o.o.

> More than half of revenue is generated in Slovenia, followed by Serbia.

Parent company Poslovni sistem Mercator, d.d.

In 2016, the company Poslovni sistem Mercator, d.d., generated sales revenue of EUR 1,348.2 thousand. Compared to the year before, this is a drop of 3.9%.

Cost of sales and selling and marketing costs for the company Poslovni sistem Mercator, d.d., which include the purchase value (cost) of goods sold, production costs, selling and marketing costs, and other expenses, amounted to EUR 1,318,331 thousand in 2016, which is 1.6% less than in 2015. Administrative expenses in 2016 amounted to EUR 40,624 thousand, which is 6.4% less than in 2015.

Total costs, including the purchase value (cost) and impairments and receivable write-offs, amounted to EUR 1,358,954 thousand in 2016, which is EUR 24,403 thousand, or 1.8%, less than in the year before. Labour costs declined by 3.5% and they amounted to EUR 167,061 thousand. In relative terms, costs of services decreased at the same rate as the labour costs. Unlike other costs, the costs of material and depreciation and amortization expense increased. Costs of material increased by 10.1% and amounted to EUR 28,104 thousand in 2016. Depreciation and amortization expense increased by 0.2% and amounted to EUR 37,282 thousand in 2016.

Result from operating activities in 2016 is at EUR -2,451 thousand, which is a decrease of EUR 53,529 thousand relative to the previous year. In 2016, the company Mercator, d.d., generated a negative result (i.e. loss) of EUR 77,447 thousand. Such result is a decrease by EUR 73,647 thousand relative to the 2015 result.

Gross cash flow from operating activities (EBITDA) amounted to EUR 34,831 thousand in 2016, which is EUR 53,448 thousand less than in previous year.

Gross cash flow from operating activities before rents (EBITDAR) in 2016 amounted to EUR 45,091 thousand, which is EUR 53,906 thousand less than in 2015.

Serbia

In the Serbian market, Mercator Group is present with three fast-moving consumer goods banners (or brands): Mercator, Idea, and Roda. Total number of retail units is 348, of which 313 units are under the Idea banner. Business results of the consolidation had a considerable effect on the revenue in 2016 when it amounted to EUR 869,138 thousand, or 6.5% less than in 2015.

Croatia

In Croatia, sales revenue declined by 9.3% in 2016 relative to the year before, reaching a total of EUR 57,980 thousand. The company Mercator - H, d.o.o., ended the 2016 fiscal year with a loss of EUR 37,793 thousand, which is 82.5% less than in the previous year.

Bosnia and Herzegovina

In the market of Bosnia and Herzegovina, revenue also decreased in 2016 compared to the year earlier, by 3.7%. In this market, Mercator was only present with real estate operations. In 2016, revenue of Mercator - BH, d.o.o., was at EUR 22,861 thousand, which is 12.9% more than in the year before, which is the result of merger of the company M - BL, d.o.o., in February 2016. In 2016, net result was negative at EUR 12,768 thousand.

Montenegro

In the market of Montenegro where Mercator Group was present with the companies Intersport CG, d.o.o., and Mercator - CG, d.o.o., revenue in 2016 increased relative to 2015. Revenue totalled at EUR 125,488 thousand, or 6.8% more than in the year before. In 2016, the company Mercator - CG, d.o.o., generated revenue of EUR 124,087 thousand, which is 7.6% more than in the previous year. The company's net result for 2016 was at EUR 1,871 thousand, which is 5.0% less than in the year before.

Main indicators by markets

in EUR 000, except of shares	Slovenia	Serbia	Montenegro	Croatia	Bosnia and Herzegovina	Mercator Group
Revenue	1,418,545	869,138	124,087	57,980	24,051	**2,493,802**
Share Group revenue	56.9%	34.8%	5.0%	2.3%	1.0%	**100.0%**
Gross cash flow from operating activities (EBITDA)	43,746	24,834	4,515	-22,856	-9,203	**41,037**
EBITDA / revenue	3.1%	2.9%	3.6%	-39.4%	-38.3%	**1.6%**
Gross cash flow from operating activities before rental expenses (EBITDAR)	52,839	63,975	10,630	-10,712	-1,645	**115,088**
EBITDAR / revenue	3.7%	7.4%	8.6%	-18.5%	-6.8%	**4.6%**

OPERATIONS AND PERFORMANCE PLANS FOR 2017

Planned revenue in 2017 lower than in 2016 due to loss of revenue from divested non-core operations

For 2017, Mercator Group is planning to generate revenue of EUR 2.4 billion, which is less than in 2016. The drop in revenue is a result of divestment of non-core operations in 2016, which was not taken into account in the 2017 budgeting process (sales process for Modiana was completed in late September 2016, and the Intersport Group was divested in early December 2016). The drop of revenue will be the highest in Croatia and Bosnia and Herzegovina, as in these markets Mercator will only conduct its real estate operations in 2017.

EUR 68.5 million allocated for investment in 2017

In 2017, Mercator Group will allocate EUR 68.5 million to investment, the majority of which will be dedicated to the project of constructing a logistics and distribution centre in Ljubljana, scheduled for opening in 2019. Thus, Slovenia will account for the predominant part (72%) of total investment funding. Aside from the funds for the new logistics and distribution centre in Ljubljana, 39.7% of the remaining investment funds will be allocated to refurbishments and investment maintenance of the existing sales units, 34.4% will be dedicated to expansion of retail capacity, 19.2% for logistics, 4.6% for IT, and 2.1% will be invested into non-trade activities.

Our marketing activities will be focused on the benefits offered to our customers

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 and making the offer more appealing in order to retain the existing customers and to attract new ones. In our aisles, we offer a selection of authentic, local Slovenian produce and products, paying particular attention to the design and orderliness of our stores, and to implementation of new technologies and services that allow faster shopping and a better overall shopping experience for the modern consumer.

After successfully completed divestment processes in 2015 and 2016, Mercator Group remains focused on our core activity, pursuing is key goal of profitability improvement. Mercator Group revenue in 2017 is planned at EUR 2.4 billion.

RISK MANAGEMENT

Improvement in economic conditions can be perceived in the markets of Mercator Group operations; however, external environment continues to affect the company operations and performance. We remained focused on our core activity. Consistently with the changes in Mercator Group operations, we actively manage our risks. 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.

In 2016, we kept the ISO standards 9001 and 14001.

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 2016 the risks of the company Poslovni sistem Mercator, d.d., and the Mercator Group.

We held 4 Risk Management Council sessions, kept the Mercator Group Risk Register up to date, proposed 195 risk mitigation or hedging measures and monitored their implementation, held training and education for management, took part in Audit Committee and Supervisory Board sessions, and conducted the risk analysis for the Mercator Group for the year 2017.

Risk management is included in the new versions of management system standards, such as the quality management system ISO 9001:2015 and Environmental Management System ISO 14001:2015. In May 2016, the SIQ certification institute conducted an external audit for both standards at the company Poslovni sistem Mercator, d.d., in which the auditors praised the risk management system and emphasized that risk management is a managerial took requiring active involvement of all employees, particularly.

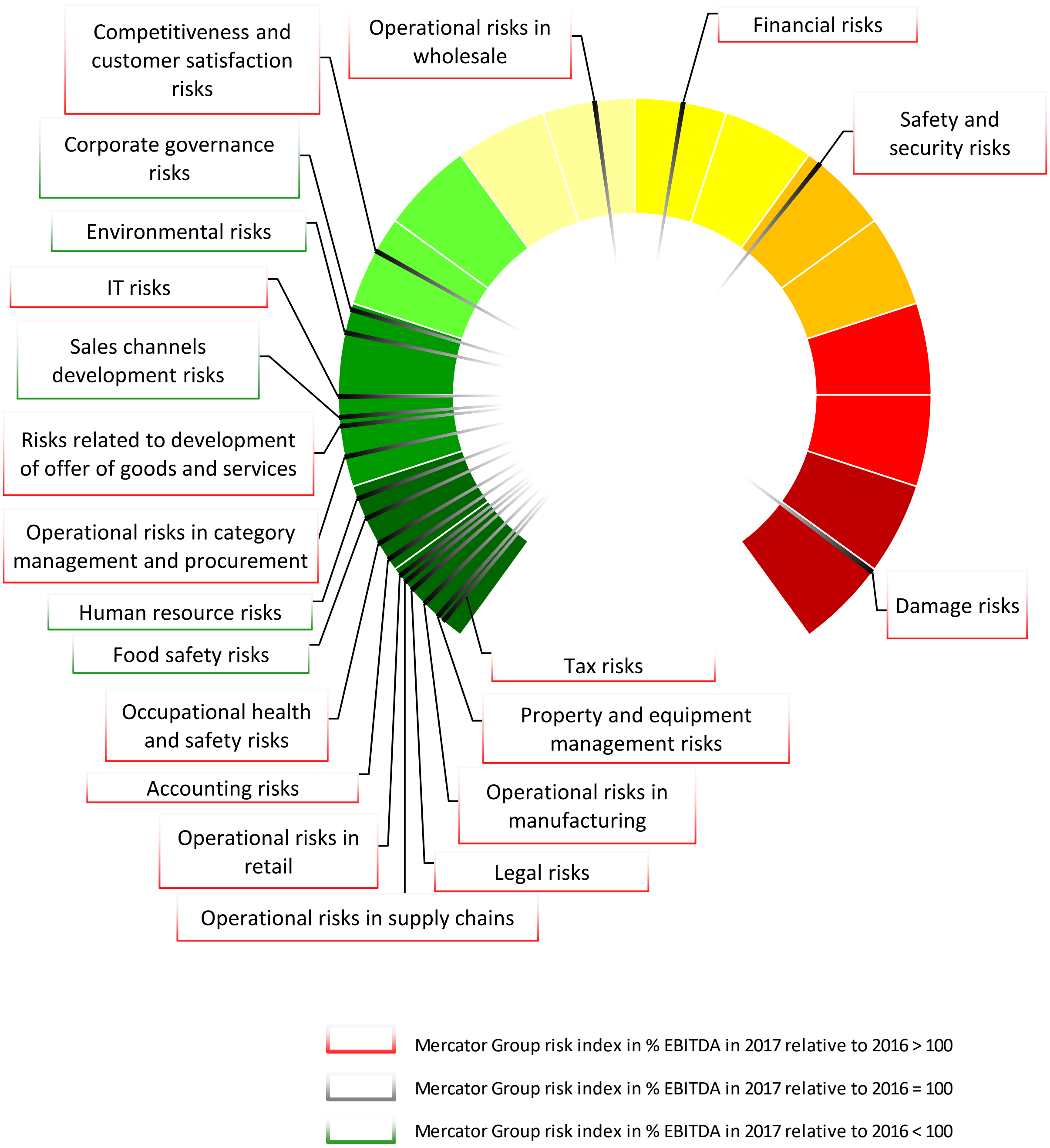
The SIQ certification institute praised the risk management system in place at the company Poslovni sistem Mercator, d.d.

We actively managed the Mercator Group Risk Register in which we monitor the risks both for respective companies and for the entire Mercator Group. The risks are assessed in qualitative and quantitative terms so that the risk values are expressed in EUR and in % of EBITDA or Mercator Group. Risks meeting the following criteria are classified as key risks:

- key risks for a particular company are all risks that exceed 1% of EBITDA or the largest risk within a particular risk category (or type) in terms of value for the particular company;
- key risks for the Mercator Group are all risks that exceed 1% of Mercator Group EBITDA or the largest risk within a particular risk category (or type) which exceeds the value of 1% of Mercator Group EBITDA.

In the register, the risks are divided down into 5 fields, and within those, they are divided further into a total of 21 risk categories or groups. Following is a summary of all risk categories for the year 2016. Then, only the key risks are presented in more detail.

Mercator Group risks classified in terms of relevance in 2016



KEY RISK ANALYSIS FOR THE MERCATOR GROUP

The 2016 risk analysis identifies 21 key risks that were monitored during the year and reported at the Mercator Group level. Twenty-eight key risks were identified for the year 2017. A total of 195 measures were adopted to mitigate or eliminate risks. Data is not entirely comparable between the years 2016 and 2017 as the Mercator Group EBITDA was decreased consistently with the strategy of focusing on the core activity (divestment of Modiana and Intersport operations in 2016). Methodology of perceiving the key risks for 2017 did not change. Thus, absolute threshold for classifying a particular risk as a key risk is lower for the year 2017 due to lower budgeted EBITDA.

In 2016, we adopted 195 risk management measures.

Based on the analysis of all fields of risks at Mercator Group, we find that the key risks at the entire Group level are divided into strategic, financial, operational, support, and compliance risks. In 2016, Mercator Group was the most exposed to risks of loss events, followed by safety and security risks, financial risks, wholesale risks, and risks of competitiveness and customer satisfaction. In all groups of risks, we believe that among all companies of the Mercator Group, the company Poslovni sistem Mercator, d.d., has the highest exposure. The key reason in this respect is that the company generates the majority of EBITDA for the entire Mercator Group. We believe Mercator Group will see the highest exposure in 2017 to the risk of wholesale, risk of loss events, and risks of safety and security.

KEY RISK ANALYSIS FOR THE COMPANY POSLOVNI SISTEM MERCATOR, D.D.

Identified groups or categories of key risks were the same for the company Poslovni sistem Mercator, d.d., and for the entire Mercator Group. This means that the key risks for the company Poslovni sistem Mercator, d.d., are strategic, financial, operational, support, and compliance risks. In 2016, the company Poslovni sistem Mercator, d.d., was the most exposed to risks of loss events, followed by safety and security risks, wholesale risks, and risks of competitiveness and customer satisfaction. Most risks are smaller for the Mercator Group than for the company Poslovni sistem Mercator, d.d. Financial risks are more pronounced at the Mercator Group level as it depends on Mercator Group performance which is diversified across several markets. The occupational health and safety risk is also identified as higher at the Mercator Group level than at the company level. In 2017, particular attention will be paid to the risk of wholesale, risk of loss events, and risks of safety and security.

DETAILED RISK ANALYSIS

Following is an account of key risks, divided by field and risk category (or group).

Strategic risks

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

Corporate governance risks

Key risk	RISK OF CORRECT DEFINITION AND EXECUTION OF STRATEGY (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	Correct definition and effective execution of strategy is the foundation for successful Mercator Group operations, as an ill-defined strategy could have a major negative impact on revenue. At Mercator, the process of drawing up and implementing the strategy is organized in a way that considers all current theoretical and practical aspects that include both the specific features of the trade or retail industry and the specifics of respective markets in which the Mercator Group is conducting its business.
Risk management analysis for 2016	Early in 2016, we actively approached defining a new long-term strategy and redefined the Mercator Group's mission. Following the fire at the Ljubljana warehouse in May 2015 and the competitive conditions in the market, we introduced many organizational, process, and tactical changes, as well as revised our short-term strategy. Our operating strategy has been aimed in the last 2 years at executing the strategy of focusing on our core activity. Consistently with this strategy, the brands of the ground coffee category Santana and Loka were divested, as were the Grosuplje Bakery and the M Holidays tourist service. In 2016, operations of Modiana and Intersport were divested as well.
Activities planned for 2017	In 2017, we will direct our activities towards consistent pursuit of strategy and strategic goals.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be HIGHER.

Competitiveness and customer satisfaction risks

Key risk	RISK OF A DECLINE IN MARKET SHARE RESULTING FROM NEW OPENINGS OF OUR COMPETITION (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	Change in market share is related to a change in net retail area of Mercator and that of the competition. If our competition opens more new retail area than Mercator, this may lead to a decline in our market share.
Risk management analysis for 2016	We monitored the risk of a decline in market shares on a monthly basis by keeping track of the changes in net sales area operated by Mercator and its competitors. We refurbished our existing stores and continuously looked for new potential locations
Activities planned for 2017	We will continue to monitor on a monthly level the changes in market share and net retail area of our own stores and those of our competitors, as a part of regular monthly reporting. We shall open new stores and refurbish the existing ones, pursuant to the plan for 2017. Moreover, we shall continuously look for new potential locations.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be HIGHER.

Risks related to development of offer of goods and services

Key risk	RISK OF POOR PRICE COMPETITIVENESS (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	Risk of poor price competitiveness is related to pricing management. Inefficient pricing management may lead to loss of revenue, loss of profit margin, or both.
Risk management analysis for 2016	In 2016, prices were managed based on the revised pricing policy and regular monitoring of competitiveness of our regular retail prices. Particular attention was paid to products that have the strongest impact on price perception. Weekly price lists were taken as a part of the "lowest price guaranteed" project, and monthly lists were taken for other prices, based on which price analyses and corrections were made. We also regularly analyzed, on a monthly basis, the pricing perception of the company Mercator, d.d., by consumers, as a part of the Consumer Perception survey.
Activities planned for 2017	We shall monitor and analyze on a monthly level the pricing perception among consumers. We shall monitor, analyze and adjust as necessary our prices on a weekly level.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Key risk	RISK OF SUB-OPTIMUM ASSORTMENT AND RETAIL AREA MANAGEMENT AT THE MICRO LEVEL (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	The risk of sub-optimum assortment and retail area management at the micro level is related to assortment management, and to development and implementation of planograms at retail units. Inadequate management of assortment and retail area at the micro level may lead to lower revenue and profit margin, and increase in inventories at retail units.
Risk management analysis for 2016	In 2016, our marketing mix was managed with established strategies and tactics for most categories. We regularly monitored various performance indicators (cost/purchase value, sales value, profit margin, market share). Based on the identified consumer shopping behaviour and competition monitoring, we actively managed our assortment as well. Revised material operation processes allow easier and more automated implementation of assortments and planograms, as well as inventory optimization in retail.
Activities planned for 2017	We will manage our assortments in compliance with the strategies and tactics laid down for individual categories. Assortment modules and planograms will be additionally managed for the categories of cosmetics, accessories, delicatessen, organic (eco), and special diet products. We shall actively monitor market developments and global trends.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Sales channels development risks

Key risk	RISK OF INADEQUATE INVESTMENT INTO SALES CHANNEL DEVELOPMENT AND MISALIGNMENT BETWEEN STORES AND CUSTOMER EXPECTATIONS. (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	Inadequate investment into sales channel development and the resulting inability for faster development (refurbishment or update) of stores on the one hand, and misalignment between the stores and customer expectations on the other, can lead to a drop in revenue.
Risk management analysis for 2016	In 2016, store refurbishments or updates were carried out as planned. Over 130 stores were entirely or partly refurbished, or saw their layouts updated, spanning a total of over 39,000 m^2 of gross sales area.
Activities planned for 2017	In 2017, new real estate development, refurbishments and layout updates will involve around 100 retail units, in order to optimize the sales area and to improve the key departments (bakery, seasonal items etc.), consistently with the strategy laid down: • We shall continue to invest in updates to the existing store network and, as a result, mitigate the drop in revenue resulting from obsolescence and lack of appeal of our stores. • We shall adjust our stores to customer expectations (new concepts, adjustment of offer), new designs etc. • We shall invest into new sales area (additional area and turnover) and new sales channels (online store, development of convenience stores etc.).
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Financial risks

Financial risks pertain to financial management. They involve credit, interest rate, currency, liquidity, inflation, price, and other similar risks. Financial risks are described in more detail in the financial part, under note No. 30 for the Mercator Group and the company Poslovni sistem Mercator, d.d.

Key risk	CREDIT RISK RELATED TO LEGAL PERSONS (MERCATOR - S , D.O.O.)
Key risk description	Credit risk represents the possibility of a loss as a result of failure on the part of our customer to comply with the contract.
Risk management analysis for 2016	Due to higher turnover in wholesale, the share of revenue exposed to credit risk has increased.
Activities planned for 2017	In 2017, we shall continue our work as to date. This way of work will also be employed in the future as it has shown positive effects in terms of decrease of receivables, especially those with the highest level of risk. Implementation of a workflow is in the closing stage, which will allow more automated assignment and correction or amendment of credit limits, with participation of all key Mercator sectors and departments. This will make sure a certain customer is assigned the maximum credit limit with minimum risk of payment default.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Key risk	CURRENCY RISK (MERCATOR - S, D.O.O.)
Key risk description	Currency risk is the risk of a financial loss due to a change in the value of one currency relative to another one.
Risk management analysis for 2016	Keeping track of macroeconomic changes in the economies in which we do business
Activities planned for 2017	As every year, we shall continue to constantly monitor in 2017 the macroeconomic background of the changes in the exchange rates at hand, and other related macroeconomic indicators and trends. Based on the general trends and expectations, we shall look to adapt our operations, as far as possible, in such way that it foreign currency risk is naturally hedged.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Key risk	LIQUIDITY RISK (MERCATOR - S, D.O.O., IN MERCATOR - H, D.O.O.)
Key risk description	Liquidity risk is a risk that the company does not have enough liquid assets available at a certain point to settle its matured liabilities.
Risk management analysis for 2016	Mercator - S d.o.o.: Setting up an application for sending offsets. Mercator - H d.o.o.: Regular sending of outstanding mature (overdue) accounts, and compiling a report on the results of notifications.
Activities planned for 2017	Mercator - S d.o.o.: In 2017, the stress will be on effective working capital management.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Operational risks

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

Operational risks in category management and procurement

Key risk	SEASONAL EFFECT (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	The risk of the effect of bad weather on the seasonal products is related to efficient management of such categories. Increasingly unpredictable weather introduces higher probability of lower sales of certain products during their peak season which depends on nice sunny weather. In order to provide a varied in appealing offer, stores have to stock up for the summer season. However, bad weather increases the probability of low sales, which results in loss of revenue, high inventory, or low profit margin due to extraordinary discounts on retail prices. Other products of seasonal character, related to holidays, are not subject to weather conditions.
Risk management analysis for 2016	In 2016, we carefully planned our orders of seasonal products. We specified appropriate dates for the start of sale of seasonal products, as well as appropriate dates for the start of clearance sales. We monitored the actual profit margin and the inventory level for seasonal products. We reached agreements with some suppliers for additional discounts in case of additional price cuts and for return of goods following the end of season.
Activities planned for 2017	In 2017, we shall reach agreements with the suppliers for additional discounts in case of additional price cuts to seasonal products, or agree on return of goods following the end of season. We shall carefully plan our orders of seasonal products. We shall specify suitable dates for the start of sale of seasonal products, and start in a timely manner the clearance sales for any remaining seasonal stock.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Key risk	INCREASE OF TRADABLE COMMODITY PRICES (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	This is the risk of increase of prices of traded commodities, which is related to efficient management of those categories that may be subject to considerable effect from the commodity market. Ineffective management leads to lower revenue, lower profit margin, and lack of goods.
Risk management analysis for 2016	Last year, we closely monitored the effect of the increase of tradable commodity prices on the categories that may be subject to considerable effect from the commodity market. We monitored on a daily basis the prices of sugar, wheat, corn, milk, sunflower oil, electricity and oil in their respective markets and exchanges. We also monitored on a daily basis the development of the EUR/USD exchange rate. We stayed up to date with trends and causes of any fluctuations through reports on commodity prices. Appropriate annual volumes and stable private label product prices were ensured via central purchasing offer. We monitored European Union's and Russia's trade measures which can result in a rapid increase or decrease in the supply of goods in Europe. This applied in particular to milk, meat, fruit and vegetables, and sunflower seed oil.
Activities planned for 2017	In 2017, we shall monitor the commodity exchange prices for raw materials with a considerable impact on particular products and categories. We shall continue to monitor the trade measures by the European Union and Russia. We shall actively monitor the trade measures negotiated with other countries. Appropriate annual volumes and stable private label product prices will be ensured via central purchasing offer.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be HIGHER.

Operational risks in wholesale

Key risk	RISK OF LOSS OF FRANCHISE PARTNERS AND EXTERNAL CUSTOMERS (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	The risk is defined as a key risk due to potentially critical customer receivables, entry of new franchisors, a new model of franchising, and more favourable commercial terms.
Risk management analysis for 2016	In 2016, we were faced with intensive entry into the market and development of the franchise model with the company Spar Slovenija, d.o.o.
Activities planned for 2017	We wish to mitigate the risk. Therefore we launched an analyses and devised the following activities: • preparation of new price lists (delineation of profit margin between retail and wholesale), • updating the super rebate scale, • developing measures for uninterrupted supply to customers (closed distributors for fresh produce).
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Support risks

Support risks pertain to employees, legal affairs, property and equipment management, IT support, and management of demage events.

Human resource risks

Key risk	LACK OF HUMAN RESOURCES (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	A notable risk in trade is the risk of a lack of human resources in operations (retail, logistics etc.). If suitable human resources are not available, work processes cannot take place correctly, which in turn could lead to lower sales.
Risk management analysis for 2016	In 2016, we worked actively with the employment offices, regularly posted our needs on employment portals and the Mercator Group website, announced internal calls for applications, posted ads at the units, and occasionally posted ads on social networks. We also held regular mentorship to provide properly trained human resources. Newly hired workers are assigned a mentor for an induction period of at least 3 working days. Training is also held to provide suitably trained shop managers. An internal call for applications was announced for re-training for skill shortage (excess-demand) jobs. We work regularly with high schools to invite high school students who will be eligible employment candidates in a few years to do their mandatory work placement at Mercator. We are also a member of the Training and Education Committee with the Slovenian Chamber of Commerce.
Activities planned for 2017	In 2017, we shall: • continue our hiring activities (announcements of employment ads; processing job applications; interviews; cooperation with employment offices; cooperation with employment agencies (labour brokers); internal training etc.); • provide mentorship to all newly hired and employees transferred to a new job; • identify and train future retail managers, i.e. hypermarket managers and shop managers; • examine the possibilities of internal re-training for skill shortage jobs; • actively take part in preparing the work placement programs for high school students taking their work placement at Mercator units.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be HIGHER.

IT risks

Key risk	FAILURE OF CENTRAL IT SYSTEMS (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	The risk is related to the failure of the central IT systems. Failures may occur for various reasons such as natural disasters, fires at the premises, failure of individual system components, failure in system or application software etc.
Risk management analysis for 2016	The risk of central IT system failure was managed with regular operating activities and establishment of relevant architecture of central IT systems. IT system security management procedures were updated, and we implemented the stricter security requirements for our hardware. We revised the management processes for information assets, changes, and problems related to the central IT systems.
Activities planned for 2017	The risk management plan includes carrying out all regular operating activities and maintenance of suitable IT system architecture. Stricter security requirements coordinated at the corporate (Group) level, will be implemented, in addition to hardware, at all levels of operations. Activities to optimize the management processes for information assets, changes, and problems related to central IT systems will be continuously carried out. We shall introduce new IT systems that will affect the operation of the existing central information systems and which will be managed in a controlled way.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Damage risks

Key risk	EARTHQUAKE AND FIRE (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	In analysis of all damage risks managed by insurance, we reached the conclusion that two risks are critical to Mercator: fire and earthquake.
Risk management analysis for 2016	We are aware that insurance does not entirely hedge the risk of loss of funds in case of loss (or damage) events, but only serves to even out or balance the financial fluctuations in company operations, resulting from any loss events.
Activities planned for 2017	Activities planned for 2017 are the same as in 2016, which means keeping the insurance policies at the same level as in previous years.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Safety and security risks

Key risk	**FRAUD BY ABUSE OF POSITION (POSLOVNI SISTEM MERCATOR, D.D.)**
Key risk description	The risk is related to abuse of position of trust in the course of conducting business activity. By definition, this is a criminal offence which is prosecuted ex officio.
Risk management analysis for 2016	In 2016, the following activities were conducted to manage the risks: • gathering notifications or reports; • informing the hierarchical leaders; • taking part in the procedures of obtaining and securing evidence; • providing partial organizational independence, • providing independence of Supervisory Board members; • establishing adequate IT support. These activities carried out by the experts at the corporate security sector, while risk management activities are also carried out by audit departments, internal controls department, and other stakeholders, both directly and indirectly.
Activities planned for 2017	In 2017, the following activities are planned: • We shall continue our activities to provide adequate IT support. • We shall train employees for surveillance or supervisory departments. We shall provide continuous upgrades to knowledge and experience, both within and outside of the organization. • We shall maintain the level of independence of Supervisory Board members, as their independence in such work is essential due to unnecessary and prohibited influences exerted on them, on the progress of investigation or control (or surveillance), and, in turn, unregulated reporting to responsible persons. • We shall continue to carry out the activities to provide full access to required information.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Key risk	**TERRORISM (POSLOVNI SISTEM MERCATOR, D.D.)**
Key risk description	Terrorism is defined as a criminal offence in Slovenia. A terrorist attack can result in a large number of casualties and major direct and indirect material or financial damage or loss to the company. Regarding the level of threat, we follow the assessment of the relevant government authorities.
Risk management analysis for 2016	Activities taking place in 2016: • Monitoring the status and threat level in the country • Working with the government authorities in terms of notification about potential danger or threat • Developing an action plan for conduct of stakeholders in case of a threat or occurrence or execution of the risk
Activities planned for 2017	In 2017, the following activities are planned: • continue the activities from the preceding year, • raising employee awareness about the threat, • employee training about the measures to be taken in case of threat, occurrence or execution of the risk.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Compliance risks

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

Occupational health and safety risks

Key risk	**INSPECTION (MERCATOR - S D.O.O.)**
Key risk description	Potential risk of inspection control is assessed as potential expense on account of penalties or sanctions imposed by the inspection authorities (or by the inspector).
Risk management analysis for 2016	In Niš and Novi Sad, two experts on occupational health and safety and fire safety were hired. In 2016, we held training for the employees on occupational health and safety and fire safety, and held training at the newly opened units, as well as at the Management Board building (administration) in Belgrade.
Activities planned for 2017	In 2017, the following activities are planned: • We shall provide occupational safety training for all employees without such training, and we shall continuously monitor the relevant expiry dates. • We shall comply with the work safety legislation. • We shall carry out regular control inspections at business units and buildings by expert services.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be LOWER.

Food safety risks

Key risk	**ARRANGEMENT OF FACILITIES AND EQUIPMENT (POSLOVNI SISTEM MERCATOR, D.D.)**
Key risk description	Food safety risk pertaining to the *provision of facilities and equipment* deals with proper landscaping, entry, sales area, storage and auxiliary areas, storage area for goods eliminated from sale, locker rooms, toilets etc. whose inadequate condition or maintenance could affect the quality and safety of food and materials in touch with food. Pollution can be microbiological, chemical, or physical due to negative effects from the environment, unsuitable materials, equipment, spatial arrangement etc.
Risk management analysis for 2016	The food safety department and internal control are actively involved in the resolution of inspection issues. They draw attention to and report any non-compliance identified during internal controls and, if requested, takes part in the process of introducing new features and in refurbishments with regard to facility and equipment layout and design, from the aspect of food safety and compliance. A mobile application is currently being tested for recording the findings of internal controls, which also includes provision of equipment and facilities.
Activities planned for 2017	In 2017, we shall: • carry out internal controls as a part of verification of internal control according to the HACCP system in retail; • monitor and eliminate any deviations identified during inspection audits; • consult on food safety and compliance when implementing new equipment coming into come into contact with food.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

Environmental risks

Key risk	ELECTRICAL ENERGY (POSLOVNI SISTEM MERCATOR, D.D.)
Key risk description	Environment risk for the environment aspect of electric energy is related to inefficient use of electric energy due to suboptimal design of business processes and technologies employed.
Risk management analysis for 2016	The employees are informed on a quarterly basis on the measures for efficient use of energy. On a monthly level, we control the employee measures for efficient use of energy in respective units at the company Poslovni sistem Mercator, d.d. Within the project of upgrading the current energy accounting system with a more detailed targeted power consumption monitoring and implementation of measures for efficient use of energy, in cooperation with our contractual partner Maked Energea, our goal is to cut energy consumption at the company Poslovni sistem Mercator, d.d., by 1% annually: • Energy accounting was established for all facilities of the company Poslovni sistem Mercator, d.d. All information for power and gas are obtained from the supplier GEN-I. Other data is transferred into the system via the SAP application. • On 359 facilities, 15 min data on electricity was transferred from the main power meters. • Efficient use of energy was implemented at 172 buildings with respect to electric energy (of the 172 buildings, efficient use of energy was implemented at 51 buildings with respect to heating). Measures were implemented on 39 buildings until September 2016. Until and including August 2016, Maked Energea displayed power savings of 1,586,341 kWh, and heat savings of 612,036 kWh, or total savings of nearly EUR 170 thousand.
Activities planned for 2017	In 2017, we shall: • continue to inform the employees on a quarterly basis about the efficient use of energy; • upgrade the existing energy accounting system with a more detailed targeted monitoring of energy consumption.
Assessment of exposure 2017/2016	Relative to 2016, we believe the risk in 2017 will be EQUAL.

FINANCIAL MANAGEMENT

Stable Financial Operations

As at December 31, 2016, Mercator Group net financial debt amounted to EUR 805,320 thousand, which is 5.1 percent less than as at the end of 2015. In the last year, Mercator Group thus continued its stable financing activities and maintained a long-term sustainable maturity profile of its financial liabilities.

in EUR 000	Dec 31, 2015	Dec 31, 2016	Index Dec 31, 2016/ Dec 31, 2015
Non-current borrowings and other financial liabilities	758,208	738,354	97.4
Current borrowings and other financial liabilities	149,224	133,241	89.3
Financial liabilities	**907,432**	**871,595**	**96.1**
Cash and cash equivalents	18,998	26,318	138.5
Available-for-sale financial assets	524	462	88.0
Loans and deposits	38,669	39,495	102.1
Financial assets	**58,191**	**66,275**	**113.9**
Net financial debt	**849,241**	**805,320**	**94.8**

Financing costs

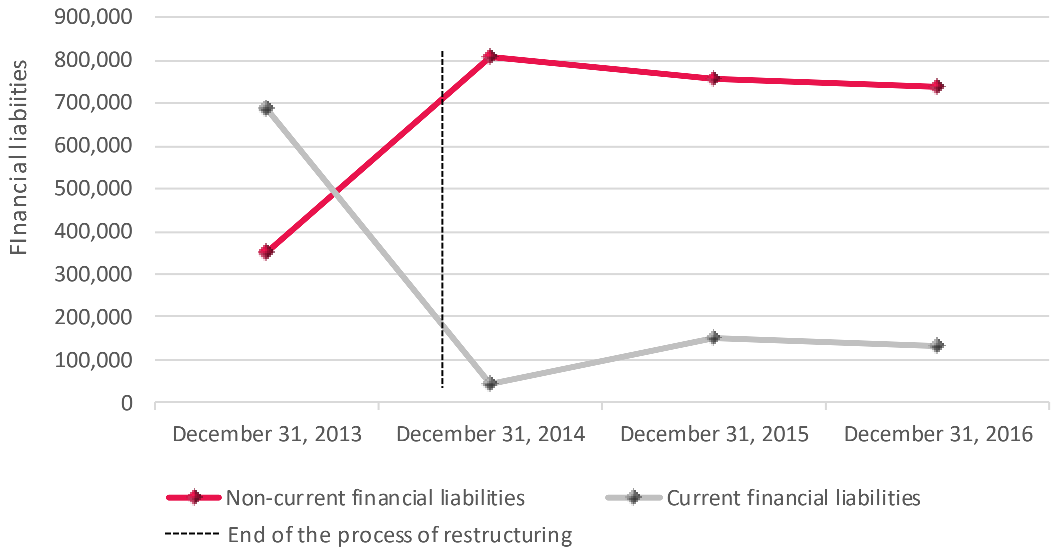
In the period 1–12, 2016, the 6-month EURIBOR averaged at -0.165%. At the end of the period, it was at -0.221%. Compared to the equivalent period of the year before when the 6-month EURIBOR averaged at 0.053%, this rate fell by 0.218 percentage point.

Debt to equity and financial liability ratio

As at December 31, 2016, Mercator Group attained a debt-to-equity (capital structure) ratio of 1:1.4. The ratio is a quotient between equity and net financial debt.

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, 2016 amounted to 84.7% (83.6% as at December 31, 2015).

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, 2016

As at December 31, 2016, Mercator Group had access to the following liquidity lines:

in EUR thousand	December 31, 2016
Cash and cash equivalents	26,318
Bank deposits	8,110
Standby revolving credit lines	82,939
Total	**117,366**

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.

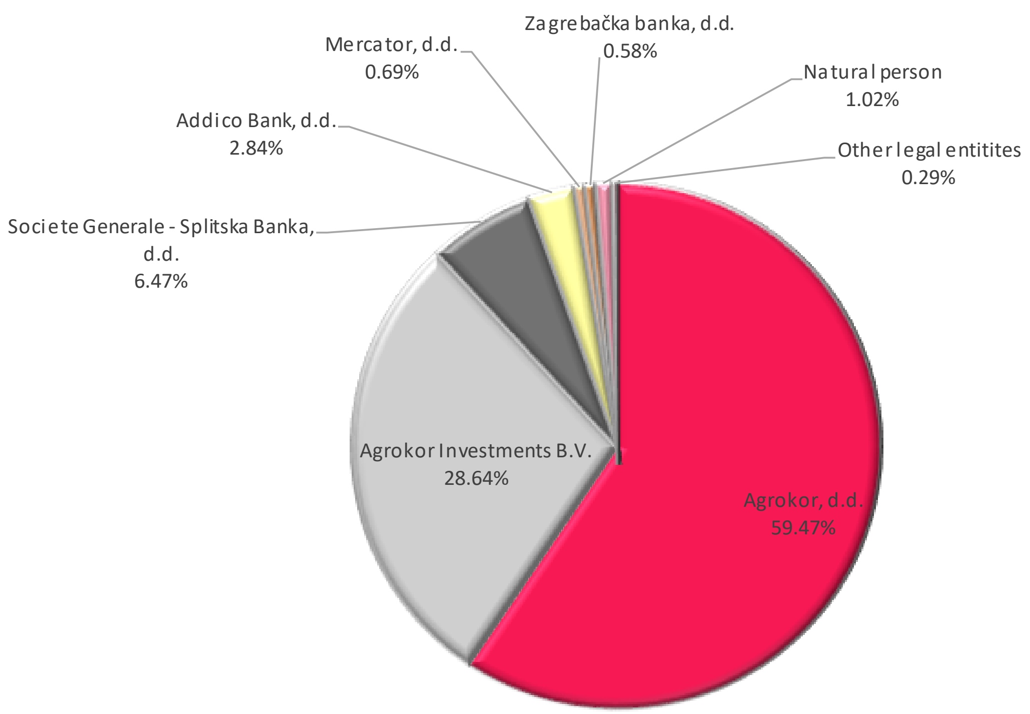
MERCATOR SHARE AND INVESTOR RELATIONS

Mercator share and ownership structure

Basic information on the share of the company Poslovni sistem Mercator, d.d., as at December 31, 2016:

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	1,849

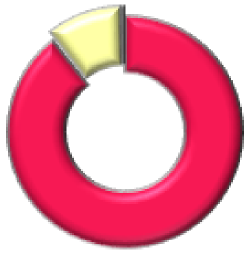
Ownership structure of the company Poslovni sistem Mercator, d.d., as at December 31, 2016:



Major Shareholders

As at December 31, 2016 the following ten largest shareholders held a combined share of **98.53%** of the company.

		Country	Number of shares	Share
1	Agrokor d.d.	Croatia	3,621,992	59.47%
2	Agrokor Investments B.V.	Netherlands	1,744,187	28.64%
3	Societe Generale - Splitska Banka d.d.	Croatia	393,792	6.47%
4	Addiko bank d. d.	Croatia	173,264	2.84%
5	Zagrebačka Banka d.d.	Croatia	35,393	0.58%
6	Galić Josip	Croatia	21,525	0.35%
7	Erste Group Bank AG	Austria	6,148	0.10%
8	Raiffeisen bank international AG	Austria	1,891	0.03%
9	Clearstream Banking SA	Luxembourg	1,875	0.03%
10	Banque Pictet and CIE SA	Switzerland	1,107	0.02%
	Total		**6,001,174**	**98.53%**



*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%. The share of their voting rights remains unchanged.

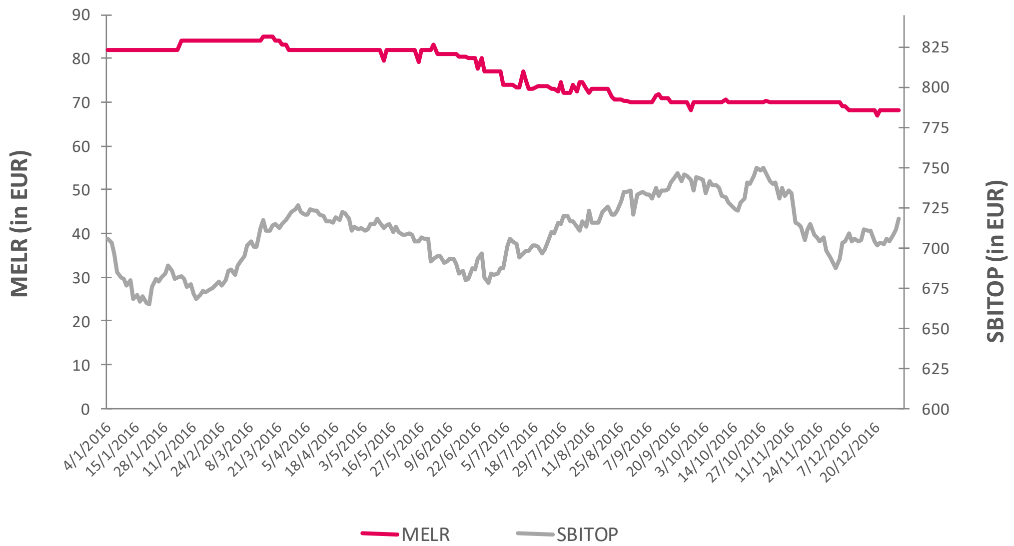
Shares held by Management and Supervisory Board Members as at December 31, 2016

Management Board and Supervisory Board Members did not own shares of the company Poslovni sistem Mercator, d.d., as at December 31, 2016.

Foreign shareholders

As at December 31, 2016, the share in the company Poslovni sistem Mercator, d.d., held by foreign investors amounted to **98.6%**, which is 0.15 percentage point more than at the end of 2015.

Movement of closing price per MELR share in the period 1-12 2016, compared to the movement of the SBITOP index



Key information for the shareholders[11]

	Dec 31, 2015	Dec 31, 2016	Index Dec 31, 2016/ Dec 31, 2015
Number of shares registered in Court Register	6,090,943	**6,090,943**	100.0
Number of treasury shares	42,192	**42,192**	100.0
Market capitalization (in EUR)	499,457,326	**414,184,124**	82.9
Market value of share (in EUR)	82.0	**68.0**	82.9
Book value per share (in EUR)	104.3	**91.1**	87.4
Minimum close rate in the period (in EUR)	70.1	**67.0**	95.6
Maximum close rate in the period (in EUR)	86.0	**85.0**	98.8
Average close rate in the period (in EUR)	77.2	**76.4**	99.0
Earnings per share (in EUR)*	-0.6	**-12.8**	2,038.3
Price/earnings ratio (P/E)	24.6	**-5.7**	-
Capital gains yield (in %)	13.9	**-17.1**	-

Dividend policy
Dividends will not be paid in 2017.

Treasury shares
As at December 31, 2016, 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 2016 the company Poslovni sistem Mercator, d.d., neither acquired nor disposed of treasury shares.

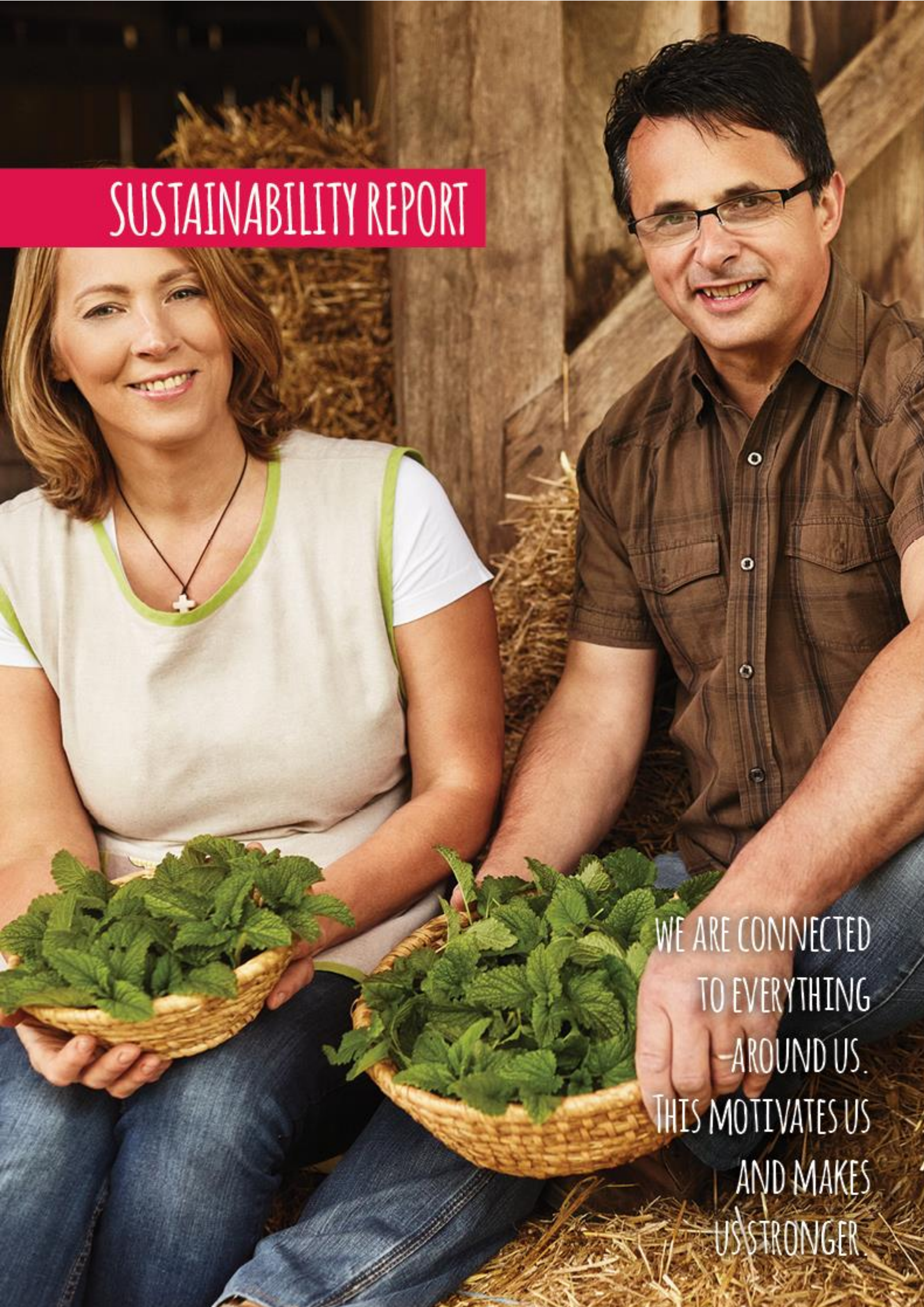
Investors

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

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

11 **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.

SUSTAINABILITY REPORT



At Mercator, we are aware of the importance of our effect on the environment into which we are integrated, and on our stakeholders. All employees do their best every day for our customers as we provide a quality and pleasant shopping experience. Our suppliers are an important link in our activities. We seek to maintain long-term cooperation with them, based on transparent communication and mutual trust; particular attention is paid to local suppliers. Responsible and sustainable operations are not restricted merely to our stores and trade activities. We are aware of our importance for the entire society and therefore, we are actively involved in the broad social happening. With our sponsorships, donations, and other charity campaigns we seek to help the broad society, and to contribute to more optimism for the future.

RESPONSIBILITY TO EMPLOYEES

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

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

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

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

In the third quarter, a large share of HR activities in the markets of Slovenia, Serbia, Bosnia and Herzegovina, and Croatia, was related to the divestment of Modiana operations, which was completed on September 30, 2016. As a result, macro-organizational changes at the company Poslovni sistem Mercator, d.d., Mercator - H, d.o.o., and Mercator - BH, d.o.o., too place.

2016 was the year of the company's reorganization.

In the last quarter of 2016, a major part of the activities in human resources was related to the process of divesting the operations of Intersport on all five markets of the Mercator Group, which took place in December 2016. Prior to that transaction, Intersport had been separated from the parent companies at Mercator - BH ,d.o.o., as of January 1, 2016; at Mercator - H, d.o.o., as of March 1, 2016; at Mercator - S, d.o.o., as of July 1, 2016; and at Mercator - CG, d.o.o., as of September 1, 2016.

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 are not restricted at Mercator Group companies, and that there is no child or forced labor at our companies.

Information about the employees

The following information about our employees pertains to either December 31, 2016, or to the period 1–12, 2016. Information as at the last day of the year only includes companies that were a part of the Mercator Group as at that day, while periodic information includes all companies that were a part of the Mercator Group in the period at hand. Thus, for example, information for Intersport companies are involved in the data for the period, but they are not included in the data as at December 31, 2016, as the company had been divested prior to the end of the year.

The number of employees declined as a result of the completion of Modiana and Intersport divestment process.

Number of employees

As at December 31, 2016, Mercator Group had 20,354 employees, of which 10,335 were employed in markets outside Slovenia. Total number of employees decreased by 5.1% relative to the end of 2015, especially on account of the completed divestment process for Intersport and Modiana.

Market	Number of employees as at December 31, 2016	Number of employees as at December 31, 2015	Index number of employees Dec 31, 2016/ Dec 31, 2015	Number of employees based on hours worked in the period Jan-Dec 2016
Slovenia	10,019	10,550	95.0	9,664
Serbia	8,830	8,843	99.9	8,344
Montenegro	1,436	1,333	107.7	1,330
Croatia	49	557	8.8	422
Bosnia and Herzegovina	20	176	11.4	133
TOTAL	20,354	21,459	94.9	19,893

Share of employees by type of employment contract

As at December 31, 2016, the company Mercator - CG, d.o.o., had the largest share of employees on fixed-term (temporary) employment contracts. In Croatia and Bosnia and Herzegovina, there were no employees with fixed-term employment contracts as at December 31, 2016.

Market	Individual contract (in %)	Standard contract (in %)	Permanent contract (in %)	Contract for a fixed period (in %)
Slovenia	0.5	99.5	91.8	8.2
Serbia	0.8	99.2	69.1	30.9
Montenegro	0.1	99.9	57.5	42.5
Croatia	4.1	95.9	100.0	0.0
Bosnia and Herzegovina	5.0	95.0	100.0	0.0
TOTAL	0.6	99.4	79.6	20.4

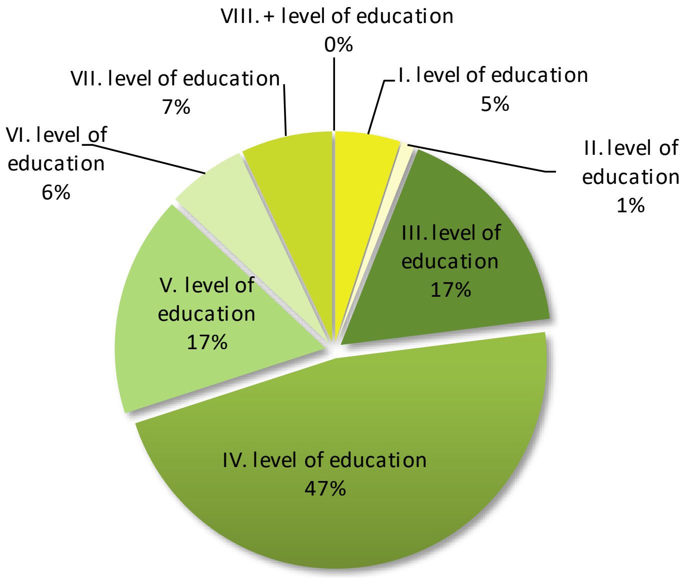
Employees with disabilities

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, 2016, at 814.

Market	Employees with disabilities on Dec 31, 2016	Employees with disabilities on Dec 31, 2016 (in %)	Employees with disabilities on Dec 31, 2015 (in %)
Slovenia	814	8.1	7.6
Serbia	109	1.2	1.2
Montenegro	1	0.1	0.1
Croatia	5	10.2	0.2
Bosnia and Herzegovina	0	0.0	0.6
TOTAL	929	4.6	4.2

Actual level of education

The largest share of Mercator Group employees have IV level of education (9,549 employees), which reflects our core activity of retail.



Employees by gender

Mercator employs more female than male employees: 69.7% of employees are women and 30.3% are men.

Year	Number ob employees	% men	% woman
2016	20,354	30.3	69.7
2015	21,459	30.0	70.0

External fluctuation

A total of 5,607 new employees were hired at Mercator Group companies in 2016. Employment relationship was terminated for 6,954 employees, of which 907 as a result of the completion of divestment process for Intersport, and 628 upon divestment of Modiana.

The highest level of external fluctuation in 2016 was seen in the markets of Croatia and Bosnia and Herzegovina, as most employees in these to markets were employed at Modiana and Intersport operations. 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 2016	Number of interrupted employment (excluding transfers between affiliated companies) in 2016	External turnover (in %)
Slovenia	1,229	1,762	15.0
Serbia	3,400	3,614	29.5
Montenegro	885	813	36.7
Croatia	83	592	92.5
Bosnia and Herzegovina	10	173	93.0
TOTAL	5,607	6,954	25.7

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

In 2016, Mercator Group devoted nearly 167,499 hours to training and education that involved 34,091 employees. The number of employees taking part in a variety of training and education courses was higher than in the year before, and the average training and education course was shorter. Investment into employee training and education amounted to EUR 1,046,845.

Review of the number of hours, participants, and funds allocated to functional training and education

Year	No of hours	No of participants	Funds allocated (in EUR)
2016	167,499	34,091	1,046,845
2015	166,799	26,454	815,405

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, first aid, forklift truck operator course, responsible person training, driver training, and other contents. A total of 391 events were held throughout the year, attended by 5,962 employees.

In development and selection, we conducted many **potential assessment activities** in 2016, both for **new employee hiring** and for **development** of our current employees. 593 individuals were assessed.

In October, we started the **development activities** for our key support field in retail, i.e. **distribution centres in logistics**. We launched the activities at the Slovenčeva unit. 21 employees in managerial and non-managerial positions took part in psychological testing and career interviews, and received feedback with elements of career coaching. In 2017, we shall continue with **individual development activities** in other distribution units of logistics. Moreover, we shall extend them with **development activities at the unit level**.

Development activities were also conducted for **retail unit managers (or leaders)**. In February, we conducted the **360 measurement** that involved self-assessment on the part of the managers / leaders, as well as their assessment by their subordinates and superiors. Measurement results were the basis for training and education in six modules, which took place from February to October in order to further **develop the competencies** of retail unit managers. Measurement was repeated in November. The results will be the basis for further development activities in 2017.

In July 2016, we announced a **call for application** to find **25 young**, dynamic, creative employees to take part in the pursuit of the strategy for the years 2016/2017. Following the selection procedures that included psychological testing, an evaluation centre, interviews with employees from the human resource sector, and relevant directors, we gave the opportunity to the best among the many applicants. Young experts will be working at the project management office for a period of one year, working on projects in category management and purchasing, retail, logistics, and marketing. All employees first completed a 26-day job rotation induction program to become closely familiar with our company, the field of work, working environment, and their co-workers.

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

From March to October, we carried out 24 **teambuilding workshops on Vogel**, attended by 378 employees.

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

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

The third generation of Academy trainees will soon complete their training. They have already completed 10 modules. The last meeting and the final ceremony are scheduled for January 2017. Most participants of the **3rd Retail Academy** also work with internal coaches who help the participants step out of their respective comfort zones to discover their potentials. Some participants were already offered promotion opportunities, and they took more challenging positions in retail.

The workshop **Creating an excellent shopping experience**, lasting 6 academic hours, has been developed as an upgrade to the two-day program of Sales Skill Development. This year, the training has already been attended by 1,873 employees. During the refurbishments, 216 employees took part in the training called "Refurbishment, Opportunity to Improve our Selling Skills", and 123 employees took part in the training "Understanding Different Types of Personalities Leads to Successful Sales".

The result of the **Stock Assistant School** that lasted from September to October, was 22 newly trained employees who were promoted to the position of a sales assistant. The employees were pleased about the program that allowed them to acquire a lot of new knowledge and skills. Training at all departments (check-out counters, fruit and vegetables, bread and deli) allowed them to learn about the work of the entire retail unit. In December, they were presented the certificates of successfully completed program, new employment contracts, and a small token of appreciation of their effort.

In September, we started the selection procedures for participants of the **4th Retail Academy**. 125 employees from retail were invited to take part in psychological testing. Over 80 qualified for further selection at assessment centres. Selection procedures were completed in December, and the list of selected candidates was presented to retail. We shall form two groups of Retail Academy participants which will start their training early in 2017.

As a part of our **cooperation with the IEDC Bled**, we completed the training program for sector directors. The Leadership Quest program is practically oriented and intended to **develop and strengthen leadership competencies**. The main goal of the program is to see a shift among Mercator's managers from the current situation in which they are described as "managers", to the future desired state in which a manager works as a "leader". In terms of competencies, we recommend improving all Mercator's leadership or managerial competencies, with particular emphasis on **decision-making and assuming responsibility** in terms of taking internal control of the work and **care for development** in the sense of nurturing a culture of feedback and encouragement of thinking on the part of the employees.

In the **Career Challenge project** we started training and education for the employees we identified as talented. We prepared the Leadership Academy for our leaders, and Business Academy was prepared for all other experts. The programs, taking place in modules until June 2017, were developed in cooperation with the Faculty of Economics.

In December, top management and participants of the **Career Challenge** had a **business lunch with the president**. As we were looking to thank the employees for the work and motivate them for further work, Dr Aleksander Zadel lectured on emotions in the world of business.

In this year, we again made it possible for seven of our employees to take part in the **Agrokor key talent development program**. The program took place under the auspices of the IEDC Bled school of business, and it involved 23 participants from the retail part of the Group. Participants were from Slovenia, Croatia, Serbia, and Bosnia and Herzegovina. The program consisted of 5 modules and it took place over the course of 21 days from March to December. After successful completion of the last module, the employees received their certificates.

Consistently with the initiatives that are a part of **Mercator's strategic policies**, 788 employees were trained in this year for bread and pastry baking, and 63 employees took part in workshops for finishing of organic pre-baked bread. As a part of the revision of competence centres, 18 of our best meat department trainers took part in the 4-day selling skills training in Zagreb, while 8 new trainers for the **fish** and seafood department were trained in the same way as the **meat** department trainers, and they were educated on HACCP and the trade and retail legislation. The one-day course at the Slovenian Chamber of Commerce was also attended by trainers for bakery and **delicatessen** departments. In autumn, sales assistants from the delicatessen departments also took part in training on preparation of sandwiches (12 participants), cold cuts (36 participants), and daily training on both the profession and selling skills (87 participants). We additionally trained 10 employees for the **hot bar** sections.

The five-day program of the revised **shop manager** school was attended by 338 shop managers in 2016. The goal of the school is to develop shop manager competencies, and it took place in the form of two-day modules at Hotel Ribno pri Bledu, and one one-day computer module at the company premises. We will continue with the school in 2017.

On November 8, we rewarded our best employees in a ceremony held at Pri Avseniku in Begunje. We presented 32 certificates and awards for the **best shop assistant**, 15 awards for the **best store**, 10 awards for **the best boss**, and 18 of the most prestigious **Mercator awards** presented by Mercator only for outstanding achievements.

In 2016, we launched the **development dialogues** with our employees in positions from the 25th pay scale category and above, working in administration. The first dialogue was dedicated to work climate, and it was attended by 247 employees. 191 employees took part in the second dialogue intended to discussion of talent. Brief 2-hour training is held before every leader dialogue.

RAZVOJNI DIALOG

delovna klima

talenti

PROMOCIJA ZDRAVJA

The Health Promotion project included the **Health Promoter School** completed by 56 employees who expressed their wish to promote health at the units at which they work. Each Monday, the promoters receive a Health Tips newsletter which is the basis for their activities in the current week, aimed at raising the awareness among co-workers about the importance of care for their health.

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

In 2016, the companies Poslovni sistem Mercator, d.d., Intersport ISI, d.o.o., and Mercator IP, d.o.o., 448 employees were awarded their annual promotions.

The company **Mercator - Emba, d.d.,** is included in the **project health squared** conducted by the Slovenian Chamber of Commerce and Industry – Chemical Industry Association. The purpose of the project is to promote health, offer free-of-charge workshops, professional assistance, well-priced exercise options etc. for the employees of chemical industry, food processing industry, and some other activities. In 2016, we received consulting in the form of individual mentor assistance on compiling menus and on assistance to the cooks at our internal cafeteria for the employees.

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

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

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

Responding to invitation by the Employment Agency of the Republic of Slovenia, Regional Unit Celje, Labour Office Slovenske Konjice, we took part at the event Open Door Day 2016 in September 2016. The event was dedicated to hiring of persons with disabilities, and raising the awareness on the employability of this vulnerable target group.

On October 23, 2016, the TV show "**A quarter of persons with disabilities work at social enterprises"** was aired on RTV Slovenia, in which the company Mercator IP, d.o.o., was also presented.

The "Beautiful Bloggers MeetUp" conference, taking place in early October 2016, brought together Slovenian beauty bloggers, experts on blogging, social media, digital marketing, and providers of beauty products and services. The conference also included an award ceremony for the **"Beauty Bloggers Awards 2016"**. In the category of facial care, the award went to **Dvorec Trebnik – moisturising serum with hyaluronic acid**.

In December, we prepared our in-house e-fair for the Dvorec Trebnik products, allowing our employees favourable shopping for gifts for nicer holidays.

On Friday, December 9, 2016, the Ekvilib Institute, working with the Ministry of Labour, Family, Social Affairs and Equal Opportunities, presented the basic and full certificates **Family-Friendly Company**. Festive award ceremony was held at the Poligon Creative Centre in Ljubljana. They also presented special awards for spreading the culture of family friendly company, which was received by the companies Poslovni sistem Mercator, d.d., and Mercator IP, d.o.o., social enterprise.

Description of human resource management activities in Serbia

The **Individual Performance** (IRU – Individualni radni učinak) project was implemented for the field of retail in the first quarter and for administration in the second quarter **at the company Mercator - S, d.o.o.** In 2016, 6 employees took part in the program "Developing Key Talents for Organisation Excellence 2016", organized by the IEDC Bled. In cooperation with the Berlitz language school, our employees attend group classes and individual lessons. Ten workshops "English Goes to Store" have been held for 52 employees in Belgrade and Novi Sad. The purpose of the workshops is to teach the retail employees the basics of English language to be able to communicate with customers from abroad.

As of August 1, 2016, the company migrated to a new human resource management IT system. Transition to work in HR.net required training of personnel for keeping the work time records.

The goal of the **Shop Manager Academy** project was to develop future shop managers. It was intended for employees in retail, working as check-out counter operators / cashiers, or department managers, who have shown potential for promotion to the position of a store manager or deputy store manager.

The program **Top-class shop manager for top-class results**, intended for shop managers and their deputies for the Idea brand is one of the most successful specific training programs looking to standardize the business processes at all Idea retail units.

For the participants of the **"First job, the right move"** project, their activities included daily work and training at retail units, as well as training in performing skills, job delegation, communication, providing feedback, and time organization.

"Trading Academy" is a program for assessment and acquisition of required skills in retail. Ten modules have been set up, and participants were selected from among category managers and assistants in retail.

Early in 2016, the concept of **new employee induction process** was completed. It includes the concept of play to present the company processes to newly hired employees, thus cutting short the time new employees need to learn and adapt. **Escape room** was selected as the best tool for new employee induction. This is a team psychological adventure in which the employees are required to solve a number of tasks within a certain amount of time. The tasks pertain to business processes in retail.

Specialized retail training for the fruit and vegetables category has also been completed. It has improved the business processes in this field. Training for 80 employees to sell meat at meat departments in all IDEA regions was completed in the first half of the year. The **"Academy for Meat Department Sales Assistants"** started in September, held in cooperation with the Technical School for Chemistry and Food Industry. The goal of this Academy is to retrain in a structured and systematic way the interested employees working in various departments for the job of a butcher. The Academy consists of two parts. The first two parts involve theoretical training, followed by 6 weeks of practical work. Eight employees were successfully trained for work in the meat department under the leadership of internal mentors. In Belgrade, 75 employees took part in the training for work at the bakery. Specialized training was held for employees working as sales assistants in delicatessen departments in the Belgrade region. A total of 2015 employees took part in ten training sessions in October and November 2016.

As a part of the trainer network, schools were selected in 2016 for all four regions. Training was held on the skill of knowledge transfer at work for all 92 permanent coaches. Moreover, 150 assistant coaches were selected for all segments regions. Trainer network development program has been set up, including all relevant documentation which is currently in the process of standardization and approval.

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

In order to implement new tools for employee selection and development, activities of the sector of employee selection and development included testing of several offers in the market.

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

The **360 assessment** project included presentation of assessment results within individual meetings. The assessment was focused on basic and managerial skills. For each assessed employee, further development activities were also defined.

In August, an educational video was shot titled **"Standards and Procedures in the Delicatessen Departments of the Idea Retail Units"** which will be one of the training methods in the training network for the delicatessen segment. In order to change the business processes, work processes in IT (administrator position) and in retail (the position of shop manager) are being recorded. The goal of the project is to define the criteria for attainment of standards, and to define and encourage in this respect new processes and improvements. In the last quarter, we visited eight retail units and defined the status and carried to the activities of the IN-STORE process, and sought to improve the management skills for shop managers. After the process, the results are positive at all eight units across most of the key performance indicators.

Description of human resource management activities in Montenegro

On January 15, 2016, twelve university graduates started their internships at the company **Mercator - CG, d.o.o.,** based on the government expert training program. In mid-February, 20 employees completed their two-month training for new shop managers, of which 12 employees had already worked as shop managers and 8 were new. In the course of March, all employees took part in retail and administration conventions which also included training and education on re-branding of the Roda banner to Idea, and communication of this change.

Retail employees took part in the training course **Usluga plus** ("Service Plus") in order to improve the quality of services at the departments. To satisfy the needs for human resources at meat departments, we started the training for job of a butcher. Newly hired employees are assigned to respective retail units and assigned a mentor for their two-month induction period.

The project "**Idea Manager**" is currently in progress, with the aim of training young managers to take over and manage respective business units. Four candidates with completed university degree were selected who will be trained for 6 to 9 months in a variety of fields (communication, assertiveness, leadership, etiquette, processes and procedures). Fifteen young talented employees is taking art in the training to improve their communication skills. In the third quarter of 2016, activities were defined to improve work on the check-out counters, and training was carried out to this end. Also, the preparation of manual to serve as the guide to all cashiers has started. Decisions were adopted to reward the cashiers with the best results in active sales. In order to improve employee satisfaction, a survey was conducted on a sample of 350 employees to determine the level of satisfaction at work in terms of interpersonal relations, salaries, work conditions, training and education possibilities, promotion etc. Based on the results, and action plan was laid down to improve the level of satisfaction at work, and implementation of this plan will take place from September 2016 to May 2017.

On December 22, the **annual Idea Conference** was held in Podgorica, attended by 265 employees. At the conference, we summarized the results of 2016, and presented the new corporate values. At the same time, we took the opportunity to hold an award ceremony for the **Best Fellow Employee** awards. The awards went to 10 employees in administration and 20 in retail.

New Year's activities included a project **Secret Santa Claus**. The stress of this activity was on connecting and on interpersonal relations.

Description of human resource management activities in Croatia

As of March 1, 2016, the company **Mercator-H, d.o.o.,** introduced a **new HRM IT system called HRpro**.

Description of humanitarian foundation activities

In Slovenia, **Mercator Humanitarian Foundation** provided aid to 165 employees of Poslovni sistem Mercator, d.d., or Mercator IP, d.o.o., who were in need of help. We have paid out humanitarian aid in the total amount of EUR 80,992. We also granted social scholarships to five children of our employees, in the total amount of EUR 4,700. In Serbia, the Mercator Solidarity Foundation provided aid to 111 employees, in the total amount of EUR 28,584. In Croatia, 10 employees were provided aid in the total amount of EUR 3,962; and in Montenegro, 27 employees received total aid of EUR 5,800.

RESPONSIBILITY TO CUSTUMERS

Consumer is at the centre of our efforts. Therefore, responsibility to consumers comes first. A part of our mission is to see satisfied customers who perceive us as the best retailer offering everything our competitors can offer, yet at better terms, and much more.

Marketing activities related to the offer of local products

Within the **Locally Grown** project, we continue to focus in recent years on Slovenian offer of fresh produce. To this end, we continue to sign agreements with growers on larger purchasing volumes for Slovenian produce. We work with the growers to provide an increasingly broad offer for our customers, with a variety of sorts of Slovenian fruit and vegetables. The project contributes to preservation of the environment and provides a faster route to our stores, aisles, and shelves for the growers.

The project Locally Grown was upgraded with the project We Love Local.

In 2016, the project Locally Grown ("Iz domačih krajev") was upgraded with the project **We Love Local** ("Radi imamo domače"). Special stands as well as aisles were set up at Mercator stores, offering exclusively genuine local products. For easier recognition, the stands and aisles are labelled with red hearts with the sign "We Love Local. The stands offer genuine produce and products from local farmers, growers, and producers.

Mystery shopper

The goal of the mystery shopper survey is to examine the level of service, suitability of communication, and expertise of the sales staff at Mercator stores. The results are used to improve the quality of service. The survey includes evaluating the following aspects: attitude to customers, cleanliness and neatness of stores and employees, knowledge about the products, selling skills, product presentation, stocking, price labelling, waiting time, and Pika card.

Compared to 2015, average overall mystery shopper result improved in 2016. Moreover, the result for respective store formats improved as well.

Customer complaints

One of the sources of information and data for improvement of our offer and services are the customer complaints that we receive. We consider every complaint or proposal and we seek to take it into consideration as closely as possible, and to upgrade or do away with any deficiencies in any field, and to improve the offer and service.

All customer complaints, regardless of who received the complaint and how it was presented (phone, e-mail etc.), are collected at our Contact Center. We coordinate their resolution and provide feedback on the solution. Received complaints are analyzed and based on our customer's desires, we develop proposals for improvement and measures for their pursuit.

Mercator Call Centre won the QUDAL award for resolution of customer complaints.

For 2016, **Mercator Call Centre won the QUDAL award** for quality in customer complaint resolution.

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 consumers safe, compliant, and quality products, our activities in 2016 included the following:

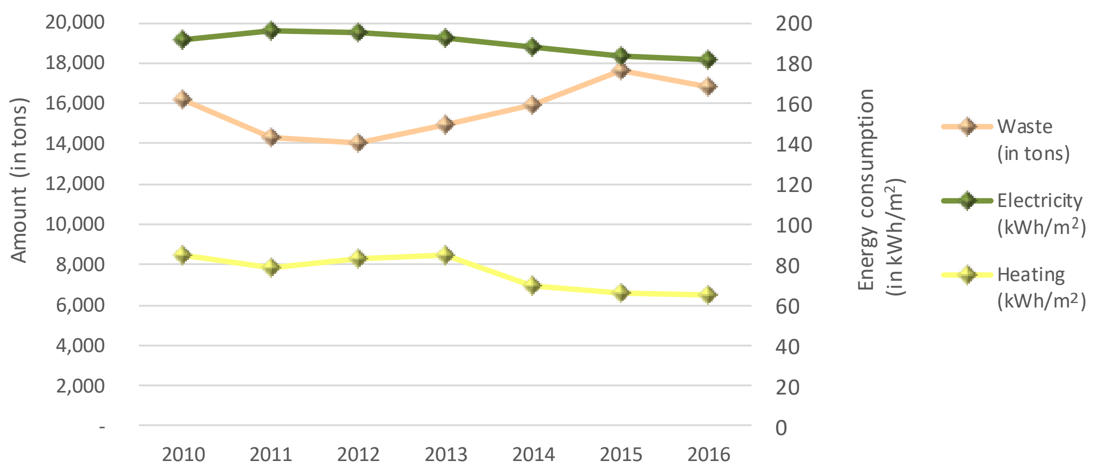
- a total of 2,272 private label product samples were analyzed in our own laboratory and by third-party institutions;
- we conducted monitoring on 2,277 food samples from our open departments;
- we recorded 210 samples as a part of national monitoring;
- we carried out 556 regular and 20 outstanding internal controls at our sales units;
- we conducted a total of 2,202 hours of expert training and education on the HACCP internal control system, for 590 responsible persons;
- we successfully completed the audit for marketing organic food under our Mercator private label, and obtained a new certificate for the sale of organic bread from our own pre-baked assortment, non-pre-packed fresh beef, and eggs;
- by upgrading the system for recall or withdrawal of non-compliant products, we further restricted the possibility of purchase of such products.

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

Consistently with the adopted ambitious package on circular economy by the European Commission, the company Poslovni sistem Mercator, d.d., 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. We are striving for our measures to include the entire life cycle of our products, from production and consumption to management of secondary raw materials and waste.

Energy consumption and waste at the company Poslovni sistem Mercator, d.d., for the period 2010–2016



Energy efficiency

The pace and purpose of exploitation of renewable and non-renewable natural resources are increasingly reducing the ability of our planet to restore the sources of energy on which our welfare and growth depend. Therefore, the company Mercator, d.d., is making every effort to preserve the natural resources and reduce the negative impact on the environment by embracing the principles of sustainability which include rational production and consumption.

We are aware of the importance of energy efficiency. Therefore, our **goal is to cut energy consumption** at the company Poslovni sistem Mercator, d.d., **by 1% per year**. In order to attain this goal, the following activities were carried out:

- Energy accounting was established for all facilities of the company Poslovni sistem Mercator, d.d. All information for power and gas are obtained from the supplier GEN-I. Other data is transferred into the system via the SAP application.
- On 359 facilities, 15 min data on electricity was transferred from the main power meters via the electricity supplier GEN-I to emes.energia.si.
- Efficient use of electric energy (power) was launched at 172 of our buildings.
- Efficient use of thermal energy (heating) was launched at 51 of our buildings.
- Measures were implemented on 46 buildings by the end of the year 2016.

The goal is to cut energy consumption at the company Poslovni sistem Mercator, d.d., by 1% annually.

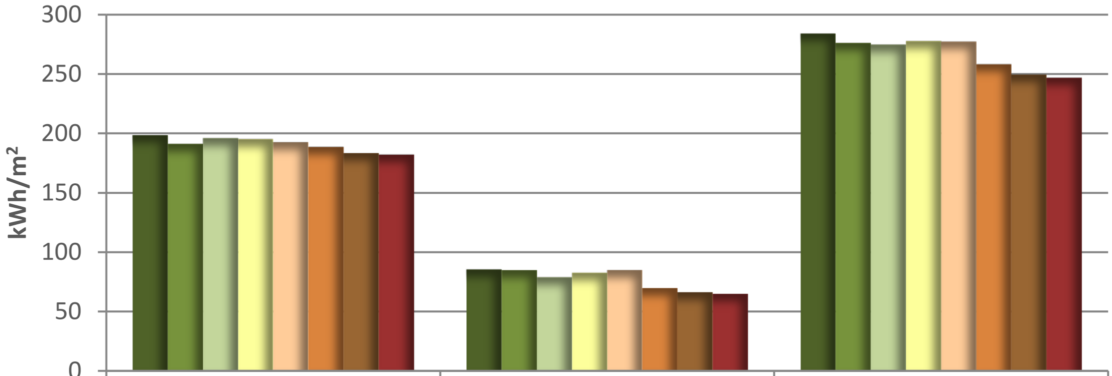
Until and including August 2016, contractual partner Maked Energea displayed power savings of 1,586,341 kWh, and heat savings of 612,036 kWh, or total savings of EUR 168,482.

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 2017, 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.

Data on the amount and type of waste packaging, electrical and electronic equipment, and biological waste, which account for the largest share among separately collected waste at the company Poslovni sistem Mercator, d.d., is presented in the graphs for the period from 2009 to 2016. The amounts of separately collected, or sorted, waste packaging by years vary as a result of mergers of companies, changes in the shares of private label sales and own imports, and other factors.

Use of specific total final energy for the company Poslovni sistem Mercator, d.d., in the years 2009–2016



	ELECTRICITY	HEATING	TOTAL
2009	198	86	284
2010	191	85	276
2011	196	79	275
2012	195	83	278
2013	193	85	277
2014	188	70	258
2015	183	66	249
2016	182	65	247

Waste and other environmental aspects

Management of environmental aspects

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. The company Poslovni sistem Mercator, d.d., is the only trade company in Slovenia, engaging in wholesale or retail of fast-moving consumer goods, to be awarded the ISO 14001 certificate.

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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 mitigate negative impact on the environment. In order to reduce environmental impact, we conducted various activities for managing the environmental aspects in 2016.

Environmnetal risks

Environmental risks are risks related to identified environmental aspects in Mercator Group. These aspects involve areas like use of raw materials and energy, emissions into air, emissions into water, waste management etc. They include risks related to inefficiently designed business processes, risks related to environmental penalties, risks related to extraordinary conditions (fires, floods etc.) and risks related to requests and requirements by stakeholders in environmental protection.

In order to efficiently manage the environmental aspects, we assessed our environmental risks. The greatest environmental risks identified for 2016 were risks related to electricity, heating, and waste management. Critical risk was identified at the companies Poslovni sistem Mercator, d.d., Mercator - S, d.o.o., Mercator - CG, d.o.o., Intersport ISI, d.o.o., and Mercator - Emba, d.d., for the environmental aspect of "use of electric energy", which is related to less efficient use of electric energy due to suboptimal business processes and integrated technologies. At Mercator IP, d.o.o., critical risk was identified for the environmental aspect waste generated; at M - Energija d.o.o., critical risk was identified for the environment aspect of light pollution.

We laid down 10 resolutions to mitigate the effects of critical environmental risks in 2016. Of these, 8 measures have been implemented and completed, while 2 are no longer relevant.

We identified the stakeholders for the Mercator Group companies in the field of environment protection, which can affect company operations and performance or which can be affected by the company operations. Failure to meet the requirements, needs, and expectations of these stakeholders may result in a risk for the Mercator Group companies due to, for example, emergency conditions, suboptimal costs, impediments to operations etc.

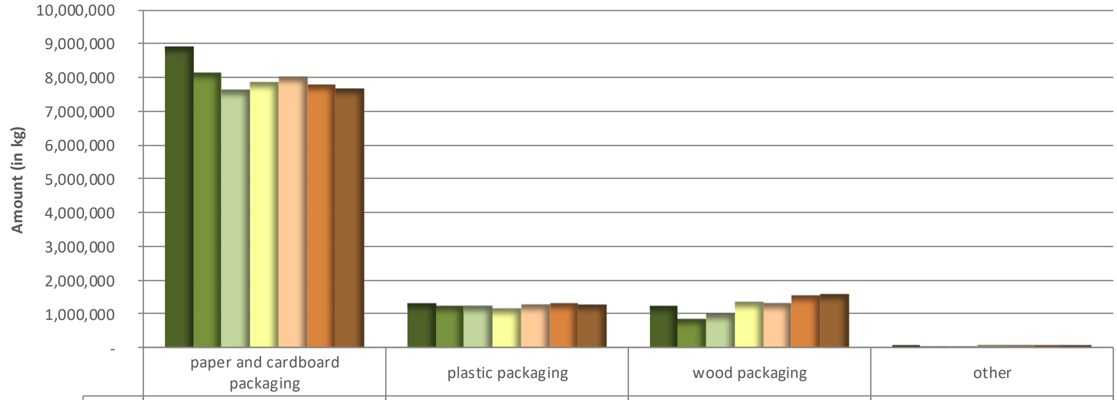
In 2016, the following measures and activities were implemented, by respective segments:

1. **Waste and raw materials**
   - 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 45 units and provided 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 by EUR 45,592 per year.
   - For easier and more accurate waste sorting, we updated the labels for waste at all locations of the company Poslovni sistem Mercator, d.d.
   - At 40 refurbished retail units of the company Poslovni sistem Mercator, d.d., we installed waste bins for separate waste collection for the customers.
   - At the company Poslovni sistem Mercator, d.d., we have been systematically cutting our use of paper for years, by going paperless. To this end, we started to introduce e-invoicing in 2016 for purchase of non-trade goods and services.
   - We actively controlled the separate waste packaging collection and sorting at the units of the company Poslovni sistem Mercator, d.d. In order to increase the amounts of separately collected packaging, we raised employee and tenant awareness at our units.
   - 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., was entered into the register of manufacturers and buyers of tyres, and met other legal requirements regarding environment protection.
   - At the company Poslovni sistem Mercator d.d., we worked with the recycling and reuse centre "Center za ponovno uporabo (CPU)", providing it with damaged products that are restored at the CPU with minor repairs and innovative refurbishment so that they can be reused. Thus we reduced the amounts of waste generated and showed responsible conduct towards resources, raw materials, and social groups in distress. We presented the shelves or racks we no longer needed after the refurbishment of the Mercator center to the Smet Umet society.
   - 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.

- At the company Mercator - S d.o.o., we signed contracts with authorized waste collection companies for collection of all sorts of waste generated as a result of our operations.
- At the company Mercator - S, d.o.o., we separately collected 2.61 tons of waste electric and electronic equipment. Of this amount, 700 kg was hazardous waste. The waste was taken over and processed by the authorized waste collection centre.

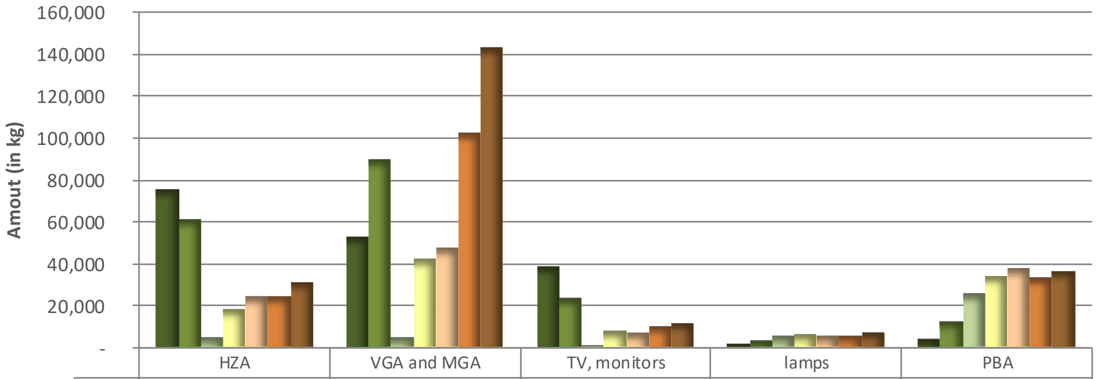
Data on the amounts, specific amounts and type of waste packaging, waste electrical and electronic equipment, and biological waste, which account for the largest share among separately collected waste at the company Poslovni sistem Mercator, d.d., is presented in the graphs below for the period from 2010 to 2016. The amounts of separately collected, or sorted, waste packaging by years vary as a result of mergers of companies, changes in the shares of private label sales and own imports, and other factors.

WASTE PACKAGING



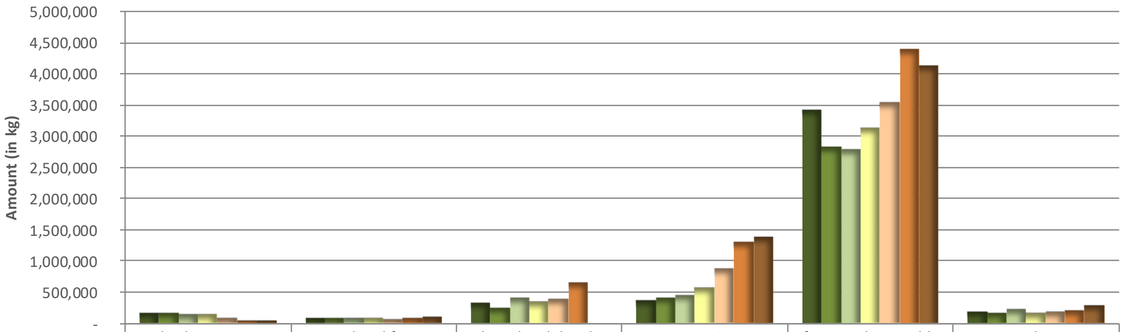
	paper and cardboard packaging	plastic packaging	wood packaging	other
2010	8,898,005	1,299,773	1,212,192	45,913
2011	8,131,188	1,209,451	829,200	31,021
2012	7,622,590	1,220,621	1,014,293	34,306
2013	7,860,094	1,169,763	1,329,811	45,280
2014	8,021,549	1,271,820	1,311,912	80,593
2015	7,804,348	1,319,838	1,553,860	82,779
2016	7,687,499	1,280,226	1,565,565	73,760

WASTE EE EQUIPMENT



	HZA	VGA and MGA	TV, monitors	lamps	PBA
2010	75,940	53,330	38,950	1,913	4,365
2011	61,060	90,230	23,730	3,258	12,011
2012	5,040	4,610	1,000	5,444	25,951
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

ORGANIC WASTE



	kitchen waste	oil and fat	bread and dough	Category 3 ABPs	fruits and vegetable	animal tissue
2010	168,492	74,655	325,531	359,934	3,425,050	192,136
2011	164,841	84,891	250,707	404,980	2,831,434	174,193
2012	144,746	79,059	399,461	453,085	2,793,425	218,523
2013	147,478	75,857	356,743	565,178	3,139,626	168,665
2014	78,360	70,565	390,057	869,160	3,551,387	181,675
2015	36,418	80,658	650,340	1,295,890	4,405,487	209,289
2016	36,163	102,781	-	1,377,716	4,144,285	292,892

2. **Water and wastewater**

- At the Maribor distribution centre, we obtained a Decision on the amendment to our water course permit as a result of relocation of a part of operations from the distribution centre Zalog, for pumping ground water for the requirements of cooling. Despite the increased volume of operations, the increase of water consumption at the distribution centre Maribor was lower than the reduction in water increase at the distribution centre Zalog, which in turn contributed to a combined decrease in water consumption at these two locations.
- At Mercator center Nova Gorica, we set up a container for separate collection of waste oil for our customers, in order to prevent discarding the waste oil into drains, which in turn results in water pollution.
- At the company Mercator - S, d.o.o., operational waste water quality monitoring is conducted three times per year, consistently with the relevant legislation. Operational monitoring was conducted at 37 units with installed oil skimming devices. The results of monitoring proved that the anticipated dynamics of cleaning and the selection of cleaning approach were optimal.

3. **Emissions into atmosphere and substances harmful to health**

- We have installed environmentally friendlier refrigeration and other equipment at 50 newly constructed or refurbished facilities of the company Poslovni sistem Mercator, d.d.
- 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 hazardous waste generated as a result of non-compliant merchandise. Using reverse logistics, we shall continue to collect such goods in a lower number of collection points where hazardous waste will be collected by the authorized waste collection company.
- Measurements of emissions into air from movable property or equipment (business / commercial and freight vehicles) at the company Mercator - S, d.o.o., are being conducted as a part of vehicle inspections (MOT tests) at least once per year. Emissions measurements from immovable property are taken, in compliance with the law, twice per year – at the start and at the end of the year. Measurements were conducted at 20 units on a total of 26 heating devices.

4. Hazardous substances and preparations

- Pursuant to the requirements of the CLP Regulation EC No. 1272/2008 on sorting, labelling, and packaging of hazardous chemicals, new and stricter rules for hazard identification have been put into place, and new requirements for labelling have been introduced, resulting in the redesign of the labels and symbols, and updates to safety data sheets for products in the sales network of the company Poslovni sistem Mercator, d.d.
- We have established more suitable records of safety sheets for hazardous chemicals, which are used only in our internal processes, e.g. as fuels, refrigerants, gases etc., which will be made available via an intranet portal.
- For chemicals that we import and which the company Poslovni sistem Mercator, d.d., is liable to report to the Chemicals Office of the Republic of Slovenia, we obtained access to the online application allowing electronic data entry.

5. Noise

- At 31 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 commissioned noise measurements by companies authorized for measurements of noise emissions into the environment.
- 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.
- At the company Mercator - S, d.o.o., the authorized noise measurement agency conducted 25 measurements of noise into the natural environment. If the critical values for noise emissions were exceeded, relevant measures were put into place to restore the noise source.

6. Light pollution

- At the company M - Energija, d.o.o., we developed starting points for replacement of lighting at gas stations MAXEN, which is obsolete and inefficient in terms of energy consumption. We have prepared calculations for new LED technology, negotiated the restoration of the currently existing lighting, and approved the dynamic plan for replacing the technology which will be completed in 2017.

7. States of emergency

- At the company Poslovni sistem Mercator, d.d., we established an extended record of states of emergency, complete with their effects on the environment. Based on the new records, we will be able to develop more efficient measures to cut the negative effects on the environment and update the organizational rule on identification of states of emergency or events affecting the environment, and on the conduct in such cases.
- At other Mercator Group companies, there were no states of emergency affecting the natural environment in 2016.

Communication, promotion of awareness, education

A system of internal communication has been established with employees whose work has considerable environmental impact. We are striving for correct and balanced two-way communication. We enter dialogue responsibly and we build trust with the environment in which we operate. Our commitment to protection of environment is also manifest in communication with our customers and other interested communities (or public).

- 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, we teamed up with product suppliers with whom we will carry out a new circular economy project in 2017.
- We have updated the Environment Protection portal which is intended for all employees of the company Poslovni sistem Mercator, d.d. It provides in a single place all environment protection information required by the employees for their work.
- We released environmental information for our employees on the intranet.
- We updated the environment protection information on the Poslovni sistem Mercator, d.d., website. This information is intended for our customers and other interested public.

- In order to efficiently manage the environment aspects, we developed and standardized the Waste Management Rules for locations of the company Poslovni sistem Mercator, d.d. - for the users, and Waste Labelling Instructions. We have updated the technological procedure of waste electric and electronic equipment management, technological procedure for biological waste management, technological procedure for management of waste plant protection products, and instructions for entry of environment data of respective products into the GOLD application.
- At the company Mercator - S, d.o.o., we were active in training and raising awareness on environment protection. We set up the IDEA PORTAL on which the employees can access all documentation of the environmental management system (ISO 14001), waste management, and reports on conducted measurements (water quality, emissions etc.).

Following were the activities related to environment legislation and environment protection in 2016:

1. External audits

At the company Poslovni sistem Mercator, d.d., external audit of the environmental management system according to the ISO 14001 standard was carried out; 1 case of non-compliance was identified, and 7 recommendations were issued.

The external auditor of the environmental management system at the company Mercator - S, d.o.o., praised the intent to observe the requirements of the new version of the ISO 14001:2015 standard. System improvement recommendations were included in the activity plan for the year 2017.

2. 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; 76 cases of non-compliance were identified. All corrective measures issued based on the findings have been implemented.

3. Cooperation with the government authorities

As members of the Sustainable Development and Environment Protection Council, we are 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.

Environment protection expenses

At Poslovni sistem Mercator, d.d., EUR 758 thousand was allocated in 2016 for environment protection investments. In addition, current environment protection expenses exceeded EUR 4.406 thousand, while revenue from environment protection activities exceeded EUR 880 thousand.

According to the Reader's Digest magazine readers, the company Poslovni sistem Mercator, d.d., ranks number 1 in environment protection among food retailers.

According to the Reader's Digest readers, the company Poslovni sistem Mercator, d.d., ranks number 1 in the category of food retailers in the field of environment protection.

Sustainable logistics and supply chain organization– 2016 annual report

Operations of the business field of logistics within the company Poslovni sistem Mercator, d.d., in 2016 were focused on stabilizing the supply after the fire at the distribution centre Zalog in May 2015. We continued our processes of consolidation of material flows in centralized supply, and thus to optimize the business processes in the new circumstances.

The basic mission of the field of logistics at the company Poslovni sistem Mercator, d.d., remains efficient supply of goods, or merchandise, to delivery points, to our sales network, and to our external customers. In pursuing this mission, we use the logistics infrastructure – warehouses and means of transport. Adequate operation of both is inevitably related to the use of several fuels or energy sources, which in turn poses a burden for the environment.

Physical volume of goods distribution in 2016 was identical to the one in 2015; however, we succeeded in optimizing our business processes, particularly transport, to cut the number of kilometres clocked up by 15 percent relative to the year before. In absolute terms, this means 2.2 million fewer kilometres.

Simultaneously with the transport route optimization, we partial updated our fleet of freight vehicles in the last two years. In 2015, we acquired 27 new freight vehicles with motors complying with the EURO6 standard; in 2016, we acquired 22 more freight vehicles; and in 2017, we are planning to acquire additional 34 new freight vehicles meeting the latest exhaust gas emissions standards.

RESPONSIBILITY TO SOCIAL ENVIRONMENT

In 2016, Mercator Group continued 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 responded to all applications submitted by societies, organizations, clubs, and individuals. Considering the current situation in the country, our funds are primarily allocated to humanitarian projects. In 2016, we supported over **900 different** humanitarian, cultural, educational, and sports **projects**.

We supported over 900 different humanitarian, cultural, educational, and sports projects.

Donating food surpluses for hot meals

In 2016, we continued the **Donated Food project**. Volunteers from Lions Clubs from Celje, Maribor, Trbovlje, Velenje, Koper, Domžale, Brnik, Slovenj Gradec, Novo Mesto and the Institute "Pod strehco" ("With Roof Over Your Head") of Ljubljana collected food from 20 stores across Slovenia every evening.

We like to do good deeds

In April 2016, a pan-Slovenian donation activity "We Like to do Good Deeds" took place at 100 minor Mercator stores for the third year in a row. Three hundred local societies and organizations from around Slovenia competed for a donation of a total of EUR 130,000. The winners were chosen in cooperation with our customers. After each check-out, the customers voted for their favourite organization to be awarded a donation of EUR 1,000 for a project of local importance. Over 800 thousand votes were cast by our customers in the course of the campaign. A donation was also presented to the first and second runner up, in the amount of EUR 200 or 100, respectively.

Traditional Slovenian breakfast

By distributing the Slovenian Breakfast, Mercator has been contributing for the sixth year in a row to raising the awareness of a healthy breakfast, and also supporting local growers and Slovenian tradition.

In 2016, Mercator employees worked with the Ljubljana Airport to distribute the Slovenian breakfast to passengers leaving from and arriving to the Airport. Breakfast was also distributed to all airport employees, taxi and other drivers, police officers, customs officials, and employees of the establishments at the airport. We distributed a total of **1,100 breakfast** packages.

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 2016, we **donated 5 tons of bread** within the **Drobtinica (Breadcrumb) project**, organized each year by the Slovenian Red Cross organization.

Sponsorship

In sports, we sponsored the Slovenian Olympic Committee, Handball Club Krim Mercator, Handball Club Celje Pivovarna Laško, Football Association of Slovenia, Football Club Maribor, Ski Jumping Club Ilirija, wheelchair basketball team of the Ljubljana Region Society of Paraplegics, stand-up paddle surfer Manca Notar, and whitewater kayaker Nejc Žnidaršič. This year, we again supported the Zlata lisica skiing competition, Hike Along the Wire of Occupied Ljubljana, international bicycle race "Tour of Slovenia", Ljubljana Marathon, and the Europa Donna foot race. We are a traditional supporter of the Kurentovanje carnival in Ptuj, and the theatre festival Borštnikovo srečanje. We also supported the Fairy Town in Maribor which sprang up in December. We also sponsor the Sales Summit, Slovenian Marketing Conference, Conference of Sales and Marketing on the Shelves, Portorož Business Conference, Trade Conference, Case Challenge contest, and high school competition in sales techniques.






Competition protection and legal proceedings

In accordance with the umbrella policy of the company Poslovni sistem Mercator, d.d., and its subsidiaries, the conduct of Mercator employees, representatives, and proxies, regardless of their location, shall comply with the relevant and binding legislation, rules, and regulations in all fields of work. A part of this commitment represents respecting the legislation on competition and trade regulations that serve the purpose of effective competition in the market both in Slovenia and abroad.

To maintain compliance of its operations in the business and broad social environment, Mercator Group adopted internal binding guidelines specifying the conduct to prevent corruption, conflict of interests, money laundering etc., and established a mechanism for identification of any disputable practices at the company.

RESPONSIBILITY TO SUPPLIERS

Long-term partnership relations with suppliers 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.

Supplier commitments, monitoring and control

Company Poslovni sistem Mercator, d.d., signs annual 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.

Assesment 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 depend 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 are only signed with suitable suppliers. 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.

Inclusion of suppliers into expansion of Slovenian and local offer

At Mercator, we work with local suppliers to offer our customers as much locally grown produce as possible. Inclusion of products by local suppliers allows cutting supply and transport routes and thus reduces carbon dioxide emissions. By offering the best from the local environment, we are encouraging innovation and supporting Slovenian farmers and growers

Our efforts for more local products in our offer were upgraded with an agreement on long-term cooperation with and support to Slovenian agriculture and cooperatives, by signing an agreement with the Cooperative Union of Slovenia.

We Love Local

In 2016, our cooperation with Slovenian suppliers was upgraded as a part of the local offer **We Love Local** which is more than just local offer on the shelves – it is a manifestation of our operation in the local environment. Local products include products made from raw materials grown and processed in Slovenia. They are identified as:

GENUINE	Because local products embody our tradition, our customs, and our flavours.
HOMEMADE	Because the farmers put the same products on the table for their families.
NATURAL	Because our farmers grow and prepare the food with love for their soil and their people.
LOCAL	Because fresh and quality food from our farmers is the closest to us.
SHARED	Because we know each other, support each other, and wish each other only the best.

To our customers, local means quality, scope of local offer, and proximity of the store.

For smaller growers, we opened a portal via which we invite them to take part in the categories of meat, meat produce, fruit and vegetables, milk and dairy products, bakery products, eggs, oil, and flour.

Currently, our customers are offered, on special shelves at 300 retail units, 900 types of homemade products supplied by 100 farmers and growers. We also work with Slovenian farmers and growers through twenty agricultural cooperatives, including: KZ Krka, KZ Šaleška, KZ Laško, KZ Tolmin, Loška zadruga - KGZ Škofja Loka, KZ Sevnica, KZ Idrija, KZ Ptuj.

RESPONSIBILITY TO QUALITY

Efficient management of business processes is provided through compliance with the requirements of the international quality management systems. Respective systems were connected into an integrated management system, the basic requirements of which are implemented at all Mercator Group companies. The system is constantly developed and expanded, and systemic monitoring of key indicators allows us to efficiently manage the processes, and to continuously improve and transfer good practices between Mercator Group companies.

Management of certified management systems

There are **13 certified management systems** maintained at Mercator Group companies.

Management Quality Systems	**Poslovni sistem Mercator, d.d.**	**Mercator - S, d.o.o.**	**Mercator IP, d.o.o.**	**Mercator - Emba, d.d.**
ISO 9001 - Quality Management Systems	✓	✓		✓
ISO 14001 - Environmental Systems	✓	✓		
HACCP - Food safety		✓		
IFS - International Food Standard				✓
SQMS - Supplier Quality Management System				✓
AEO - Supplier Food Standard	✓			
Familiy Friendly Company	✓		✓	
Organic production	✓			
UTZ - Production of cocoa products based on sustainable principles				✓

Document management – managing knowledge anf information

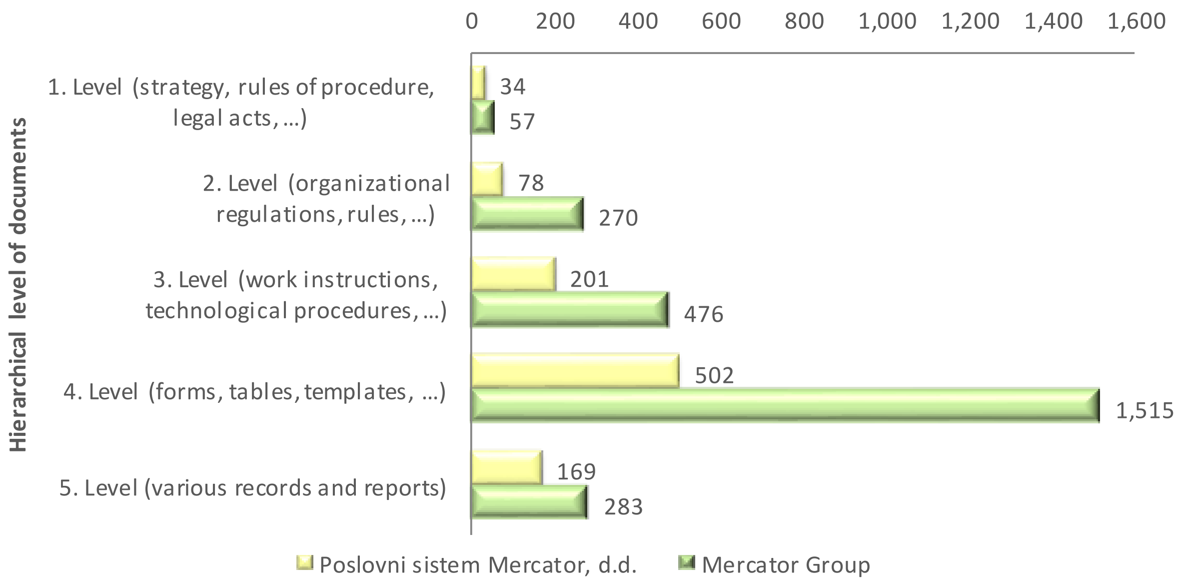
Requirements or rules of operation at Mercator Group are specified in internal documents controlled electronically in the Mercator Standards Collection. All employees may access the collection to browse or search for documents related to their role in the business process, and provide proposals for improvements. This way, we also improve communication and the flow of knowledge and information between employees.

Valid documents are regularly revised: document owners have to revise the documents at least once per year, and the document contents are updated based on good practices and suggestions for changes.

Leaders use automated notifications to inform on a daily basis about all new documents at Mercator Group companies, while access counters are used to find which documents are most frequently used by our employees in their work.

Documents are monitored in a variety of ways, most frequently by companies, functions, and hierarchy.

Number of valid documents at Mercator Group and company Poslovni sistem Mercator, d.d., as at December 31, 2016



Source: Mercator Standards dokuments as at December 31, 2016

As at December 31, 2016, there were 2,601 valid documents in the Mercator Standards Collection for the Mercator Group. In 2016, we published 629 new or revised documents; 642 documents were archived (removed from use).

As at December 31, 2016, Mercator Standards Collection included 984 valid documents. In 2016, we published 216 new or revised documents; 108 documents were archived.

External and internal control of operation

External control at Mercator Group is conducted by inspection agencies and external auditors who regularly review the compliance of operations with the requirements of certified management systems, currently applicable legislation, and internal rules.

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.

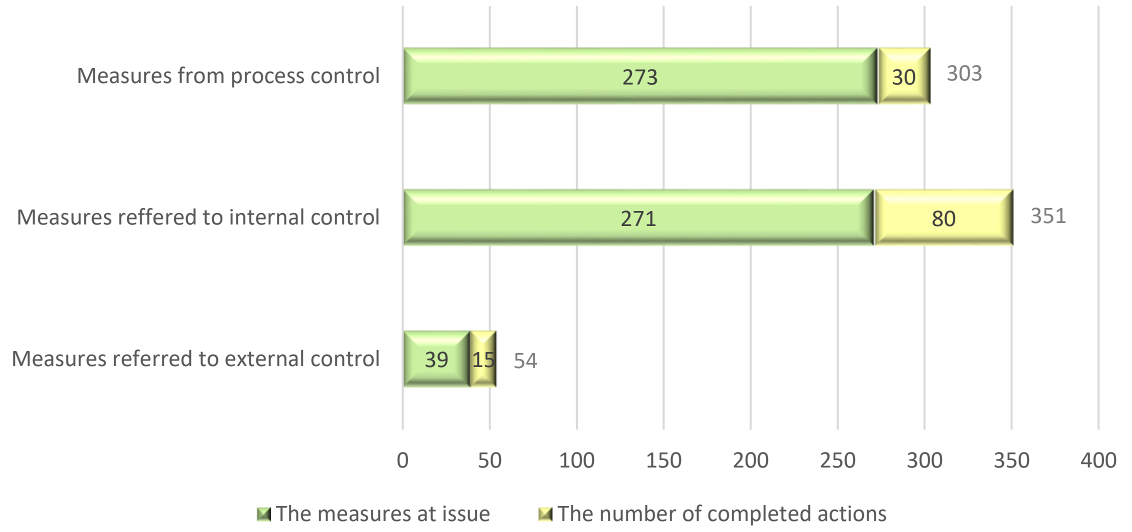
Findings of internal controls are combined in systemic corrective measures which have the same relevance and are considered in the same way as the corrective measures recommended by external audits or supervision.

Management of the continuous improvement system

Continuous improvement process is consistent with the policy and quality goals, based on the findings of councils, third-party control, internal control, 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. Everyone concerned by a report is notified by electronic mail about their task, and the reporting entity quickly receives relevant feedback for the solution of a problem or a proposal. Analyses are used to identify major discrepancies and to introduce corrective measures based on our findings. Application supporting the continuous improvement system is used at all Mercator Group companies.

Number of measures addressed and completed at Mercator Group in 2016



Source: Intern application

In 2016, 708 measures were addressed at the Mercator Group level in the internal applications. Except for one measure initiated by the company Mercator IP d.o.o., all measures were initiated from the company Poslovni sistem Mercator, d.d. However, measures are implemented and resolved across all Mercator Group companies; this applies in particular to the measures initiated based on risk analysis.

Due to confidentiality, all measures are not resolved with the application for continuous improvement system management. Among external control measures, we resolve within the application the measures following inspections and external audits for the ISO 9001 and ISO 14001 systems; among external control measures, we use the application for monitoring of open departments and measures following internal audits for the ISO 9001 and ISO 14001 systems. Process control measures include: user reports, measures following customer complaints, findings in retail, measures from the managerial audit of ISO 9001 and 14001 systems, and measures of the risk management system.

FINANCIAL REPORT

BEING FOCUSED HELPS US MAINTAIN THE STABILITY OF OUR OPERATIONS.

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 2016, 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 2016.

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 2016.

Ljubljana, April 25, 2017

Tomislav Čizmić
President of the Management Board

Draga Cukjati
Member of the Management Board

Igor Mamuza
Member of the Management Board

FINANCIAL REPORT OF THE MERCATOR GROUP

Consolidated balance sheet

EUR thousand	Note	Dec. 31, 2016	Dec. 31, 2015
ASSETS			
Non-current assets			
Property, plant and equipment	15	1,569,905	1,371,405
Investment property	17	9,899	3,352
Intangible assets	16	21,963	19,538
Deferred tax assets	19	23,529	18,057
Loans and deposits	23	31,385	30,604
Available-for-sale financial assets	18	462	524
		1,657,143	**1,443,480**
Current assets			
Disposal groups	20	-	217,482
Inventories	21	224,328	280,853
Trade and other receivables	22	205,707	256,189
Current tax assets		1,230	656
Loans and deposits	23	8,110	8,065
Cash and cash equivalents	24	26,318	18,998
		465,693	**782,243**
Total assets		**2,122,836**	**2,225,723**
EQUITY	25		
Share capital		254,175	254,175
Share premium		286,772	286,772
Treasury shares		(3,235)	(3,235)
Revenue reserves		41,685	41,686
Fair value reserve		104,541	108,865
Retained earnings		37,515	15,365
Profit (loss) for the year		(72,463)	20,245
Currency translation reserve		(91,720)	(89,668)
Equity attributable to the controlling company owners		**557,270**	**634,205**
Non-controlling interests		**106**	**228**
Total equity		**557,376**	**634,433**
LIABILITIES			
Non-current liabilities			
Trade and other payables	29	45,183	38,352
Loans received and other financial liabilities	27	738,354	758,208
Deferred tax liabilities	19	31,356	29,947
Provisions	28	26,818	25,918
		841,711	**852,425**
Current liabilities			
Trade and other payables	29	590,021	588,117
Current tax liabilities		488	1,524
Loans received and other financial liabilities	27	133,241	149,224
		723,750	**738,865**
Total liabilities		**1,565,460**	**1,591,290**
Total equity and liabilities		**2,122,836**	**2,225,723**

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

Consolidated income statement

Continuing operations[12] (EUR thousand)	Note	2016	2015
Revenue *	10	2,374,538	2,467,430
Cost of goods sold and selling costs	12	(2,372,026)	(2,382,432)
Administrative expenses	12	(81,102)	(82,289)
Impairment of property, plant and equipment and intangible assets	12	-	(178)
Other income	11	32,582	48,662
Results from operating activities		**(46,009)**	**51,194**
Finance income	14	1,980	4,118
Finance expenses	14	(38,968)	(38,914)
Net finance expenses	**14**	**(36,988)**	**(34,796)**
Profit (loss) before tax		**(82,997)**	**16,398**
Income tax	19	4,934	(6,245)
Net profit (loss) for the year from continuing operations		**(78,063)**	**10,153**
Discontinued operations[13]			
Net profit (loss) for the year from discontinued operations	7	5,328	10,001
Net profit (loss) for the year	**7**	**(72,735)**	**20,154**

*Sales revenue from continuous operations include revenue from internal rent received by the Mercator Group from Intersport in the period when it was a legal person; in 2016, this revenue amounted to EUR 4,254 thousand; in 2015, it amounted to EUR 2,332 thousand. Taking into account the currently effective contractual rent, Mercator Group generated additional EUR 4,215 thousand of revenue from rent in 2016, and EUR 7,978 thousand in 2015.

Profit (loss) for the year attributable to:			
Owners of the parent company		(72,463)	20,245
Non-controlling interests		(272)	(91)
Basic and diluted earnings (loss) per share in EUR	26	(12.9)	1.7

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

12 Continuing operations are operations of the Mercator Group excluding Modiana and Intersport activities (also for the period in which they were part of the Mercator Group). In Compliance with IFRS 5, internal rents of Modiana and Intersport are excluded from operations; however, depreciation is accounted for at the Group level for these premises, during the period when Modiana and Intersport were not yet legal persons.

In the Annual Report, all the notes relating to the income statement are presented for continuing operations, which includes the following notes: 7, 8, 10, 11, 12, 13, 14, 19 and 26.

13 Discontinued operations are operations including Modiana and Intersport activities.

Consolidated statement of other comprehensive income

EUR thousand	Note	2016	2015
Net profit (loss) for the year		**(72,735)**	**20,154**
Other comprehensive income			
Items subsequently not reclassified to profit or loss		**(2,611)**	**(6,775)**
Net profit/loss recognized in revaluation surplus in relation to property, plant and equipment	15	-	-
Provisions for termination benefits		(294)	(3,730)
Other changes		(1,109)	(3,569)
Deferred tax for items subsequently not reclassified to profit or loss	19	(1,208)	525
Items that may be reclassified subsequently to profit or loss		**(2,452)**	**(624)**
Foreign currency translation differences - foreign operations		(2,047)	(452)
Net gains/losses on available-for-sale financial assets recognized in revaluation surplus		(404)	(208)
Gains/losses recognized in revaluation surplus	25	(404)	(208)
Net gains/losses recognized in revaluation surplus in relation to cash flow hedges (successful hedging)	25	-	-
Deferred tax for items that may be reclassified subsequently to profit or loss	19	-	36
Other comprehensive income for the year		**(5,063)**	**(7,398)**
Total comprehensive income for the year		**(77,798)**	**12,756**
Total comprehensive income for the year attributable to:			
Owners of the parent company		(77,676)	12,846
Non-controlling interests		(122)	(90)

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

Consolidated statement of changes in equity

EUR thousand	Note	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Net profit (loss) for the year	Currency translation reserve	Capital attributable to the parent company owners	Non-controlling interests	Total equity
Balance as at January 1, 2015		**254,175**	**286,772**	**(3,235)**	**41,686**	**115,411**	**(53,485)**	**69,353**	**(89,215)**	**621,462**	**215**	**621,677**
Total comprehensive income for the year												
Net profit (loss) for the year		**-**	**-**	**-**	**-**	**-**	**-**	**20,245**	**-**	**20,245**	**(91)**	**20,154**
Sale of revalued land		-	-	-	-	(1,020)	1,020	-	-	-	-	-
Other changes in land		-	-	-	-	(2,140)	2,140	-	-	-	-	-
Change in fair value of available-for-sale financial assets		-	-	-	-	(208)	-	-	-	(208)	-	(208)
Deferred taxes		-	-	-	-	576	(15)	-	-	561	-	561
Expenses from previous years - retained earnings		-	-	-	-	-	(3,569)	-	-	(3,569)	-	(3,569)
Exchange rate differences		-	-	-	-	-	-	-	(453)	(453)	1	(452)
Provisions for termination benefits		-	-	-	-	(3,754)	24	-	-	(3,730)	-	(3,730)
Other comprehensive income		**-**	**-**	**-**	**-**	**(6,546)**	**(400)**	**-**	**(453)**	**(7,399)**	**1**	**(7,398)**
Total comprehensive income for the year		**-**	**-**	**-**	**-**	**(6,546)**	**(400)**	**20,245**	**(453)**	**12,846**	**(90)**	**12,756**
Transactions with owners directly recognized in equity												
Change in the interest in a subsidiary		-	-	-	-	-	(103)	-	-	(103)	103	-
Distribution of profit for the year pursuant to the Management Board decision		-	-	-	-	-	69,353	(69,353)	-	-	-	-
Total transactions with owners		**-**	**-**	**-**	**-**	**-**	**69,250**	**(69,353)**	**-**	**(103)**	**103**	**-**
Balance as at December 31, 2015		**254,175**	**286,772**	**(3,235)**	**41,686**	**108,865**	**15,365**	**20,245**	**(89,668)**	**634,204**	**228**	**634,433**

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

Consolidated statement of changes in equity (continued)

EUR thousand	Note	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Net profit (loss) for the year	Currency translation reserve	Capital attributable to the parent company owners	Non-controlling interests	Total equity
Balance as at January 1, 2016		**254,175**	**286,772**	**(3,235)**	**41,686**	**108,865**	**15,365**	**20,245**	**(89,668)**	**634,204**	**228**	**634,432**
Total comprehensive income for the year												
Net profit (loss) for the year		**-**	**-**	**-**	**-**	**-**	**-**	**(72,463)**	**-**	**(72,463)**	**(272)**	**(72,735)**
Deferred taxes		-	-	-	-	(2,938)	1,814	-	-	(1,124)	-	(1,124)
Correction of income taxes		-	-	-	-	-	(84)	-	-	(84)	-	(84)
Fair value transfer on sale of fixed assets		-	-	-	-	-	(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 (loss) for the previous year to retained earnings		-	-	-	-	-	742	-	-	742	-	742
Distribution of profit for the year pursuant to the Management Board decision	25	-	-	-	-	-	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)**	**557,269**	**106**	**557,375**

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

Consolidated cash flow statement

EUR thousand	Note	2016	2015
Cash flows from operating activities			
Net profit (loss) for the year		**(72,735)**	**20,154**
Adjustments:			
Tax	19	(4,255)	6,643
Depreciation of property, plant and equipment	15	74,951	73,583
Depreciation of investment property	17	100	108
Amortisation of intangible assets	16	5,861	5,122
Impairment of receivables towards Agrokor Group	16	46,012	0
Impairment of property, plant and equipment and intangible assets		-	200
(Gains) losses on disposal of property, plant, and equipment		(3,708)	956
Change in provisions	28	900	1,482
(Gains) losses from disposal of subsidiaries	14	3,488	-
Dividends received, impairment and disposal of available-for-sale financial assets	14	(443)	(1,261)
Net foreign exchange differences	14	(936)	644
Other financial expenses	14	1,974	-
Interest received	14	(1,558)	(2,605)
Interest paid	14	34,590	35,493
		84,240	**140,519**
Change in inventories		19,813	(23,530)
Change in trade and other receivables		(15,694)	(1,857)
Change in trade and other payables		43,762	(90,651)
		132,121	**24,481**
Interest paid	14	(34,590)	(35,493)
Tax paid	19	94	(2,014)
Cash from operating activities		**97,625**	**(13,026)**
Cash flows from investing activities			
Acquisition of subsidiaries and business operations, net of cash acquired		-	(1,200)
Acquisition of property, plant and equipment and investment property	15, 17	(81,301)	(67,455)
Disbursements for acquisition of intangible assets	16	(9,137)	(8,708)
Acquisition of available-for-sale financial assets		(5)	(168)
Loans and bank deposits made		(826)	(10,407)
Proceeds from sale of subsidiaries		16,510	-
Proceeds from sale of property, plant and equipment and investment property	15, 17	18,600	23,494
Proceeds from sale of available-for-sale financial assets	18	149	1,817
Interest received	14	1,558	2,605
Dividends received	14	12	50
Loans and deposits repayments received		8,239	-
Net cash used in investing activities		**(46,201)**	**(59,972)**
Cash flows from financing activities			
Repayment of long-term loans received		(28,703)	(67,378)
Long-term loans received		611	18,946
Net proceeds (disbursements) arising from short-term loans		(15,983)	106,226
Dividends paid		-	-
Net cash from (used in) financing activities		**(44,076)**	**57,794**
Net increase (decrease) in cash and cash equivalents		**7,348**	**(15,204)**
Cash and cash equivalents at the beginning of the year		18,998	34,224
Effect of exchange rate fluctuations on cash and cash equivalents		(28)	(22)
Cash and cash equivalents as at the end of the year	**24**	**26,318**	**18,998**

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

Notes to consolidated financial statements

1. REPORTING COMPANY

Poslovni sistem Mercator, d.d., (hereinafter referred to as Mercator, d.d.), is a company headquartered in Slovenia. The address of its registered head office is Ljubljana, Dunajska cesta 107. The consolidated financial statements of the Mercator Group as at and for year ended December 31, 2016 comprise the company Mercator, d.d., and its subsidiaries (together referred to as the "Group"). 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 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 financial statements were approved by the company's Management Board on April 25, 2017.

(b) Basis of measurement

Consolidated financial statements 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, which is 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 attached herewith are presented in EUR, i.e. in the functional currency of the company Poslovni sistem Mercator, d.d. 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

Each year, impairment test is conducted by the Group concurrently with the preparation of financial statements. Upon acquisition, goodwill was 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 Mercator Group as a whole. The Management Board has prepared projections based on the business performance record (history) and expectations with regard to development of the market. 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 measures land using the revaluation 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, pursuant to IAS 23 Borrowing Costs (2007), capitalizes 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 2016, no investment meets the above criteria for capitalization of borrowing expenses.

(iv) Available-for-sale financial assets

The Group's long-term financial investments 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 insurance (backed by security) 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.
General rule (grocery and appliances programs inventories):

- 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;

Exceptions:

- inventories in the Modiana and Intersport business units are adjusted only when older than two years, namely by 50% of their cost;

Inventories adjustments based on fashion features are not carried out.

(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. However, the Group does not expect any events in the future that would significantly influence the accounting estimates.

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 does not expect any events that would significantly influence the accounting estimates.

(viii) Deferred 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 Group companies recognize deferred tax assets for transfer of unused tax losses and unused tax credit to the following period 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 Mercator Group's medium-term business plan.

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

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies defined below have been applied consistently to all periods presented in these consolidated financial statements for all Group 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 contingent liability fair value 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 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 recognizes 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 becomes a party under contractual provisions of the instrument.

The Group derecognizes 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 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 has a 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 recognizes 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 becomes the contractual party in relation to the instrument.

The Group derecognizes 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 has 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 recognizes 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 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
Property, plant and equipment are measured using the cost model, except for land, which is measured using the revaluation model. Property, plant and equipment are 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 2016, the Group 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, plant and equipment are determined by comparing the proceeds from disposal of an item of property, plant and equipment 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 uses the 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 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). In valuation of land, the comparable sales and land residual methods are used. 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 periodically, at least every three years, reviews the fair value of its land. The appraisal was last carried out as at the end of 2014 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 Mercator Group, fixed assets are depreciated by the straight line depreciation method, using the depreciation rates that reflect estimated useful lives of different assets in each Mercator Group company. 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 may reclassify property used by the owner to investment property. Investment property is appraised using the cost model; therefore, reclassification is carried out at cost. 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 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 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:

	2016	**2015**
Buildings	20-50 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.

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

(iii) 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.

(iv) 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:

	2016	**2015**
Brands/labels	unlimited	unlimited
Software and licenses	5-10 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 cost model. Depreciation is calculated using the straight-line method, so the purchase value of assets is divided in their respective remaining values throughout the estimated useful life, which is 30 to 33 years for the current and comparable year.

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 historical cost.

(i) Leased assets

Leases for which the Group assumes 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 Group's balance sheet.

(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 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 subject to the Group's consent; indications of bankruptcy of a debtor; deteriorated solvency of borrowers or securities issuers in the Group 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 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.

<u>Loans and receivables</u>
The Group assesses 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 uses 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 reviews the residual carrying amount of its 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 Group's corporate assets do not generate separate cash inflows and are used by more than one CGU. The Group's assets 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 evaluates and determines 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 defines the recoverable amount of the asset. Impairment loss is reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized in respect of the asset in prior year.

(m) Employee benefits

(i) Other long-term employee benefits – provisions for termination benefits and long-service awards
In the balance sheet, the Group 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 is 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 does not have a realistic possibility of withdrawal. Termination benefits for voluntary redundancies are recognized as an expense if the Group has 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 discounts 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 has 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 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 determines 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.

(i) Onerous contracts
A provision for costs arising from onerous contracts is recognized when the unavoidable costs of fulfilling contractual obligation exceed the benefits the Group expects to obtain from those contracts. Provisions are measured at the present value of the lower of the expected costs of terminating the contract and the expected costs of continuing the contractual relation. Before a provision is established, the Group discloses any potential losses from impairment of the assets associated with such contract.

(ii) Restructuring
A provision for restructuring costs is recognized when the Group has approved a detailed formal restructuring plan and has either commenced to exercise it or has announced it publicly. The item does not include future operating costs.

(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 stops 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 issues 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 allocates 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 in this way ensures 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 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 determines 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 separates payments and other consideration required by such arrangement to lease payments and to other elements, based on their relative fair values. If the Group concludes 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 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 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.

(i) 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.

(ii) 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 relief associated with the asset can be utilized in the future.

(t) Earnings per share

The Group calculates 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 does 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 use of new amendments to the existing standards and interpretations effective for the current financial period

In the current period, the following amendments to the existing standards and new interpretations issued by the International Accounting Standards Board (IASB) and adopted by the EU apply:

- **Amendments to IFRS 10 'Consolidated financial statements', IFRS 12 'Disclosure of interests in other entities' and IAS 28 'Investments in associates and joint ventures'** - Investment entities: Applying the consolidation exception, which were adopted by the EU on September 22, 2016 (effective for annual periods beginning on or after January 1, 2016);
- **Amendments to IFRS 11 'Joint arrangements'** – Accounting for acquisitions of interests in joint operations, adopted by the EU on November 24, 2015 (effective for annual periods beginning on or after January 1, 2016),
- **Amendments to IAS 1 'Presentation of financial statements'** – Disclosure initiative, adopted by the EU on December 18, 2015 (effective for annual periods beginning on or after January 1, 2016),
- **Amendments to IAS 16 'Property, plant and equipment' and IAS 38 'Intangible assets'** – Acceptable methods of depreciation and amortization, adopted by the EU on December 2, 2015 (effective for annual periods beginning on or after January 1, 2016),
- **Amendments to IAS 16 'Property, plant and equipment' and IAS 41 'Agriculture' – Agriculture:** Bearer plants, as adopted by the EU on November 23, 2015 (effective for annual periods beginning on or after January 1, 2016),
- **Amendments to IAS 19 'Employee Benefits**' - Defined Benefit Plans: Employee Contributions, adopted by the EU on December 17, 2014 (effective for annual periods beginning on or after February 1, 2015),
- **Amendments to IAS 27 'Separate financial statements'** – Equity method in separate financial statements, adopted by the EU on December 18, 2015 (effective for annual periods beginning on or after January 1, 2016).

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

Amendments to the existing standards issued by 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 IASB and adopted by the EU were published 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).

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

At present, IFRS as adopted by the EU do not significantly differ from regulations adopted by the International Accounting Standards Board (IASB) except for the following new standards and amendments to the existing standards, which were not endorsed for use in the EU as at December 31, 2016 (the effective dates indicated below apply for entire IFRS):

- **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 16 'Leases'** (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 subsequent amendments (the effective date has been postponed to a later date until the research project on capital method is concluded),
- **Amendments to IFRS 15 'Revenue from contracts with customers'** – Interpretation of IFRS 15 'Revenue from contracts with customers' (effective for annual periods beginning on or after January 1, 2018),
- **Amendments to IAS 7 'Statement of cash flows'** – Disclosure initiative (effective for annual periods beginning on or after January 1, 2017),

- **Amendments to IAS 12 'Income taxes'** – Recognition of deferred tax assets for unrealized losses (effective for annual periods starting on or after January 1, 2017),
- **Amendments to IAS 40 'Investment property'** – Transfer of investment property (effective for annual periods beginning on or after January 1, 2018);
- **IFRIC 22 'Foreign currency transactions and advance consideration'** (effective for annual periods beginning on or after January 1, 2018).

The Group expects that the implementation of IFRS 9, IFRS 15 and IFRS 16 will affect its financial statements. The Group has not yet assessed the impact. The implementation of new standards and amendments to the existing ones will have no material impact on the Group's financial statements in the period of initial application.

At the same time, 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 estimates, 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 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.

(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 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 17%. As of January 1, 2017, the 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 2016, the companies recognized and reversed deferred income tax related to the following items:

- differences between operating and tax depreciation and amortization,
- 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 2016, the company recognized and reversed deferred income taxes in relation to the following:

- differences between operating and tax depreciation and amortization,
- 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 20%.

When calculating corporate income tax, the following tax reliefs can be exercised:

- relief for promoting investments in non-current assets,
- relief for taxpayers in areas under special government protection,
- reinvested profit relief,
- relief for taxpayers in areas of free zones.

In 2016, 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 (taxpayers investing at least BAM 20 million for 5 years in succession),
- relief for hiring new employees for a period of at least 12 months.

In 2016, 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 2016, the company recognized deferred tax liabilities arising from differences between business and tax deductible depreciation.

7. DISCONTINUED OPERATIONS

On July 14, 2016, the companies **Poslovni sistem Mercator, d.d.,** and **Montecristo SL, d.o.o.**, successfully signed the contract on **selling the Modiana operations**. The selling process involved textile stores and Beatique cosmetics shops on all markets of operations (Slovenia, Croatia, Serbia, and Bosnia and Herzegovina). The contract specifies the take-over of operations on all locations, purchase of fixed assets and transfer of all employees. The selling procedure was formally concluded on September 30, 2016.

On September 13, 2016 the companies **Poslovni sistem Mercator, d.d**., and **Enterprise Fund VII** from Poland, a private investment fund managed by Enterprise Investors, signed the contract on selling and buying the company **Intersport ISI, d.o.o.**, the parent company of the Intersport Group, which is a 100% owner of foreign subsidiaries: Intersport BH, d.o.o., Bosnia and Herzegovina; Intersport CG, d.o.o., Montenegro; Intersport H, d.o.o., Croatia, and Intersport S trgovina, d.o.o., Serbia. The selling procedure was formally concluded in the beginning of December 2016.

Taking into account the relatively small share in the Group's assets, the impact of discontinued operations of the Modiana (January to September 2016) and Intersport (January to November 2016) activities is presented below in compliance with the accounting standards only for the income statement, but not also for the balance sheet. The joint income statement includes the results of discontinued operations, also separately showing the results of discontinued operations of the Modiana and Intersport activities.

Discontinued operations (EUR thousand)	**2016**	**2015**
Revenue	119,265	144,988
Cost of goods sold and selling costs	(110,623)	(130,616)
Administrative expenses	(3,405)	(4,130)
Impairment of property, plant and equipment and intangible assets	-	(22)
Other income	899	97
Results from operating activities	**6,135**	**10,316**
Finance income	21	190
Finance expenses	(148)	(107)
Net finance expenses	**(127)**	**83**
Profit (loss) before tax	**6,007**	**10,399**
Income tax	(679)	(398)
Net profit (loss) for the year from discontinued operations	**5,328**	**10,001**

The income statement of the Mercator Group including the operations of Modiana and Intersport for 2016 and 2015 is presented below.

EUR thousand	**2016**	**2015**
Revenue	2,493,802	2,612,418
Cost of goods sold and selling costs	(2,482,650)	(2,513,048)
Administrative expenses	(84,508)	(86,419)
Impairment of property, plant and equipment and intangible assets	-	(200)
Other income	33,480	48,759
Results from operating activities	**(39,875)**	**61,510**
Finance income	2,000	4,308
Finance expenses	(39,116)	(39,021)
Net finance expenses	**(37,115)**	**(34,713)**
Profit (loss) before tax	**(76,990)**	**26,797**
Tax	4,255	(6,643)
Net profit (loss) for the year	**(72,735)**	**20,154**

Net loss of the Mercator Group including discontinued operations (Modiana, January to September 2016; Intersport, January to November 2016) equals EUR -72,735 thousand.

8. BUSINESS SEGMENTS

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 2016, the Mercator Group was operating in five countries:

- Slovenia, the location of the parent company, 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.

Market prices are used for selling goods, products and services between the segments.

	Slovenia		Serbia		Croatia		Bosnia and Herzegovina		Montenegro		Total	
EUR thousand	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**	**2016**	**2015**
Revenue from segment sales	**1,368,949**	**1,406,934**	**862,122**	**912,138**	**33,771**	**24,539**	**18,139**	**13,198**	**122,878**	**114,262**	**2,405,859**	**2,471,072**
Revenue from inter-segment sales	9,822	2,438	5,703	482	10,689	13	3,682	709	1,426	-	31,321	3,642
Amortization/depreciation	(38,868)	(38,608)	(26,023)	(23,672)	(8,879)	(9,657)	(2,825)	(2,854)	(2,734)	(2,286)	(79,329)	(77,077)
Operating results per segment	**405**	**56,943**	**(1,907)**	**7,868**	**(34,840)**	**(16,286)**	**(13,324)**	**(1,227)**	**852**	**989**	**(48,814)**	**48,287**
Interest income	5,687	5,668	523	676	21	54	606	664	264	335	7,101	7,397
Interest expenses	(20,766)	(23,123)	(10,237)	(8,147)	(7,641)	(7,494)	(1,268)	(1,328)	(140)	(143)	(40,052)	(40,235)
Income tax	3,477	(5,259)	1,447	(900)	-	-	-	(34)	9	(54)	4,934	(6,245)
Assets	1,323,649	1,334,325	528,675	570,279	287,281	320,964	104,093	118,223	63,639	61,116	2,307,336	2,404,906
Liabilities	1,007,860	1,003,451	400,072	427,654	272,506	269,135	40,587	41,951	28,936	28,280	1,749,961	1,770,472
Capital expenditure	56,898	41,155	25,867	29,538	2,518	884	210	529	2,379	3,946	87,872	76,052

Reconciliation of the segment revenue, operating profit or loss, assets and liabilities, and other material items

Revenue

EUR thousand	2016	2015
Total segment revenue	2,405,859	2,471,072
Elimination of inter-segment revenue	(31,321)	(3,642)
Consolidated revenue	**2,374,538**	**2,467,430**

Results from operating activities

EUR thousand	2016	2015
Total reportable segments results from operating activities	(48,814)	48,287
Elimination of inter-segment profits	2,805	2,907
Consolidated results from operating activities	**(46,009)**	**51,194**

Assets

EUR thousand	2016	2015
Total assets for reportable segments	2,307,336	2,404,906
Inter-segment elimination	(184,501)	(179,182)
Consolidated total assets	**2,122,836**	**2,225,723**

Liabilities

EUR thousand	2016	2015
Total liabilities for reportable segments	1,749,961	1,770,472
Inter-segment elimination	(184,501)	(179,182)
Consolidated total liabilities	**1,565,460**	**1,591,290**

Other material items in 2016

EUR thousand	Segments	Inter-segment eliminations	Consolidated totals
Interest income	7,101	(109)	6,992
Interest expenses	(40,052)	109	(39,943)
Amortization/depreciation	(79,329)	-	(79,329)
Impairment of property, plant and equipment and intangible assets	(1,892)	-	(1,892)
Income tax	4,934	-	4,934
Capital expenditure	87,872	-	87,872

Other material items in 2015

EUR thousand	Segments	Inter-segment eliminations	Consolidated totals
Interest income	7,397	(4,811)	2,586
Interest expenses	(40,235)	4,811	(35,424)
Amortization/depreciation	(77,077)	-	(77,077)
Impairment of property, plant and equipment and intangible assets	(4,273)	-	(4,273)
Income tax	(6,245)	-	(6,245)
Capital expenditure	76,052	-	76,052

Revenues from any individual customer do not reach 10% of total revenues of the Group.

As at December 31, 2016, the Mercator Group included the following companies (figures in EUR thousand are based on audited reporting packages by companies reporting to the parent company):

SLOVENIA

Poslovni sistem Mercator, d.d. Slovenia	
equity	551,283
financial liabilities	600,933
net profit or loss	(78,714)
net sales revenue	1,321,092
no. of employees	9,498

Mercator - Emba d.d. Slovenia	**100%**
equity	15,023
financial liabilities	-
net profit or loss	2,438
net sales revenue	18,424
no. of employees	107

Mercator IP, d.o.o. Slovenia	**100%**
equity	6,202
financial liabilities	-
net profit or loss	1,501
net sales revenue	13,884
no. of employees	405

M - Energija, d.o.o. Slovenia	**100%**
equity	2,088
financial liabilities	4,418
net profit or loss	(835)
net sales revenue	22,634
no. of employees	9

SERBIA

Mercator - S, d.o.o. Serbia	**100%**
Equity	167,126
financial liabilities	150,824
net profit or loss	(14,993)
net sales revenue	862,499
no. of employees	8,830

CROATIA

Mercator - H, d.o.o. Croatia	**99.3%**
Equity	14,775
financial liabilities	229,521
net profit or loss	(38,294)
net sales revenue	33,129
no. of employees	49

BOSNIA AND HERZEGOVINA

Mercator - BH, d.o.o. Bosnia and Herzegovina	**100%**
Equity	63,502
financial liabilities	36,466
net profit or loss	(13,242)
net sales revenue	18,398
no. of employees	20

MONTENEGRO

Mercator - CG, d.o.o. Montenegro	**100%**
Equity	34,702
financial liabilities	2,902
net profit or loss	1,738
net sales revenue	123,627
no. of employees	1,436

The consolidated financial statements also include the Macedonian companies Mercator - Makedonija, d.o.o.e.l., and Investment Internacional, d.o.o.e.l., which do not carry out business activities.

9. BUSINESS COMBINATIONS AND REORGANISATION OF THE GROUP

Slovenia

In March 2016, the change in company name of Platinum - F, d.o.o., was entered in the Companies Register. The new name is Mercator - Velpro, d.o.o. The purpose of the new company is mostly independent development of wholesale activities and strengthening of wholesale and logistic operations. The company does not yet carry out its business activities.

At the end of June 2016, the change in company name of Platinum - E, d.o.o., was entered in the Companies Register. The new name is Mercator Maxi, d.o.o. The new company was established for the purpose of transferring the activity of Maxi catering to an independent company. The company does not yet carry out its business activities.

On July 14, 2016, the companies Poslovni sistem Mercator, d.d., and Montecristo SL, d.o.o., signed the contract on selling the Modiana operations. The selling process involved textile stores and Beatique cosmetics shops on all markets of operations. The contract specifies the take-over of operations on all locations, purchase of fixed assets and transfer of all employees. The selling procedure was formally concluded on September 30, 2016. The sale of the Modiana activity is presented as discontinued operations due to its materiality for financial statements.

On September 13, 2016, the companies Poslovni sistem Mercator, d.d., and Enterprise Fund VII from Poland, a private investment fund managed by Enterprise Investors, signed the contract on selling and buying the company Intersport ISI, d.o.o., the parent company of the Intersport Group, which is a 100% owner of foreign subsidiaries: Intersport BH, d.o.o., Bosnia and Herzegovina; Intersport CG, d.o.o., Montenegro; Intersport H, d.o.o., Croatia, and Intersport S trgovina, d.o.o., Serbia. The selling procedure was formally concluded in the beginning of December 2016. The sale of the Intersport activity is presented as discontinued operations due to its materiality for financial statements.

Serbia

In the end of April 2016, the company Intersport S trgovina, d.o.o., was established. It started carrying out its business activity in July. The new company is 100% owned by the Slovenian company Intersport ISI, d.o.o.

In compliance with the finished sales process between Poslovni sistem Mercator, d.d., and Montecristo SL, d.o.o., the Modiana activity on the Serbian market was transferred to the new owner in the end of September 2016. On concluding the sales process, Intersport S trgovina, d.o.o., was also sold within the framework of selling the Intersport activity to the company Enterprise Fund VII from Poland.

Montenegro

In August 2016, the company Intersport CG, d.o.o., was entered in the Companies Register. It started carrying out its business activity on September 1, 2016. The new company is 100% owned by the Slovenian company Intersport ISI, d.o.o.

The company Intersport CG, d.o.o., was sold within the framework of selling the Intersport activity to Enterprise Fund VII from Poland.

Croatia

In the end of 2015, the company Intersport H, d.o.o., was established. The company started carrying out its business activity in March 2016. The new company is 100% owned by the Slovenian company Intersport ISI, d.o.o.

In compliance with the finished sales process between Poslovni sistem Mercator, d.d., and Montecristo SL, d.o.o., the Modiana activity on the Croatian market was transferred to the new owner in the end of September 2016. On concluding the sales process, Intersport H, d.o.o., was also sold within the framework of selling the Intersport activity to the company Enterprise Fund VII from Poland. Mercator H, d.o.o., thus only kept its real estate activity.

Bosnia and Herzegovina
At the end of 2015, the company Intersport BH, d.o.o., was established. The company started carrying out its business activity in the beginning of 2016. The new company is 100% owned by the Slovenian company Intersport ISI, d.o.o.

The company M - BL, d.o.o., was successfully merged by acquisition with the company Mercator - BH, d.o.o., in February 2016. Accordingly, M - BL, d.o.o., ceased to exist and was deleted from the Companies Register.

In compliance with the finished sales process between Poslovni sistem Mercator, d.d., and Montecristo SL, d.o.o., the Modiana activity on the market of Bosnia and Herzegovina was transferred to the new owner in the end of September 2016. On concluding the sales process, Intersport BH, d.o.o., was also sold within the framework of selling the Intersport activity to the company Enterprise Fund VII from Poland. Mercator - BH, d.o.o., thus only kept its real estate activity.

10. REVENUE

Breakdown of revenue by category:

EUR thousand	2016	2015
Sales of goods	2,193,664	2,260,424
Sales of services	176,785	187,968
Sales of products	15,681	16,825
Sales of materials	453	1,026
Expenses for discounts granted	(12,045)	1,187
Total	**2,374,538**	**2,467,430**

Revenue from sales of goods is reduced also by the amount of discounts to customers – Mercator Pika card holders.

Sales revenue from continuous operations include revenue from internal rent received by the Mercator Group from Intersport in the period when it was a legal person; in 2016, this revenue amounted to EUR 4,254 thousand; in 2015, it amounted to EUR 2,332 thousand. Taking into account the currently effective contractual rent, Mercator Group generated additional EUR 4,215 thousand of revenue from rent in 2016, and EUR 7,978 thousand in 2015.

11. OTHER OPERATING REVENUE

EUR thousand	2016	2015
Profit from sales of property, plant and equipment	5,009	4,887
Reversal of real estate impairment	-	-
Revenue from reversal and utilization of provisions	3,389	2,885
Other operating revenue	24,184	40,891
Total	**32,582**	**48,662**

Gains from disposal of property, plant and equipment of EUR 5,009 thousand (2015: EUR 4,887 thousand) refer to the sale of Intersport equipment and sale of other non-core assets.

Revenue from disposal and utilization of provisions in the amount of EUR 3,389 thousand (2015: EUR 2,885 thousand) refers to the use of assigned assets for disability contributions in the amount of EUR 2,598 thousand, and reversal of provisions for termination benefits and long-service awards in the amount of EUR 791 thousand.

The remaining part of other operating revenue totalling EUR 24,184 thousand (2015: EUR 40,891 thousand) includes indemnities based on insurance premiums and other indemnities in the amount of EUR 1,859 thousand, income from bonuses for employing disabled people in the amount of EUR 741 thousand, and other operating revenue in the amount of EUR 21,584 thousand.

12. EXPENSES BY TYPE

EUR thousand	2016	2015
Depreciation of property, plant and equipment	73,506	72,023
Amortization of intangible assets	5,723	4,946
Depreciation of investment property	100	108
Labor costs	229,935	237,418
Costs of material	69,569	67,691
Costs of services excluding rents	135,617	135,238
Rental/lease costs	70,820	73,158
Provisioning	476	254
Other costs	14,415	14,499
Impairment of property, plant and equipment, and intangible assets	1,509	4,066
Loss from disposal of property, plant and equipment	-	200
Change in the value of inventories	(178)	(77)
Other operating expenses	49,327	3,671
Cost of goods sold	1,802,310	1,851,704
Total cost of goods sold, selling costs and administrative expenses	**2,453,129**	**2,464,898**

Costs of goods sold and selling costs in the amount of EUR 2,372,026 thousand (2015: EUR 2,382,432 thousand) include production costs in the amount of EUR 20,708 thousand (2015: EUR 19,897 thousand), selling costs in the amount of EUR 546,667 thousand (2015: EUR 508,868 thousand), historical cost of goods sold in the amount of EUR 1,802,310 thousand (2015: EUR 1,851,704 thousand), and other operating expenses in the amount of EUR 2,341 thousand (2015: EUR 1,964 thousand).

Provisions in the amount of EUR 476 thousand were created in connection with legal actions and termination benefits upon retirement.

Impairment of property, plant and equipment and intangible assets refers to impairment of certain items of equipment.

Under service costs, the Group discloses in 2016 audit costs in the amount of EUR 174 thousand (2015: EUR 167 thousand). Besides the financial statements audit, the auditor did not provide any other services for the Group.

The cost of goods sold is reduced by rebates beyond accounts/invoices and received discounts. It is increased by revaluation of inventories and write-downs of damaged, expired and obsolete inventory and deficits.

Depreciation also includes depreciation of Modiana and Intersport premises, for which rental income was excluded from the income statement.

13. LABOR COSTS

EUR thousand	2016	2015
Salaries	165,082	169,898
Pension insurance costs	19,553	18,412
Health insurance costs	10,645	11,944
Other labor costs	34,655	37,165
Total	**229,935**	**237,418**
Number of employees as at December 31	20,354	21,459*

* number includes employees from Modiana and Intersport

Other labor costs include reimbursement of meal allowances, commute allowances, annual leave allowances, and other labor costs.

The average number of employees in the Group during the year, calculated based on hours worked, amounts to 19,893 (2015: 20,440).

14. FINANCE INCOME AND EXPENSES

Recognized in the income statement

EUR thousand	2016	2015
Interest income	1,386	2,580
Gains on disposal of available-for-sale financial assets	92	1,211
Dividend income	12	50
Other finance income	489	277
Finance income	**1,980**	**4,118**
	-	-
Interest expense	(34,342)	(35,423)
Losses from disposal of subsidiaries	(3,488)	-
Losses on disposal and impairment of available-for-sale financial assets	(253)	-
Net currency translation differences	1,008	(605)
Other finance expense	(1,893)	(2,885)
Finance expenses	**(38,968)**	**(38,914)**
	-	-
Net finance expense recognized in the income statement	**(36,988)**	**(34,796)**

In 2016, the Group did not impair the rents paid in advance for leased units, as impairment test indicated that impairment was not necessary.

Finance income and expenses recognized in other comprehensive income (net), that may be subsequently reclassified to profit or loss statement

EUR thousand	2016	2015
Foreign currency translation differences on consolidation	(2,047)	(452)
Net change in cash flow hedges	-	-
Net gains/losses recognized in revaluation surplus in relation to available-for-sale financial assets	(404)	(172)
Finance income (expenses) recognized directly in the statement of comprehensive income	**(2,452)**	**(624)**
Attributable to:		
Parent company shareholders	(2,456)	(625)
Non-controlling interests	5	1
Finance income (expenses) recognized in the statement of comprehensive income		
Recognized in:		
Fair value reserve	(404)	(172)
Retained earnings	-	-
Currency translation reserve	(2,052)	(453)
Non-controlling interest	5	1
Total	**(2,452)**	**(624)**

15. PROPERTY, PLANT AND EQUIPMENT

EUR thousand		Land	Buildings	Production equipment	FA being acquired	Total
Balance as at January 1, 2015						
Cost		498,919	1,519,308	424,432	18,133	2,460,793
Revaluation		-	(555,480)	(286,474)	-	(841,954)
Carrying amount		**498,919**	**963,828**	**137,958**	**18,133**	**1,618,839**
Year ended December 31, 2015						
Opening carrying amount		**498,919**	**963,828**	**137,958**	**18,133**	**1,618,839**
Effect of foreign exchange differences		(50)	(461)	(223)	(61)	(795)
Investments		-	-	-	67,455	67,455
Transfers		(57,514)	(134,719)	30,888	(53,544)	(214,889)
Disposals		(5,814)	(11,517)	(7,733)	(358)	(25,422)
Depreciation		-	(45,657)	(27,926)	-	(73,583)
Impairment		-	-	(200)	-	(200)
Other changes		-	-	-	-	-
Closing carrying amount		**435,541**	**771,474**	**132,764**	**31,626**	**1,371,405**
Balance as at December 31, 2015						
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*	15	68,843	191,683	33,880	(83,911)	210,495
Disposals		(8,531)	(2,536)	(3,817)	(555)	(15,439)
Depreciation	11	-	(46,893)	(28,023)	(34)	(74,951)
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**

*Attributable to real estate transfer to assets held for sale and other transfers between groups.

Investments in property, plant and equipment, disclosed among investments in the amount of EUR 81,301 thousand, refer to:

EUR thousand	2016	2015
Purchase of equipment from Idea, d.o.o., in Serbia	-	120
Purchase of land, buildings and equipment (new facilities)	12,817	13,714
Refurbishment of existing retail and wholesale units	63,264	47,420
Other	5,220	6,201
Total	**81,301**	**67,455**

Disposals of property, plant and equipment in the amount of EUR 15,439 thousand refer to the sale of Intersport equipment and sale of non-core assets and write-offs. Proceeds from disposal amounted to EUR 18,600 thousand and gains from disposal amounted to EUR 5,600 thousand.

Land was last appraised as at October 31, 2014. As at December 31, 2016, property, plant and equipment were tested for impairment; no impairment signs were identified.

Depreciation of property, plant and equipment totals EUR 74,951 thousand (2015: EUR 73,583 thousand).

If land was disclosed at historical cost, the amounts would be as follows:

EUR thousand	2016	2015
Cost	358,742	296,661

Property, plant and equipment leased

Carrying amount of property, plant and equipment held under financial leases amounts to EUR 242,359 thousand (2015: EUR 255,028 thousand) and refers to land and buildings.

Insurance

As at December 31, 2016, the Group had EUR 560,776 thousand of pledged property (2015: EUR 664,952 thousand).

Contractual commitments regarding property, plant and equipment, which as at the balance sheet date are not disclosed yet in the financial statements, are presented in Note 32 (Capital commitments).

16. INTANGIBLE ASSETS

EUR thousand	Note	Goodwill	Trademarks, material rights and licenses	Total
Balance as at January 1, 2015				
Cost		463	59,358	59,821
Revaluation		-	(43,057)	(43,057)
Carrying amount		**463**	**16,301**	**16,764**
Year ended December 31, 2015				
Opening carrying amount		**463**	**16,301**	**16,764**
Effect of foreign exchange differences		1	(34)	(33)
Increase on business combinations		1,200	-	1,200
Investments		-	8,708	8,708
Disposals		-	(5)	(5)
Transfers		-	(1,975)	(1,975)
Impairment		-	-	-
Amortization	11	-	(5,122)	(5,122)
Closing carrying amount		**1,664**	**17,873**	**19,538**
Balance as at December 31, 2015				
Cost		1,664	65,783	67,447
Revaluation		-	(47,909)	(47,909)
Carrying amount		**1,664**	**17,873**	**19,538**
Year ended December 31, 2016				
Opening carrying amount		**1,664**	**17,873**	**19,538**
Effect of foreign exchange differences		5	(13)	(8)
Increase on business combinations		-	-	-
Investments		-	9,137	9,137
Disposals		-	(1,055)	(1,055)
Transfers		-	(970)	(970)
Impairment		-	1,182	1,182
Amortization	11	-	(5,861)	(5,861)
Closing carrying amount		**1,669**	**20,294**	**21,963**
Balance as at December 31, 2016				
Cost		1,669	72,646	74,315
Revaluation		-	(52,352)	(52,352)
Carrying amount		**1,669**	**20,294**	**21,963**

As at December 31, 2016, intangible assets being acquired amount to EUR 85 thousand (2015: EUR 85 thousand).

As at December 31, 2016, intangible assets amount to EUR 20,294 thousand (2015: EUR 17,873 thousand) of rights, patents, licences, trademarks and investments into software, and EUR 1,669 thousand (2015: EUR 1,664 thousand) of goodwill.

The trademark value as at December 31, 2016, 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, 2016, it was tested for potential impairment, which was not identified.

On December 31, 2016, the value of goodwill amounted to EUR 1,669 thousand. This amount includes EUR 464 thousand generated in previous periods upon the acquisition of Era Tornado, d.o.o, and Trgohit, d.o.o., in Croatia, and EUR 1,200 thousand that were realized when the Group took over the business activity of the Slovenian company Era Good, d.o.o., in 2015.

Amortization of intangible assets amounts to EUR 5,861 thousand (2015: EUR 5,122 thousand).

Within the scope of the financial liabilities restructuring, 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.

Goodwill impairment testing

Goodwill, which refers to the acquisition of the companies Era Tornado, d.o.o, and Trgohit, d.o.o., in Croatia in the amount of EUR 464 thousand, and of a part of the company Era Good, d.o.o., in Slovenia, was allocated to cash-generating units of the Group, defined according to the store format, and tested for impairment as at December 31, 2016. On December 31, 2016, goodwill was not impaired.

Allocation and changes in goodwill are presented in the table below:

EUR thousand	Dec. 31, 2015	Exchange rate differences	Increase 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**

EUR thousand	Dec. 31, 2014	Exchange rate differences	Increase in 2015	Impairment in 2015	Dec. 31, 2015
Hypermarkets	-	-	-	-	-
Supermarkets	463	1	-	-	464
Markets	-	-	-	-	-
Other stores	-	-	1,200	-	1,200
Total	**463**	**1**	**1,200**	**-**	**1,664**

Upon acquisition of Croatian companies Presoflex, d.o.o., Era Tornado, d.o.o, and Trgohit, d.o.o., goodwill was created, the value of which was allocated to the acquired cash-generating units. For the purpose of financial reporting, the test for impairment of goodwill was carried out, which is based on the estimate of value in use of the acquired cash-generating units and is prepared in line with requirements of the International Accounting Standards. The estimated value is based on the restructured business activity of the company Mercator - H, d.o.o., during the integration of operations with the company Konzum, d.d., which led to the transfer of the retail activity of Mercator - H, d.o.o., to Konzum, d.d., and a material change of the company's core trade activity into real estate activity. Future operations projections are based on market rent, under which revenue and expenses arising from lease in line with the concluded lease agreements for each business unit will be realized, and policies for future medium-term period. Nominal average rate of increase in revenue in the projection amounts to 1.5% (2015: 2.5%).

The quantity of required investments is estimated annually on the basis of necessary annual investments per m^2 of sales surface assumed for such type of stores. The remaining value is calculated on the basis of gross cash flow as infinite series function, taking into account 2% increase rate. The discount rate used for this valuation is 6.7%.

With the acquisition of Era Good, d.o.o., business activity in Slovenia in 2015, goodwill was created, the value of which was allocated to the acquired cash-generating units. For the purpose of financial reporting, goodwill was tested for impairment based on the estimate of value in use of the acquired cash-generating units. As the basis for projections of operations in the future, the revenue from sales of goods, margin realized for covering the costs associated with operations of cash-generating units, and guidelines for future medium-term period were applied. The nominal rate of increase in revenue used in the projection stands at 1.5%, while the discount rate applied in valuation amounts to 6.5%.

It was determined that the recoverable amount of all cash-generating units exceeds their carrying amount, including goodwill. As a result, goodwill was not impaired.

17. INVESTMENT PROPERTY

EUR thousand	2016	2015
As at January 1	**3,352**	**3,494**
Investments	-	-
Transfer from property, plant, and equipment	6,660	-
Disposals	(13)	(35)
Depreciation	(100)	(108)
Balance as at 31 December	**9,899**	**3,351**
Closing value		
Cost	13,410	6,877
Revaluation	(3,511)	(3,526)
Carrying amount	**9,899**	**3,352**

The following amounts were recognized in the income statement with regard to investment property:

EUR thousand	2016	2015
Rental income	185	187
Direct expenses arising from investment property and generating rental income	(222)	(243)
Total	**(37)**	**(56)**

Depreciation of investment property in the amount of EUR 100 thousand was entirely included under selling costs.

The Group did not sell any of its investment property in 2016.

As at December 31, 2016, financial liabilities are not mortgaged with investment property.

18. AVAILABLE-FOR-SALE FINANCIAL ASSETS

EUR thousand	2016	2015
As at January 1	**524**	**1,178**
Foreign exchange differences	-	(1)
Purchase of shares and interests	(59)	168
Adjustment to market value	(4)	(6)
Disposals	0	(815)
Balance as at 31 December	**462**	**524**

The Group's available-for-sale financial assets include also assets that could not be valued at fair value; thus, these assets are measured at historical costs. Shares of these companies are not listed on the stock exchange.

EUR thousand	2016	2015
Financial assets measured at cost	286	408
Financial assets measured at fair value	176	116
Total investments in shares and interests	**462**	**524**

Available-for-sale financial assets are not pledged.

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

EUR thousand	2016	2015
Current tax for continuing operations	(773)	1,592
Current tax relating to discontinued operations	679	*398*
Deferred tax	(4,161)	4,655
Tax	**(4,934)**	**6,245**

Tax recognized in other comprehensive income

		2016	
EUR thousand	Value before tax	Tax	Value after tax
Net gains/losses recognized in revaluation surplus related to property, plant and equipment	-	(1,434)	(1,434)
Gains (losses) recognized in revaluation surplus related to financial assets available for sale	(404)	-	(404)
Foreign currency translation differences on consolidation	(2,047)	-	(2,047)
Provisions for termination benefits	(294)	48	(246)
Other changes	(1,109)	178	(931)
Other comprehensive income	**(3,855)**	**(1,208)**	**(5,063)**

		2015	
EUR thousand	Value before tax	Tax	Value after tax
Net gains/losses recognized in revaluation surplus related to property, plant and equipment	-	134	134
Gains (losses) recognized in revaluation surplus related to financial assets available for sale	(208)	36	(172)
Foreign currency translation differences on consolidation	(452)	-	(452)
Provisions for termination benefits	(3,730)	411	(3,319)
Other changes	(3,570)	(20)	(3,590)
Other comprehensive income	**(7,960)**	**561**	**(7,399)**

Reconciliation to effective tax rate

EUR thousand	2016	2015
Net profit (loss) for the year	(78,063)	10,153
Tax	(4,934)	6,245
Profit (loss) before tax	(82,997)	16,398
Tax calculated at 17% tax rate	17,149	4,282
Change in tax due to increase/decrease in income for tax purposes	(23,991)	(538)
Change in tax due to decrease/increase in expenses for tax purposes	-	-
Tax of non-deductible expenses	1,841	3,821
Tax reliefs	(2,287)	(1,940)
Effect of different tax rates and other	2,617	-
Other adjustments	(263)	620
Total tax	**(4,934)**	**6,245**
Effective tax rate	**-**	**33 %**

Deferred taxes are calculated based on temporary differences under the balance sheet liability method using the tax rate effective in individual countries where Mercator Group companies operate.

Movements in deferred taxes are as follows:

EUR thousand	2016	2015
At the beginning of the year – net deferred tax (liabilities)	**(11,890)**	**(8,091)**
Exchange rate differences	20	8
Recognized in profit or loss	4,161	(4,628)
Recognized in other comprehensive income	(1,392)	561
Recognized in liabilities	1,274	261
At the end of the year – net deferred tax (liabilities)	**(7,827)**	**(11,890)**

Deferred tax assets and liabilities relate to the following categories:

Deferred tax liabilities

EUR thousand	Revaluation of property, plant and equipment	Revaluation of available-for-sale financial assets and derivatives	Depreciation of property, plant and equipment under EUR 500	Difference between tax recognized and business depreciation	Total
Balance as at January 1, 2015	27,098	41	626	2,627	30,392
Exchange rate differences	(6)	1	-	(5)	(10)
Recognized in profit or loss	(8)	-	186	(182)	(4)
Recognized in other comprehensive income	(134)	(36)	-	-	(170)
Recognized in liabilities	(261)	-	-	-	(261)
Balance as at December 31, 2015	**26,689**	**6**	**812**	**2,440**	**29,947**
Exchange rate differences	(15)	-	-	(14)	(29)
Recognized in profit or loss	22	-	191	(407)	(194)
Recognized in other comprehensive income	1,434	-	-	-	1,434
Recognized in liabilities	198	-	-	-	198
Balance as at December 31, 2016	**28,328**	**6**	**1,003**	**2,019**	**31,356**

Deferred tax assets

EUR thousand	Provisions not recognized for tax purposes	Impairment of trade receivables	Tax loss	Impairment of merchandise inventory	Differences between tax recognized and business depreciation	Revaluation of available-for-sale financial assets and derivatives	Other	Total
Balance as at January 1, 2015	**1,508**	**2,721**	**13,455**	**34**	**2,562**	**23**	**1,998**	**22,301**
Exchange rate differences	(1)	-	-	-	-	-	(1)	(2)
Recognized in profit or loss	(118)	(41)	(3,994)	11	78	(23)	(546)	(4,633)
Recognized in other comprehensive income	411	-	(20)	-	-	-	-	391
Recognized under receivables	-	-	-	-	-	-	-	-
Balance as at December 31, 2015	**1,800**	**2,680**	**9,441**	**45**	**2,640**	**-**	**1,452**	**18,057**
Exchange rate differences	(2)	-	(6)	(1)	-	-	-	(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
Recognized under receivables	-	-	-	-	-	-	-	-
Balance as at December 31, 2016	**2,039**	**3,938**	**11,631**	**8**	**2,802**	**347**	**2,763**	**23,529**

As at December 31, 2016, the Group holds unrecognized deferred assets from tax losses in the amount of EUR 23,873 thousand (2015: EUR 26,580 thousand). These pertain to tax losses of the companies Mercator - H, d.o.o., and M - Energija, d.o.o. Because sufficient taxable income is not expected in the future, these assets were not recognised.

In 2016, the Mercator Group companies recognized deferred tax liabilities as well as deferred tax assets. Deferred tax liabilities charged to the income statement decrease tax bases of individual companies of the Group in 2016, whereas the deferred tax assets increase them.

Deferred tax assets not recognized through profit or loss, pertaining to the revaluation of equity investment into subsidiaries Mercator - H, d.o.o., and Mercator - BH, d.o.o., amounted to EUR 2,916 thousand. These deferred tax assets were not recognized because the parent company does not intend to dispose of the said subsidiaries in the foreseeable future.

Deferred tax assets and liabilities are not offset in the balance sheet.

20. DISPOSAL GROUPS

EUR thousand	2016	2015
Land	-	77,843
Buildings	-	139,639
Total	**-**	**217,482**

As at December 31, 2016, the Group reassigned EUR 223,310 thousand of assets for disposal to non-current assets. The company reviewed the economic justification of the real estate monetization project, and discontinued the project in accordance with the results.

21. INVENTORIES

EUR thousand	2016	2015
Merchandise	224,785	284,495
Material	7,193	6,364
Work-in-progress	2	25
Finished goods	961	855
Decrease: revaluation adjustment of inventories	(8,613)	(10,886)
Total	**224,328**	**280,853**

Inventories of trade goods/merchandise, raw and processed materials, work-in-progress, and finished products as at December 31, 2016 amounted to EUR 224,328 thousand, which is 20.1% less than at the end of the previous period.

22. TRADE AND OTHER RECEIVABLES

EUR thousand	2016	2015
Trade and other receivables	173,424	221,925
Deferred costs	9,609	6,759
Accrued revenues	22,675	27,505
Total trade and other receivables	**205,708**	**256,189**

Trade and other receivables decreased by EUR 50,481 thousand.

As at December 31, 2016, the Mercator Group disclosed EUR 3,220 thousand of receivables from related parties.

Deferred costs in 2016 amount to EUR 9,609 thousand, which is EUR 2,850 thousand more than in the year before.

Uncharged revenue pertains to anticipated and included rebates and compensations.

Carrying amounts of all trade and other receivables are in materially relevant sums consistent with their respective fair values. Receivables are measured at amortized cost.

As at December 31, 2016, allowance for receivables amounts to EUR 80,790 thousand (2015: EUR 36,570 thousand). Changes in allowances for trade receivables are presented in Note 30 (Financial instruments).

23. LOANS AND DEPOSITS

EUR thousand	2016	2015
Deposits for rent payments	19,869	22,705
Loans to companies	11,516	9,566
Deposits in banks	8,110	6,398
Total loans and deposits	**39,495**	**38,669**

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%.

24. CASH AND CASH EQUIVALENTS

EUR thousand	2016	2015
Cash in banks	18,213	12,609
Cash in hand	8,105	6,389
Total cash and cash equivalents	**26,318**	**18,998**

Cash in hand in the amount of EUR 8,105 thousand includes cash in transit (daily proceeds of retail units), cash in hand, and cheques falling due in up to 90 days.

25. EQUITY

Share capital
Share capital of the company Mercator, d.d., amounts to EUR 254,175,051.39. It is divided into 6,090,943 ordinary, registered, no-par value shares (2015: 6,090,943), that are all entered into the Companies Register as at December 31, 2016.

Conditional capital increase
Shareholders' Assembly of the company Mercator, d.d., 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, 2016, the company held 42,192 treasury shares in the amount of EUR 3,235 thousand (2015: 42,192 treasury shares, EUR 3,235 thousand).

Reserves

Reserves of the Group comprise share premium, revenue reserves, fair value reserve and currency translation reserve. None of share premium, legal reserves, fair value reserve and currency translation reserve can be used for payment of dividends or other participation in profit.

As at December 31, 2016, *share premium* amounted to EUR 286,772 thousand (2015: 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. No changes occurred in share premium in 2016.

Revenue reserves, amounting to EUR 41,685 thousand as at December 31, 2016, include legal reserves, reserves for treasury shares, and other revenue reserves.

As at December 31, 2016, the Group holds legal reserves in the amount of EUR 13,389 thousand. Share premium and legal reserves can be used in surplus amount to increase the share capital from company assets and for covering the net loss of the business year or to cover the carried forward net loss if revenue reserves are not used simultaneously to pay dividends to the shareholders.

As at December 31, 2016, the company Mercator, d.d., held 42,192 treasury shares in the amount of EUR 3,235 thousand. The reserve for treasury shares is reported among other revenue reserves.

Other revenue reserves as at December 31, 2016 amounted to EUR 25,062 thousand. They include reallocated residuals of retained earnings from previous years. They can be used for any purpose, except for the amount of the reserve for treasury shares within other revenue reserves. In 2016, no changes were made in other revenue reserves.

Currency translation reserve, amounting to EUR -91,720 thousand as at December 31, 2016, has decreased by EUR 2,052 thousand in 2016, which is related to a decrease due to currency translation differences that occurred upon the integration of financial statements of foreign subsidiaries into the consolidated financial statements.

Fair value reserve, which amounts to EUR 104,541 thousand as at December 31, 2016, includes fair value reserve for 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.

Fair value reserve is shown below:

EUR thousand	**2016**	**2015**
Property fair value reserve	108,716	112,190
Fair value reserve for available-for-sale financial assets	26	28
Fair value reserve for provisions for retirement benefits	(4,200)	(3,353)
Total fair value reserve	**104,541**	**108,865**

Changes in equity in 2016 relate to:
- the decrease in equity for loss of EUR 72,735 thousand in 2016,
- the decrease in equity due to actuarial losses from the creation of retirement benefits provisions in the amount of EUR 294 thousand,
- the decrease in equity due to currency translation differences from operations with foreign subsidiaries in the amount of EUR 2,047 thousand,
- the decrease in equity due to other changes in the amount of EUR 772 thousand,
- the decrease in equity due to deferred tax effect in the amount of EUR 1,208 thousand.

Dividends

Dividends will not be paid in 2017.

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.

Continuing operations	**2016**	**2015**
Profit attributable to the owners of the parent company (EUR thousand)	(78,063)	10,153
Weighted average number of ordinary shares	6,048,751	6,048,751
Basic net loss per share (in EUR)	**(12.9)**	**1.7**

Discontinued operations	**2016**	**2015**
Profit attributable to the owners of the parent company (EUR thousand)	5,328	10,001
Weighted average number of ordinary shares	6,048,751	6,048,751
Basic net loss per share (in EUR)	**0.9**	**1.7**

	2016	**2015**
Issued ordinary shares as at January 1	6,090,943	6,090,943
Effect of treasury shares	(42,192)	(42,192)
Effect of new issue	-	-
Weighted average number of ordinary shares as at December 31	**6,048,751**	**6,048,751**

Since the Group does not have any preference shares or convertible bonds, diluted net loss per share is the same as basic net loss per share.

27. LOANS AND OTHER FINANCIAL LIABILITIES

EUR thousand	**2016**	**2015**
Long-term financial liabilities		
Loans from banks	590,739	621,330
Finance lease	127,216	115,250
Loans from others and companies	400	1,628
Loans from related companies	20,000	20,000
Total	**738,354**	**758,208**
Short-term financial liabilities		
Loans from banks	40,730	43,002
Loans from other companies	40,672	40,469
Current portion of finance lease	16,967	48,198
Current portion of long-term bank loans	34,873	17,555
Total	**133,241**	**149,224**
Total financial liabilities	**871,596**	**907,432**

As at December 31, 2016, the Group had EUR 560,776 thousand of pledged property. Loans collateralized by a mortgage amounted to EUR 452,334 thousand as at December 31, 2016.

Effective interest rates as at the balance sheet date:

	2016	2015
Bank loans	3.13%	3.17%
Other loans	1.99%	1.96%

Floating interest rates are mostly interest rates related to EURIBOR. Fixed interest rates are mostly related to borrowings from domestic banks, with fixed nominal interest rate.

Finance lease

Finance lease liabilities - minimum lease payments:

EUR thousand	Future minimum lease payments 2016	Interest 2016	Principal 2016	Future minimum lease payments 2015	Interest 2015	Principal 2015
Less than one year	28,310	2,240	26,070	50,900	2,702	48,198
Between one and five years	84,677	5,857	78,820	77,984	7,827	70,157
More than five years	40,973	1,680	39,293	48,025	2,932	45,093
Total	**153,960**	**9,777**	**144,183**	**176,909**	**13,461**	**163,448**

The Mercator Group has also 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 expire 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, 2016 amounted to 85% (84% as at December 31, 2015).

28. PROVISIONS

EUR thousand	Provisions for restitution claims	Provisions for company reorganization costs	Legal claims	Provisions for retirement benefits and long-service awards	Other provisions	Total
As at January 1, 2015	**-**	**3**	**3,197**	**17,304**	**202**	**20,706**
Creation	-	-	49	8,777	2,102	10,928
Utilization	-	-	(179)	(2,648)	(1,848)	(4,675)
Reversal	-	-	(272)	(768)	-	(1,040)
Exchange rate differences	-	-	-	(1)	-	(1)
As at December 31, 2015	**-**	**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)	(3,352)
Exchange rate differences	-	-	-	(17)	-	(17)
As at December 31, 2016	**-**	**-**	**2,953**	**23,241**	**623**	**26,818**

Compared to the end of 2015, total provisions increased by EUR 900 thousand. Additional provisions of EUR 7,163 thousand were established (EUR 6,097 thousand debiting costs and expenses and EUR 1,066 thousand debiting other comprehensive income). Provisions debiting liabilities decreased by EUR 6,264 thousand (drawing of provisions in the amount of EUR 1,609 thousand, reversal of provisions crediting other operating expenses of EUR 3,465 thousand and reversal of provisions crediting other comprehensive income of EUR 1,190 thousand). Net effect on the income statement amounted to EUR -2,632 thousand. The decrease of EUR 17 thousand refers to foreign exchange differences.

Legal claims
In 2016, provisions for legal claims increased by EUR 158 thousand. Based on received legal claims and legal opinion, the Group created additional provisions in the total amount of EUR 298 thousand in 2016. Following the completion of legal proceedings decided in favor of Mercator, provisions in the amount of EUR 70 thousand were reversed. Liabilities of EUR 70 thousand were paid to plaintiffs.

Provisions for termination benefits and long-service awards
Provisions for termination benefits and long-service awards were calculated applying the following methods and assumptions:

- actuarial projected unit credit method taking into account attribution of employment benefits on a straight-line basis;
- actuarial assumptions of mortality (0.2%), staff fluctuation (3.3%) and average employee age (44 years);
- retirement date was calculated on the basis of gender, date of birth, overall period of service as at December 31, 2016;
- the discount rate applied in calculations equals 1.3%;
- applying the average gross salary from September 2015 to August 2016 as the average gross salary;
- average salary increase rates in the Republic of Slovenia from the Autumn forecast of economic trends for 2016 and 2017; from 2017 onwards, the forecast average salary increase rate is 2% and real growth is 0.5%;
- long-service awards 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.

On December 31, 2016, the value of provisions for termination benefits and long-service awards amounted to EUR 23,241 thousand. In 2016, termination benefits and long-service awards of EUR 1,350 thousand were debited to provisions; new provisions of EUR 3,950 thousand were created (debited to costs and expenses in the amount of EUR 2,884 thousand and to other comprehensive income in the amount of EUR 1,066 thousand); reversed provisions in the amount of EUR 833 thousand were credited to other operating income and of EUR 1,190 thousand to other comprehensive income. The decrease of EUR 17 thousand refers to foreign exchange differences.

Other provisions
Other provisions refer to the provisions for improvement of working conditions of persons with disabilities at the companies Mercator, d.d., and Mercator IP, d.o.o. In 2016, they increased by EUR 167 thousand. They were drawn pursuant to relevant legislation in the amount of EUR 226 thousand, to cover the labor costs of persons with disabilities, labor costs of employees helping the persons with disabilities, and investments in property, plant and equipment related to the work of persons with disabilities.

29. TRADE AND OTHER LIABILITIES

EUR thousand	2016	2015
Trade liabilities	500,868	510,210
Payables to employees	12,523	13,624
Social security and other taxes and duties	26,495	21,714
Other payables	63,117	44,768
Accrued costs and deferred revenues	32,201	36,154
Total	**635,204**	**626,469**
Trade and other payables include:		
Non-current/long-term liabilities	45,183	38,352
Current/short-term liabilities	590,021	588,117

Accrued costs pertain to accrued interest paid on borrowings, rebates granted but not accounted for, and compensations, the costs of unused holiday leave and other accrued costs.

Deferred revenue includes particularly deferred revenue for claiming the discounts related to Pika bonus points.

As at December 31, 2016, 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 2016.

30. FINANCIAL INSTRUMENTS

Financial risk management

(a) Risk overview

The Group is monitoring and controlling different types of financial risks to which its operations are exposed:
- credit risk,
- liquidity risk,
- market risk,
- operating risk arisig from Agrokor Group.

Market risk management involves managing the interest rate and currency risk. The Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

This note presents the information on the Group's exposure to the risks listed above, as well as the goals, policies, and processes for measurement and management thereof and the Group's equity.

(b) Risk management policy

Active risk management at the Mercator Group 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 Mercator Group.

Risk management activities in the Mercator Group 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. Since the risks are monitored and managed from the aspect of several professional fields, Risk Management Committees, covering three main fields of risks, were founded to provide support to the Risk Management Council. Risk management is a central corporate function managed and coordinated by the company Mercator, d.d.

The Mercator Group manages financial risks in the framework of adopted policy centrally at the parent company level which enters into interest rate swap contracts at market terms (arm's length principle) based on specific policies for managing specific risks.

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 Mercator Group. 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 Mercator Group 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 is exposed.

Quality performance of the supervisory function by the Supervisory Board of the company Mercator, d.d., 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 companies.

At the Mercator Group, we are constantly studying and analyzing the existing and potential new risks, and implementing measures to manage, or hedge them.

Risk management process includes risk identification, sensitivity analysis, determination of threshold for key risks, taking measures to control risks and the implementation of these in the everyday decision-making in individual areas.

Estimates of exposure to individual risk types are prepared according to the probability and an assessment of damages in case of certain events. Exposure to risks is assessed based on sensitivity analysis which identifies by how much the gross cash flow from operating activities at the level of the Group (EBITDA) or a particular company would drop in case of occurrence of a particular event taken as the basis for risk analysis. Probability is calculated based on analysis of data on past events, and expectations on the frequency of individual events in the year ahead. The analysis includes different effects and factors adjusted to particular types of risk.

Risks that cannot be quantified are assessed qualitatively. Estimated key risks, that exceed 1% of gross cash flow from operating activities (EBITDA) of the Group or individual company, and for them no measures have been taken so far or they are not hedged in a manner that the risk would be entirely controlled, are most closely monitored and managed with measures that either minimize the damage at the occurrence of an event or reduce the level of likelihood of occurrence of an event, thus mitigating the risk to an acceptable level. Implementation of the measures adopted for managing the key risks is reviewed by a special internal audit, and reported to the Audit Committee on a quarterly basis.

Similarly as in the recent years, Mercator Group performance in 2016 was considerably affected by aggravated conditions on global financial markets, which bore a negative impact on the entire economic environment both globally and in the markets of Mercator operations. This was reflected in a notable drop in retail demand, as well as in the persistence of the trend of uncertainty with regard to financial risks which were not common in the period before the crisis. In such harsh and uncertain environment, it was crucial for the Mercator Group to carefully manage the risks that it faces in its business operations.

Credit risk

Credit risk is the risk that the Group 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 exposure to credit risk is particularly dependent on the characteristics of individual customers. However, the Mercator Group'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 offers 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 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 was:

EUR thousand	2016	2015
Trade and other receivables	205,708	256,189
Deposits for rent payments	19,869	22,705
Loans to companies	11,516	9,566
Deposits in banks	8,110	6,398
Total	**245,203**	**294,858**

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 is also constantly monitoring customer payment defaults and checks the rating of external customers and Pika card holders.

The loans granted by the Group 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 was as follows:

EUR thousand	2016	2015
Slovenia	105,094	136,510
Foreign markets	140,108	158,348
Total	**245,203**	**294,858**

Maximum exposure to credit risk for trade receivables and loans at the reporting date by type of customer was as follows:

EUR thousand	2016	2015
Retail customers	10,710	27,593
Wholesale customers and related companies	152,782	182,605
Receivables from employees and the government, and other receivables	9,932	11,727
Deferred costs	9,609	6,759
Accrued revenues	22,675	27,505
Loans and deposits	39,495	38,669
Total	**245,203**	**294,858**

In the category of retail partners the Group 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):

EUR thousand	2016	2015
Trade receivables	234,594	246,768
Secured receivables	26,793	60,889
Unsecured receivables	207,801	185,879
Other receivables and loans	81,711	84,660
Total	**316,305**	**331,428**

Trade receivables are secured with bank guarantees, paid collaterals, cash deposits, prime mortgages, and liabilities to these customers. Among other receivables, the Group reports receivables from the government, employees, as well as deferred costs and accrued expenses.

Revenues from any individual customer do not reach 10% of total revenues of the Group.

Impairment of receivables

Ageing of trade receivables and loans at the reporting date:

EUR thousand	Gross 2016	Adjustment 2016	Gross 2015	Adjustment 2015
Not past due	150,494	-	194,722	-
Past due 0-60 days	58,806	4,218	42,420	-
Past due 61-74 days	5,234	1,367	5,765	150
Past due 75-89 days	2,190	(457)	5,919	231
Past due more than 90 days	109,187	75,581	82,602	36,189
Total	**325,912**	**80,709**	**331,428**	**36,570**

Changes in revaluation adjustment to receivables and loans:

EUR thousand	2016	2015
As at January 1	**36,570**	**41,896**
Effect of exchange rate movements	(56)	(13)
Impairment loss recognized during the year	48,648	3,844
Receivable write-off	(1,864)	(7,018)
Decrease of allowance for impairment during the year	(2,589)	(2,139)
As at December 31	**80,709**	**36,570**

The quality of receivables and loans 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.

Guarantees

Parent company is providing guarantees to its subsidiaries for borrowings from banks, in the amount of EUR 299,475 thousand.

Liquidity risk

Liquidity risk is the risk that the Group will in the course of its business activities encounter difficulties in settlement of its current liabilities which are settled in cash or with other financial assets. The Group ensures its liquidity so that it always has ample liquid assets to meet its obligations in due time, both in normal as well as challenging circumstances, without the occurrence of unacceptable losses or decline in the Group's reputation.

Despite the fact that the Group has less than 2% more current liabilities than current assets, we assess that the liquidity risk exposure is low.

The Group has 55% more current liabilities than current assets, we assess that the liquidity risk does exist.

The Group has been actively managing liquidity risk in the scope of the established centralized cash management. The centralized cash management represents a system based on:

- specifically defined methodology of cash flow planning based on which every company from the Mercator 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 Mercator 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;
- efficient working capital management encompassing monthly monitoring of companies' management of inventories, trade receivables and payables.

As at December 31, 2016, the Mercator Group had access to the following liquidity lines:

EUR thousand	**2016**
Cash and cash equivalents	26,318
Bank deposits	8,110
Standby revolving credit lines	82,939
Total	**117,366**

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, 2016.

2016			Up to 6 months		6 to 12 months		1-3 years		3-5 years		Over 5 years	
EUR thousand	Carrying amount	Contractual cash flow	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest
Non-derivative financial liabilities												
Bank borrowings	666,341	752,894	47,530	4,148	28,278	10,300	88,856	40,848	501,677	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 lease	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	635,204	635,833	533,277	2,348	54,592	281	543	-	44,792	-	-	-
Total	**1,504,800**	**1,606,920**	**590,750**	**9,975**	**119,612**	**12,188**	**146,062**	**44,649**	**606,903**	**33,626**	**41,473**	**1,682**

2015			Up to 6 months		6-12 months		1-3 years		3-5 years		Over 5 years	
EUR thousand	Carrying amount	Contractual cash flow	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest	Redemption	Interest
Non-derivative financial liabilities												
Bank borrowings	681,887	788,540	41,380	4,080	19,177	4,416	52,881	35,464	153,024	40,506	415,425	22,187
Borrowings from related and other companies	62,097	62,097	-	-	40,469	-	1,628	-	-	-	20,000	-
Finance lease	163,448	176,909	40,009	1,376	8,189	1,326	27,530	4,710	42,627	3,117	45,093	2,932
Trade and other payables and current tax liabilities	627,993	627,993	589,641	-	-	-	38,352	-	-	-	-	-
Total	**1,535,425**	**1,655,539**	**671,030**	**5,456**	**67,835**	**5,742**	**120,391**	**40,174**	**195,651**	**43,623**	**480,518**	**25,119**

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 interest rate risk stems from financial liabilities. Financial liabilities expose the Group to the interest rate risk of cash flow.

The Group is exposed to interest rate risk as its 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. Consequently, the Group is managing and controlling the increase of finance expenses in an appropriate centralized manner.

Exposure

The following table presents the Group's exposure to interest rate risk:

EUR thousand	Dec. 31, 2016 Carrying amount	Dec. 31, 2015 Carrying amount
Fixed rate financial instruments		
Financial assets	38,565	37,498
Financial liabilities	(54,217)	(49,331)
Total	**(15,652)**	**(11,833)**
Floating rate financial instruments		
Financial assets	930	1,171
Financial liabilities	(817,378)	(858,101)
Total	**(816,448)**	**(856,930)**

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 2015.

	Net profit or loss	
EUR thousand	**100 bp increase**	**100 bp decrease or decrease to 0%**
2016		
Variable rate instruments	(8,164)	-
Cash flow sensitivity (net)	**(8,164)**	**-**
2015		
Variable rate instruments	(8,569)	-
Cash flow sensitivity (net)	(8,569)	-

Currency risk

The Mercator Group's operations in the international environment necessarily involve exposure to currency risk. The Mercator 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.

Exposure to currency risk

The Group's exposure to foreign currency risk was as follows:

December 31, 2016

EUR thousand	EUR*	HRK	RSD	BAM
Trade and other receivables	105,094	10,709	124,982	4,417
Available-for-sale financial assets	411	42	5	4
Cash and cash equivalents	16,723	1,084	8,214	297
Financial liabilities	(855,979)	-	-	(15,617)
Trade and other payables	(409,157)	(13,963)	(208,351)	(3,732)
Balance sheet exposure	**(1,142,908)**	**(2,128)**	**(75,150)**	**(14,631)**
Estimated sales	1,445,231	-	798,342	-
Estimated purchasing	(1,125,440)	-	(697,457)	-
Estimated transaction exposure	**319,791**	**-**	**100,885**	**-**
Forward exchange contracts	-	-	-	-
Net exposure	**(823,117)**	**(2,128)**	**25,735**	**(14,631)**

*EUR is the functional currency and it does not represent the exposure to currency risk; HRK (Croatian kuna), RSD (Serbian dinar), BAM (Bosnian convertible mark).

As at December 31, 2016, the Mercator Group does not hold any derivative financial instruments for currency risk hedging (forward exchange contracts).

December 31, 2015

EUR thousand	EUR*	HRK	RSD	BAM
Trade and other receivables	136,510	12,952	142,908	2,488
Available-for-sale financial assets	471	49	-	4
Cash and cash equivalents	11,046	866	6,193	893
Financial liabilities	(859,352)	(3,524)	(44,556)	-
Trade and other payables	(358,342)	(14,911)	(250,192)	(3,024)
Balance sheet exposure	**(1,069,667)**	**(4,568)**	**(145,647)**	**361**
Estimated sales	1,667,004	61,278	942,709	26,169
Estimated purchasing	(1,306,931)	(28,217)	(832,412)	(8,103)
Estimated transaction exposure	**360,073**	**33,061**	**110,297**	**18,066**
Forward exchange contracts	-	-	-	-
Net exposure	**(709,594)**	**28,493**	**(35,350)**	**18,427**

*EUR is the functional currency and it does not represent the exposure to currency risk; HRK (Croatian kuna), RSD (Serbian dinar), BAM (Bosnian convertible mark).

The following significant exchange rates applied during the year:

	Average exchange rate		**Reporting date spot rate**	
Units per EUR	**2016**	**2015**	**2016**	**2015**
HRK	7.53	7.61	7.56	7.64
RSD	122.90	120.56	123.60	121.23
BAM	1.96	1.96	1.96	1.96

Sensitivity analysis

A change in the exchange rate of local currencies against the Euro as at December 31, 2016 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.

EUR thousand	**Change in exchange rate**	**(Estimated) transaction exposure**		**Balance sheet exposure**	
		Net profit or loss		**Net profit or loss**	
2016					
HRK	-/+ 5%	-	-	(112)	101
RSD	-/+ 10%	11,209	(9,171)	(8,350)	6,832
BAM	-/+ 5%	-	-	(770)	697
2015					
HRK	-/+ 5%	1,740	(1,574)	(240)	218
RSD	-/+ 10%	12,225	(10,027)	(16,183)	13,241
BAM	-/+ 5%	951	(860)	19	(17)

Operating risk arising from Agrokor Group

The Group's business activities, together with the factors likely to affect its future development, its financial position, financial risk management objectives, details of its financial instruments and derivative activities, and its exposures to price, credit, liquidity and cash flow risk are described in the Business Report and in this note.

Financial performance and results of operations

The financial performance and financial result of the Mercator Group as of December 31, 2016 and for 12 months ended this date demonstrated negative trend in comparison with previous reporting period: the consolidated current liabilities outreached current assets by EUR 258,056 thousand, and the net loss for 2016 year totaled to EUR 72,735 thousand. As discussed in Business report EBITDA for the reporting period decreased from EUR 140,322 thousand for 2015 year to EUR 41,037 thousand for 2016 year.

At the same time, the Group has considerable liquidity reserves available from credit lines in the amount of EUR 82,939 thousand and generate positive cash flow. A cash flow forecast prepared by management for the following 12 months indicates that the Group will have sufficient funds to meet its obligations when fall due.

Management estimates that 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 future financial performance, including

1) Multiple downgrading 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 Management:

1) Exposure to the risk from Business operations

Mercator Group is involved in 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 turnovers 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 37,514 thousand or 1,5% of total consolidated revenue for 2016 year. Gross amount of trade receivables from Agrokor Group as of December 31, 2016 total to EUR 49,364 thousand. As discussed in Note 22, provision for Agrokor Group receivables was recognized as of 2016 year end in the amount of EUR 46,012 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), restriction on assets distribution from Mercator Group to Agrokor Group, other restrictions.

2) Risk of compliance with financial debt agreement commitments

As disclosed in Business report, Mercator Group net financial debt as of December 31, 2016 totals to EUR 805,320 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.

Change of control clause has not been triggered and no event that had a material adverse effect on financial performance of Mercator Group has occurred. Management has assumption that stakeholders in both Agrokor Group and Mercator Group will be highly incentivized to precipitate 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. Also the acceleration or enforcement as a result any event of default under the 2014 financial restructuring terms would in any event require a positive vote by lenders representing two-thirds of the total commitments or, looked at the other way around, lenders representing more than one-third of the total commitments can prevent any acceleration or enforcement

Conclusion

The management has a view that the Group has adequate internal resources to continue in operational existence. But at the same time management acknowledges that after considering the events and the combination of risks arising from Agrokor Group uncertain future perspective described above, uncertainty regarding the impact of possible future events on Mercator Group operations and financial.

Capital management

Policy of the Group 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 is the ratio between equity and net financial debt of the Group. As at reporting date, the said ratio was as follows:

EUR thousand	2016	2015
Financial liabilities and liabilities for derivative financial instruments	871,596	907,432
Less:		
Loans and deposits	39,495	38,669
Available-for-sale financial assets	462	524
Derivative financial instruments	-	-
Cash and cash equivalents	26,318	18,998
Net financial debt	**805,321**	**849,241**
Equity	**557,376**	**634,433**
Ratio between equity and net financial debt	1:1.44	1:1.34

As at December 31, 2016, the company Poslovni sistem Mercator, d.d., held 42,192 treasury shares (2015: 42,192 treasury shares).

Fair values

Fair values of assets and liabilities and carrying amounts as shown in the balance sheet:

	Dec. 31, 2016		Dec. 31, 2015	
EUR thousand	Carrying amount	Fair value	Carrying amount	Fair value
Trade and other receivables	205,707	205,707	256,189	256,189
Current tax assets	1,230	1,230	656	656
Loans and deposits	39,495	38,492	38,669	38,317
Available-for-sale financial assets	462	462	524	524
Cash and cash equivalents	26,318	26,318	18,998	18,998
Fixed rate bank borrowings	(54,217)	(54,217)	(49,331)	(48,882)
Floating rate bank borrowings	(612,124)	(612,124)	(632,556)	(632,556)
Borrowings from related and other companies	(61,072)	(61,072)	(62,097)	(62,097)
Finance lease	(144,183)	(144,183)	(163,448)	(163,448)
Trade and other payables	(635,204)	(635,204)	(626,469)	(626,469)

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
The Group measures certain financial assets 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.

2016

EUR thousand	Level 1	Valuation method
Available-for-sale financial assets	176	Quoted prices in active markets

2015

EUR thousand	Level 1	Valuation method
Available-for-sale financial assets	116	Quoted prices in active markets

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.

2016

EUR thousand	Level 1	Level 2	Level 3	Total
Loans and deposits	-	-	39,495	39,495
Trade and other receivables	-	-	205,707	205,707
Financial liabilities	-	-	(871,595)	(871,595)
Trade and other payables	-	-	(635,204)	(635,204)

2015

EUR thousand	Level 1	Level 2	Level 3	Total
Loans and deposits	-	-	38,669	38,669
Trade and other receivables	-	-	256,189	256,189
Financial liabilities	-	-	(907,432)	(907,432)
Trade and other payables	-	-	(626,469)	(626,469)

In 2016, available-for-sale financial assets included also investments valued at historical cost in the amount of EUR 286 thousand (2015: EUR 408 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:

EUR thousand	2016	2015
Less than one year	33,130	61,868
Between one and five years	106,162	188,571
More than five years	173,274	146,999
Total	**312,566**	**397,438**

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 the balance sheet as at the balance sheet date:

EUR thousand	2016	2015
Property, plant and equipment	9,608	5,929

33. CONTINGENCIES

Group contingencies also include guarantees provided in the amount of EUR 20,103 thousand (2015: EUR 56,483 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.

34. RELATED-PARTY TRANSACTIONS

The company Mercator, d.d., has a controlling owner or shareholder. The biggest owner is Agrokor, d.d., holding 88.11% of total equity with its related parties.

Related parties of the Group are its management personnel and related companies. Included in the management personnel are members of Management Boards and Supervisory Boards in the companies of the Mercator Group.

As at the end of 2016, managerial staff held no shares of the company Mercator, d.d.

In 2016, the Group paid out the following compensation in gross amounts to Management Board members and Supervisory Board members of the Group companies:

EUR thousand	2016 Amount	2016 Number of recipients	2015 Amount	2015 Number of recipients
Members of Management Boards of the Mercator Group companies	2,636	16	2,315	15
Members of Supervisory Boards of the Mercator Group companies	107	10	97	10
Total	**2,743**	**26**	**2,412**	**25**

Members of Supervisory Boards of the Mercator Group subsidiaries do not receive any compensation for their work; therefore the disclosed amounts refer solely to the parent company.

Gross payments to Management Board and Supervisory Board members of companies in the Mercator Group represent 1.1% of total employee benefit expenses (2015: 0.9%).

Gross payments to Mercator, d.d., Management Board in 2016:

EUR thousand	First and last name	Total payments	Gross payment	Base salary	Performance bonuses	Other payments
President of the Management Board	Toni Balažič	364	364	337	-	27
Member of the Management Board	Drago Kavšek	491	491	233	-	258
Member of the Management Board from January 1 to April 30, 2016	Igor Maroša	87	87	80	-	7
Member of the Management Board from April 1 to December 31, 2016	Igor Mamuza	198	198	183	-	15
		1,140	**1,140**	**833**	**-**	**307**

Gross payments to Management Board and Supervisory Board members in 2016 represent 0.75% of total labor costs of the company Mercator, d.d. (2015: 0.62%).

Gross compensation paid to members of managerial and supervisory bodies at the parent company in 2016 are reported in the following two tables (disclosure pursuant to Article 294 of the Companies Act):

in EUR	Participation in profit	Options	Performance bonuses	Cost/expenses reimbursement	Insurance premiums	Commissions	Other additional income	TOTAL
MANAGEMENT BOARD	**-**	**-**	**-**	**2,743**	**384**	**-**	**303,993**	**307,120**
Toni Balažič	-	-	-	865	128	-	26,489	27,482
Drago Kavšek	-	-	-	844	128	-	256,846	257,818
Igor Maroša	-	-	-	293	-	-	6,692	6,985
Igor Mamuza	-	-	-	741	128	-	13,966	14,835

in EUR	GROSS PAYMENT	Payment for performance of duties	Session attendance fees	OTHER PAYMENTS	Participation in profit	Options	Other rewards	Cost/expenses reimbursement	Insurance premiums	Commissions	Other additional income
SUPERVISORY BOARD	**107,017**	**97,500**	**8,365**	**1,152**	**-**	**-**	**-**	**-**	**1,152**	**-**	**-**
Todorić Ante	698	-	570	128	-	-	-	-	128	-	-
Lahovnik Matej	19,406	18,000	1,278	128	-	-	-	-	128	-	-
Crnjac Ivan	555	-	427	128	-	-	-	-	128	-	-
Kuštrak Damir	698	-	570	128	-	-	-	-	128	-	-
Knez Darko	8,188	7,500	560	128	-	-	-	-	128	-	-
Mudrinić Ivica	19,238	18,000	1,110	128	-	-	-	-	128	-	-
Stojanovič Vesna	19,228	18,000	1,100	128	-	-	-	-	128	-	-
Tatić Veljko	19,503	18,000	1,375	128	-	-	-	-	128	-	-
Grošelj Matjaž	19,503	18,000	1,375	128	-	-	-	-	128	-	-

in EUR	GROSS PAYMENT	Payment for performance of duties	Session attendance fees	OTHER PAYMENTS	Participation in profit	Options	Other rewards	Cost/ expenses reimburse ment	Insurance premiums	Commissions	Other additional income
AUDIT COMMITTEE	**10,100**	**9,000**	**1,100**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Slapničar Sergeja	10,100	9,000	1,100	-	-	-	-	-	-	-	-
Crnjac Ivan	-	-	-	-	-	-	-	-	-	-	-
Kuštrak Damir	-	-	-	-	-	-	-	-	-	-	-

in EUR	GROSS PAYMENT	Payment for performance of duties	Session attendance fees	OTHER PAYMENTS	Participation in profit	Options	Other rewards	Cost/expe nses reimburse ment	Insurance premiums	Commissions	Other additional income
SUPERVISORY COMMITTEE	**19,444**	**18,000**	**1,444**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Filipović Nenad	19,444	18,000	1,444	-	-	-	-	-	-	-	-

In 2016, no member of managerial and supervisory bodies of Mercator, d.d., received any payments for performance of tasks in subsidiary companies (disclosure pursuant to Article 294 of the Companies Act).

Sales to related parties

EUR thousand	2016
Konzum d.d.	11,428
Konzum d.o.o. Sarajevo	7,926
Agrokor-trgovina d.o.o.	7,115
Frikom d.o.o.	3,263
Dijamant a.d.	2,991
PIK Vrbovec d.d.	2,577
MG Mivela d.o.o. (Jamnica d.o.o. Beograd)	883
Belje d.d. (+ Belje Agro-vet d.o.o. and Moslavka Kutina d.d.)	269
Ledo d.o.o. Ljubljana	248
Zvijezda d.o.o. Ljubljana	204
Velpro-centar d.o.o.	192
Jamnica d.o.o. Maribor	184
Ledo d.o.o. Podgorica	80
Super kartica d.o.o. Beograd	63
A007 d.o.o.	61
Velpro d.o.o. Sarajevo	28
Ledo d.d.	26
Kikindski mlin a.d.	21
Tisak d.d. (+ Tisak usluge d.o.o., Backstage d.o.o. and e-Kolektor d.o.o.)	19
Super kartica d.o.o. BH	11
Idea d.o.o.	5
Kron a.d.	2
Nova sloga d.o.o.	1
Ambalažni servis d.o.o. Srbija	1
Multiplus card d.o.o.	(84)
Total	**37,514**

Outstanding items related to sales/purchase to/from related parties

Operating receivables from related parties

EUR thousand	2016
Konzum d.d.	26,905
Konzum d.o.o. Sarajevo	12,487
Agrokor-trgovina d.o.o.	3,855
Agrokor d.d.	3,361
PIK Vrbovec d.d.	1,642
Super kartica d.o.o. Beograd	1,496
Dijamant a.d.	703
Frikom d.o.o.	414
Agrokor AG Zug	397
MG Mivela d.o.o. (Jamnica d.o.o. Beograd)	228
Ledo d.o.o. Ljubljana	141
Velpro-centar d.o.o.	105
Tisak d.d. (+ Tisak usluge d.o.o., Backstage d.o.o. and e-Kolektor d.o.o.)	85
Jamnica d.o.o. Maribor	83
A007 d.o.o.	66
Belje d.d. (+ Belje Agro-vet d.o.o. and Moslavka Kutina d.d.)	66
Zvijezda d.o.o. Ljubljana	33
Idea d.o.o. (Ambalažni servis d.o.o. Srbija merged by acquisition)	30
Velpro d.o.o. Sarajevo	10
Kikindski mlin a.d.	6
Super kartica d.o.o. BH	4
Ledo d.d.	1
Multiplus card d.o.o.	1
Total	**52,118**

Operating liabilities to related parties

EUR thousand	2016
Idea d.o.o. (Ambalažni servis d.o.o. Srbija merged by acquisition)	21,001
Dijamant a.d.	5,847
Frikom d.o.o.	3,374
MG Mivela d.o.o. (Jamnica d.o.o. Beograd).	2,604
Super kartica d.o.o. Belgrade	1,462
Konzum d.d. (eLog d.o.o., Kor Neretva d.o.o. and Ambalažni servis d.o.o. Hrvatska - merged by acquisition)	1,442
mStart d.o.o.	1,348
PIK Vrbovec d.d.	1,006
Ledo d.o.o. Podgorica	795
Zvijezda d.o.o. Ljubljana	713
Kikindski mlin a.d.	565
Ledo d.o.o. Ljubljana	526
Jamnica d.o.o. Maribor	312
360 Marketing d.o.o.	243
Tisak d.d. (+ Tisak usluge d.o.o., Backstage d.o.o. and e-Kolektor d.o.o.)	144
Multiplus card d.o.o.	132
PIK BH d.o.o. Laktaši	127
Belje d.d. (+ Belje Agro-vet d.o.o. and Moslavka Kutina d.d.)	62
PIK Vinkovci d.d.	60
Velpro-centar d.o.o.	46
Zvijezda d.o.o Sarajevo	32
Super kartica d.o.o. BH	32
Nova sloga d.o.o.	24
Agrolaguna d.d.	21
Konzum d.o.o. Sarajevo	18
Solana Pag d.d.	18
Zvijezda d.d.	(8)
Total	**41,945**

Loans from related parties

EUR thousand	2016
Related companies:	
Agrokor d.d.	20,000
Total	**20,000**

35. Major events after the balance sheet date

On January 1, 2017, Dean Čerin was appointed Assistant to Management Board president in charge of finance, accounting and controlling.

On March 10, 2017, a contract was concluded on sale and purchase of shares between the companies Agrokor Investment B.V. and Agrokor, d.d., based on which the company Agrokor Investment B.V. transferred to the company Agrokor, d.d., 615,384 shares with the designation MELR, increasing the interest of Agrokor, d.d., from 59.47% to 69.57% and decreasing the interest of Agrokor Investments B.V. from 28.64% to 18.53%. The share of their voting rights remains the same.

In April 2016, the Agrokor restructuring program was launched. The goal of restructuring is to provide stability to Agrokor. It should be noted that Mercator Group companies have small number of business operations and financial transactions with the company Agrokor d.d. and its subsidiaries which are not a part of the Mercator Group. Mercator Group's operational risks related to Agrokor Group are described in more detail in the financial part of the Annual Report, under the note Financial Instruments.

As of April 5, 2017, the term of office of Management Board president Anton Balažič was terminated. 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. Thus, the Management Board of Poslovni sistem Mercator, d.d., is operating in the following composition: Tomislav Čizmić, president of the Management Board; Draga Cukjati, Management Board member, and Igor Mamuza, Management Board member.

As of April 15, 2017, Krešimir Ležaić was appointed Assistant to Management Board president in charge of IT and telecommunications.

In 2016, receivables payable by the Agrokor Group companies that are not a part of the Mercator Group were impaired at the companies Poslovni sistem Mercator d.d., Mercator - H d.o.o., and Mercator - BH d.o.o. Additional information related to the settlement or offsetting of the receivables written off is disclosed in the Business Report of the Annual Report under the chapter Key Events or Highlights.

Independent auditor'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 accompanying 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 2016, 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 2016, and its consolidated financial performance and consolidated cash flow statement for the year then ended in accordance with International Financial Reporting Standards (IFRSs) 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 Note 30 *"Operating risk arising from Agrokor Group"* of the financial statements, which describes the exposure of the Group to the risk arising from uncertainty in ability of Agrokor Group 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.

Key audit matter	How our audit addressed the key audit matter
Significant transactions: disposal of segments of business	
During the 2016 year the Group disposed Modiana business segment and company Intersport ISI d.o.o (further on "Intersport") and its subsidiaries in Croatia, Serbia, Bosnia and Herzegovina, and Montenegro as disclosed in Note 7. Management has assessed that the sale of Modiana and Intersport should be presented as discontinued operations in accordance with IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations*. Accordingly, the key audit matter in this regard pertains to the appropriate application of IFRS 5, in particular whether Modiana and Intersport operations represent a separate major line of business or geographical area of operations resulting in the presentation of a discontinued operation.	We evaluated whether management had appropriately applied the requirements of IFRS 5 by >> Assessing whether the operations of Modiana and Intersport represent separate major line of business for Mercator Group and meet the criteria of classification as discontinued operations; >> Ensuring the results presented as discontinued operations fairly present the financial performance of Modiana and Intersport as for the current reporting period and review of whether the presentation of comparative period as discontinued operations in accordance with IFRS 5 is accurate and complete; >> Ensuring that information disclosed in the notes to consolidated financial statements is complete and accurate following the requirements of IFRS 5. The disclosure relating to Modiana and Intersport is contained in the Note 7
Fair value measurement: application of revaluation model to tangible assets accounting	
The Group applies revaluation model to measuring land carrying value items in its books. Total carrying amount of land as of reporting date amounts to EUR 495.8 mln as disclosed in Note 15. Latest valuation of land was performed by independent appraiser in 2014 year. Management has assessed that as of 31 December 2016 the fair value of land has not changed significantly and therefore revaluation as of reporting date in not required following the IAS 16 *Property, plant and equipment* requirements. The valuation of land 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. To assess the significance of deviation of fair values from carrying amount the Group employed certified independent appraiser to make a representative sample of land items and perform valuation of selected items.	Our audit procedures included the assessment whether management judgement is appropriate and whether the IAS 16 and IAS 13 *Fair value measurement* requirements are met, including >> 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 confirmed that the approaches he used are consistent with IFRSs; >> Assessment of whether sample of land items selected for valuation as of reporting date is appropriate and comprises items which are most representative for the group of assets and have the highest exposure to the market volatility and comprises items from all geographic regions, where carrying amounts of properties is material; >> We made use of our internal experts to evaluate whether the valuation approach used by the Group Management expert is appropriate and whether the significant assumptions used are adequate for given purposes. The disclosures pertaining to the land presented in Notes 3(f) and 15.

Other information

The other information comprises the Business Report, which is an integral part of the Annual Report of the Group, but does not include the financial statements and our auditor's report thereon. 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 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 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 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 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 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 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.

Among the matters we communicate with Supervisory Board and Audit Committee, we select those matters that were of most significance in our audit of the financial statements of the current period, and, therefore, represent key audit matters. We describe these matters in our auditor's report, unless law or regulation precludes public disclosure about the matter, or, in extremely rare circumstances, we determine that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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

Ljubljana, 25 April 2017

FINANCIAL REPORT OF THE COMPANY POSLOVNI SISTEM MERCATOR, D.D.

Balance sheet

EUR thousand	Note	Dec. 31, 2016	Dec. 31, 2015
ASSETS			
Non-current assets			
Property, plant and equipment	14	867,726	643,311
Investment property	16	3,237	3,351
Intangible assets	15	13,455	10,844
Deferred tax assets	19	21,218	16,748
Trade and other receivables	22	25,664	419
Loans and deposits	23	125,202	7,057
Investment into equity of subsidiaries	17	270,758	352,045
Available-for-sale financial assets	18	296	352
		1,327,554	**1,034,127**
Current assets			
Disposal groups	20	-	217,482
Inventories	21	121,783	130,404
Trade and other receivables	22	78,786	105,229
Current tax assets		300	-
Loans and deposits	23	999	110,608
Cash and cash equivalents	24	13,344	10,046
		215,212	**573,769**
Total assets		**1,542,766**	**1,607,896**
EQUITY	25		
Share capital		254,175	254,175
Share premium		286,772	286,772
Treasury shares		(3,235)	(3,235)
Revenue reserves		16,624	16,624
Fair value reserve		76,196	79,869
Retained earnings		(1,802)	619
Profit (loss) for the year		(77,447)	(3,800)
		551,283	**631,024**
LIABILITIES			
Non-current liabilities			
Trade and other payables	29	27,198	17,715
Loans received and other financial liabilities	27	508,047	526,865
Deferred tax liabilities	19	25,229	22,779
Provisions	28	23,041	22,162
		583,514	**589,521**
Current liabilities			
Trade and other payables	29	315,082	293,323
Current tax liabilities		-	327
Loans received and other financial liabilities	27	92,886	93,701
		407,968	**387,351**
Total liabilities		**991,483**	**976,872**
Total equity and liabilities		**1,542,766**	**1,607,896**

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

Income statement

Continuing operations [14] (EUR thousand)	**Note**	**2016**	**2015**
Revenue *	9	1,321,092	1,366,882
Cost of goods sold and selling costs	11	(1,293,513)	(1,306,216)
Administrative expenses	11	(39,539)	(41,810)
Impairment of property, plant and equipment and intangible assets	11	-	-
Other income	10	8,242	30,921
Results from operating activities		**(3,718)**	**49,777**
Finance income	13	12,740	10,023
Finance expenses	13	(91,728)	(60,708)
Net finance expenses		**(78,988)**	**(50,685)**
Profit (loss) before tax		**(82,706)**	**(908)**
Income tax	19	3,992	(4,192)
Net profit (loss) for the year from continuing operations		**(78,714)**	**(5,100)**
Discontinued operations [15]			
Net profit (loss) for the year from discontinued operations	7	1,267	1,300
Net profit (loss) for the year	**7**	**(77,447)**	**(3,800)**

* Sales revenues from continuing operations do not include contractually agreed income from rents, which the Mercator Group would receive from Modiana in the period when it was a part of the Mercator Group. Taking into account currently applicable contractual rents, the Mercator Group would have generated additional income of EUR 1,470 thousand in 2016 and EUR 1,960 thousand in 2015.

Basic and diluted earnings (loss) per share in EUR	26	(13.0)	(0.8)

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

[14] Continuing operations are operations of the Mercator Group excluding Modiana (also for the period in which it was part of the Mercator Group). In Compliance with IFRS 5, internal rents of Modiana are excluded from operations; however, depreciation is accounted for at the Group level for these premises.

In the Annual Report, all the notes relating to the income statement are presented for continuing operations, which includes the following notes: 7, 8, 10, 11, 12, 13, 14, and 19.

[15] Discontinued operations are operations including Modiana activities.

Consolidated statement of other comprehensive income

EUR thousand	Note	2016	2015
Net profit (loss) for the year		**(77,447)**	**(3,800)**
Other comprehensive income			
Items subsequently not reclassified to profit or loss		**(2,369)**	**(4,204)**
Net gains/losses recognized in revaluation surplus in relation to property, plant and equipment	14	-	-
Provisions for termination benefits		(322)	(4,586)
Losses on merger of subsidiaries		-	-
Other changes in property, plant and equipment	25	-	-
Deferred tax for items subsequently not reclassified to profit or loss	19	(2,047)	382
Items that may be reclassified subsequently to profit or loss		**75**	**(173)**
Net gains/losses on available-for-sale financial assets recognized in revaluation surplus		-	(208)
Gains (losses) recognized in revaluation surplus		-	-
Gains transferred from revaluation surplus to profit or loss		-	(208)
Net gains 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	75	35
Other comprehensive income for the year		**(2,294)**	**(4,377)**
Total comprehensive income for the year		**(79,742)**	**(8,177)**

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

Consolidated statement of changes in equity

EUR thousand	Note	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Net profit (loss) for the year	Total equity
Balance as at January 1, 2015		**254,175**	**286,772**	**(3,235)**	**16,624**	**84,865**	**-**	**-**	**639,201**
Total comprehensive income for the year									
Net profit (loss) for the year		**-**	**-**	**-**	**-**	**-**	**-**	**(3,800)**	**(3,800)**
Real estate revaluation		-	-	-	-	-	-	-	-
Sale of revalued land		-	-	-	-	(717)	717	-	-
Change in fair value of available-for-sale financial assets		-	-	-	-	(208)	-	-	(208)
Actuarial gains (losses) from provisions for retirement benefits		-	-	-	-	(4,488)	(98)	-	(4,586)
Deferred taxes						417	-	-	417
Other comprehensive income		**-**	**-**	**-**	**-**	**(4,996)**	**619**	**-**	**(4,377)**
Total comprehensive income for the year		**-**	**-**	**-**	**-**	**(4,996)**	**619**	**(3,800)**	**(8,177)**
Transactions with owners directly recognized in equity									
Capital increase		-	-	-	-	-	-	-	-
Distribution of profit for the year pursuant to the Management		-	-	-	-	-	-	-	-
Board decision Distribution of reserves pursuant to Management Board decision		-	-	-	-	-	-	-	-
Total transactions with owners		**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Contributions by and distributions to owners		-	-	-	-	-	-	-	-
Balance as at December 31, 2015		**254,175**	**286,772**	**(3,235)**	**16,624**	**79,869**	**619**	**(3,800)**	**631,024**

Consolidated statement of changes in equity (continued)

EUR thousand	Note	Share capital	Share premium	Treasury shares	Revenue reserves	Fair value reserve	Retained earnings	Net profit (loss) for the year	Total equity
Balance as at January 1, 2016		**254,175**	**286,772**	**(3,235)**	**16,624**	**79,869**	**619**	**(3,800)**	**631,024**
Total comprehensive income for the year									
Net profit (loss) for the year		-	-	-	-	-	-	(77,447)	(77,447)
Real estate revaluation		-	-	-	-	-	-	-	-
Sale of revalued land		-	-	-	-	-	-	-	-
Change in fair value of available-for-sale financial assets		-	-	-	-	-	-	-	-
Actuarial gains (losses) from provisions for retirement benefits		-	-	-	-	(324)	2	-	(322)
Deferred taxes		-	-	-	-	(3,348)	1,376	-	(1,972)
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									
Capital increase		-	-	-	-	-	-	-	-
Transfer of net profit (loss) for the previous year to retained earnings		-	-	-	-	-	(3,800)	3,800	-
Distribution of profit for the year pursuant to the Management Board decision		-	-	-	-	-	-	-	-
Distribution of reserves pursuant to Management Board decision		-	-	-	-	-	-	-	-
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**

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

Proposal on the allocation of accumulated loss

Distributable accumulated loss for 2015 consists of the following [16]:

(in EUR)	2016	2015
Loss for the year	**(77,447)**	**(3,800)**
Retained earnings	(1,802)	619
Loss for the year and retained earnings covered from other revenue reserves	-	-
Loss for the year and retained earnings covered from share premium	-	-
Accumulated loss for the year	**(79,249)**	**(3,180)**

The company proposes that the balance sheet (distributable) loss in the amount of EUR 79,249 thousand be covered to the debit of reversal of revaluation adjustment to equity.

[16] The company has made distribution of acumulated loss pursuant to he Article 230 of the Companies Act.

Consolidated cash flow statement

EUR thousand	Note	2016	2015
Cash flows from operating activities			
Net profit (loss) for the year		**(81,439)**	**392**
Adjustments:			
Depreciation of property, plant and equipment	14	32,876	33,298
Depreciation of investment property	16	100	108
Amortisation of intangible assets	15	4,306	3,796
Impairment of receivables towards Agrokor Group		6,782	-
Impairment of property, plant and equipment and intangible assets and (Gains) losses on disposal of property, plant, and equipment	10,11	(2,000)	766
(Gains) losses from disposal of subsidiaries		69,287	34,168
(Gain)/loss on sale of available-for-sale financial assets		(4,604)	(1,204)
Other net financial income / expense		1,524	-
Dividends received, impairment of available-for-sale financial assets	13	(2,282)	(1,936)
Interest received	13	(5,491)	(5,542)
Interest paid	13	20,554	22,711
		39,613	**86,557**
Change in inventories	21	8,621	(11,694)
Change in trade and other receivables	22	(5,884)	(5,668)
Change in trade and other payables	29	31,557	(35,059)
Interest paid	13	(20,554)	(22,711)
Tax paid	19	-	(327)
Cash from operating activities		**53,353**	**11,098**
Cash flows from investing activities			
Acquisition of subsidiaries and other business operations		(2,000)	(1,245)
Acquisition of property, plant and equipment and investment property	14,16	(49,549)	(34,766)
Disbursements for acquisition of intangible assets	15	(7,063)	(4,199)
Acquisition of available-for-sale financial assets	18	-	(119)
Loans and bank deposits made		(20,846)	14,148
Proceeds from disposal of subsidiaries	13,17	16,510	-
Proceeds from sale of property, plant and equipment and investment property	14,16	11,741	17,238
Proceeds from sale of intangible assets	15	77	14
Proceeds from sale of available-for-sale financial assets	18	149	1,817
Interest received	13	5,491	5,542
Dividends received	13	2,282	1,936
Loans and deposits payments/ repayments received		12,310	(43,321)
Net cash used in investing activities		**(30,899)**	**(42,955)**
Cash flows from financing activities			
Repayment of long-term loans received		(208,444)	(159,311)
Long-term loans received		190,015	194,100
Net proceeds (disbursements) arising from short-term loans	27	(727)	(11,457)
Dividends paid		-	-
Net cash from (used in) financing activities		**(19,156)**	**23,332**
Net increase (decrease) in cash and cash equivalents		**3,298**	**(8,525)**
Cash and cash equivalents at the beginning of the year		10,046	18,571
Cash and cash equivalents as at the end of the year	24	**13,344**	**10,046**

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

Independent autior's report

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INDEPENDENT AUDITOR'S REPORT
to the owners of Poslovni sistem Mercator, d.d.

Opinion

We have audited the accompanying financial statements of the company Poslovni sistem Mercator d.d. (hereinafter 'the Company'), which comprise the statement of financial position as at 31 December 2016, and 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 2016, and its financial performance and cash flow statement for the year then ended in accordance with International Financial Reporting Standards (IFRSs) 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 Note 30 *"Operating risk arising from Agrokor Group"* of the financial statements, which describes the exposure of the Company to the risk arising from uncertainty in ability of Agrokor Group 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.

<table>
<tr><th>Key audit matter</th><th>How our audit addressed the key audit matter</th></tr>
<tr><td colspan="2">Fair value measurement: application of revaluation model to tangible assets accounting</td></tr>
<tr><td>The Company applies revaluation model to measuring land carrying value items in its books. Total carrying amount of land as of reporting date amounts to EUR 305.6 mln, as disclosed in Note 14.
Latest valuation of land was performed by independent appraiser in 2014 year.
Management has assessed that as of 31 December 2016 the fair value of land has not changed significantly and therefore revaluation as of reporting date is not required following the IAS 16 Propety, plant and equipment requirements.

The valuation of land 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.

To assess the significance of deviation of fair values from carrying amount the Company employed certified independent appraiser to make a representative sample of land items and perform valuation of selected items.

Because of the significance of judgement required for fair value measurement and substantial land value, the matter is considered as key area of focus.</td><td>Our audit procedures included the assessment whether management judgement is appropriate and whether the IAS 16 and IFRS 13 Fair value measurement requirements are met, including

>> 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 confirmed that the approaches he used are consistent with IFRS;

>> Assessment of whether sample of land items selected for valuation as of reporting date is appropriate and comprises items which are most representative for the group of assets and have the highest exposure to the market volatility and comprises items from all geographic regions, where carrying amounts of properties is material;

>> We made use of our internal experts to evaluate whether the valuation approach used by the Group Management expert is appropriate and whether the significant assumptions used are adequate for given purposes.

The disclosures pertaining to the land presented in Notes 3(e) and 14.</td></tr>
<tr><td colspan="2">Impairment of investments in subsidiaries in separate financial statements</td></tr>
<tr><td>Investments in subsidiaries amount to EUR 270.8 mln as of 31 December 2016 in the Company's separate financial statements. The Company recognized EUR 69 mln of impairment in investments in subsidiaries in 2016 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 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 31 December 2016 year.

Significant Management judgment is involved in determination of appropriate approach to</td><td>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 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</td></tr>
</table>

recoverable amount determination and calculation, accordingly, the impairment test of these assets is considered to be a key audit matter.	

Other information

The other information comprises the Business Report, which is an integral part of the Annual Report of the Company, but does not include the financial statements and our auditor's report thereon. 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 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 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.

Among the matters we communicate with Supervisory Board and Audit Committee, we select those matters that were of most significance in our audit of the financial statements of the current period, and, therefore, represent key audit matters. We describe these matters in our auditor's report, unless law or regulation precludes public disclosure about the matter, or, in extremely rare circumstances, we determine that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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 2017

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LOCAL AND HOMEMADE IS WHAT WE HAVE IN COMMON, SO WE SUPPORT AND WISH EACH OTHER ONLY THE BEST.

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