2005
Annual Report

Mercator

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To help. To offer your hand. Contribute to a better living. Do whatever is supposed to be done. Take the responsibility. Find satisfaction in work you've done well.

Wherever we showed up in all of these years we tried hard to fulfill our valued beliefs. Without any doubt we can easily say we succeeded in that. We managed to rise up the living standards in Slovenia and bring back hope to our hearts.

We believe our duty is to help and all of those who receive our help already know what repays our efforts. Nevertheless they usually say it with their own words of gratitude. Those humble words are simply "Thank you, Mercator."

That's more than enough for us.

On the Open Door Day of the Children Hospital Mercator prepared a small but pleasant surprise: every participant got delicious presents including the products from the product line "Zdravo življenje" (Healthy Life). Mercator's culinary presents rejoiced the sick children and were a perfect ending of a pleasant day full of cultural, entertaining and sport activities.

Key Events in 2005

Consolidation of operations

— On December 1st 2005, the merger of the companies Mercator - Dolenjska, d. d., Mercator - Goriška, d. d., and Živila Kranj, d. d., with the company Poslovni sistem Mercator, d. d., was duly entered into the Court Register; the Company began the gradual takeover of the retail and wholesale operations of the Companies Mercator - Dolenjska, d. d., and Mercator - Goriška, d. d., already during 2005.

— In 2005, the company Poslovni sistem Mercator, d. d., performed a capital increase in the companies abroad in the total amount of SIT 25,407 million. Furthermore, the company acquired an additional ownership stake in the company Emona Maximarket, d. d., in the sum of SIT 740 million (the ownership in this company on December 31st 2005 thus adds up to 98.95%); it has also bought the shares from minority interest holders in the companies Alpkomerc Tolmin, d. d., in the sum of SIT 456 million (ownership on December 31st 2005 is 97.45%) and the companies Mercator - Goriška, d. d., and Živila Kranj, d. d., in the sum of SIT 111 million.

Retail network development

— Two Mercator Centers were opened - in Zadar (Croatia) and Čačak (Serbia and Montenegro).

— Three trade centers were opened - in Ajdovščina, Idrija and Dobrinja (Bosnia in Herzegovina) - as well as an expanded trade center in Grosuplje.

— Eight Hura! discount stores were opened in Novo mesto, Šempeter in Savinjska Dolina, Gornja Radgona, Črnomelj, Žalec, Brežice, Jesenice and Dravlje in Ljubljana.

— Supermarkets, self-service stores and superettes were opened in Vrhnika, Mislinja, Kočevje, Srednjaci (Croatia), Zemuno (Serbia and Montenegro); an expanded superette was opened in Ljubljana and two renovated stores were opened in trade centers Vrhnika and on Parmova Street in Ljubljana; Mercator web store was transferred to this location.

— A renovated department store was opened in Krško and Velika Gorica (Croatia).

— New and renovated Mercator specialized stores were opened: furniture store in Kranj, Intersport Savski otok in Kranj and in Ljubljana, Modiana in Celje and a technical apparel store in Hrastnik.

Expansion of operations through capital connections

— Based on the preliminary agreement, the management boards of the companies Poslovni sistem Mercator, d. d., and Era, d. d., signed the agreement on acquisition of Era's trade network in Croatia, through the subsidiary undertaking Mercator - H, d. o. o. The investment sum was SIT 11 billion, comprising the acquisition of the companies Era Tornado, d.o.o., Trgohit, d. o. o., and a real-estate - the Samobor Shopping center. The companies also signed the agreement on the purchase of the Skopski Sejem complex, with the intent to expand the business operations in Macedonia. The investment sum totaled to SIT 120 million.

— In September 2005, the company Poslovni sistem Mercator, d. d., purchased a business stake in the company Investment International, d. o. o., with headquarters in Skopje, thus acquiring another piece of land in Skopje for the purpose of expanding the trade operations in Macedonia. By purchasing this estate for SIT 2,407 million, the company acquired 50,153 m^2 of landed estate.

— On October 27th, the company Poslovni sistem Mercator, d. d., purchased a 51% stake of the company Savski otok, d. o. o., at the price of SIT 791 million; thus, the Mercator Group became a 100% owner of the company Savski otok, d. o. o., which comprises the shopping center in Kranj.

— Following the endorsement at the Shareholder Assembly of Era, d. d., on November 2nd 2005, the Management Boards of Mercator, d. d., and Era, d. d., signed on December 22nd 2005 the agreement on successive purchase of retail, wholesale and technical apparel units in Slovenia, along with pertaining inventory; the purchase was finalized by January 31st 2006. Mercator also took over all employees of retail units and warehouses. By this acquisition, worth SIT 14 billion, Mercator gained approximately 84,000 m^2 of gross facilities (66,000 m^2 retail and 18,000 m^2 wholesale), or 47 shops with market program, 12 technical apparel stores and 3 warehouses, while also assuming the rights and liabilities from financial leasing contracts and lease agreements for a total of 7 facilities in the total value of SIT 3.6 billion.

Company management

— In June 2005, the members of the Worker's Council of the company Poslovni sistem Mercator, d. d., for the period 2005-2009 were elected. Mrs. Nevenka Rajhman was elected the Council president and Mr. Dušan Gnezda Šuligoj was elected the Worker's Council vice president.

— On August 30th 2005, 11th Shareholder's Assembly meeting of the company Poslovni sistem Mercator, d. d., was held; in line with Article 31, Section 2 of the company By-Laws, the number of Supervisory Board members was increased to 12. As representatives of the shareholders, whose term began on October 30th 2005, the following members were elected: Mr. Matjaž Božič, Mr. Gorazd Čuk, Mr. Dušan Mohorko, Mr. Kristjan Sušinski, Mr. Robert Šega and Mrs. Mateja Vidnar.

— The first Supervisory Board meeting of the company Poslovni sistem Mercator, d. d., was held on November 15th 2005. The agenda included the constitution of the new Supervisory Board, election of Mr. Robert Šega as the Chairman, and Mr. Gorazd Čuk as vice-president, while Mrs. Vera Aljančič Falež, Mrs. Ksenja Bračič, Mr. Jože Cvetek, Mrs. Dragica Derganc, Mrs. Jelka Žekar and Mr. Ivica Župetič were elected as employee representatives. The Supervisory board ousted Mr. Zoran Jankovič from the post of the Management Board president of the company Poslovni sistem Mercator, d. d., on the grounds of other economic - business reasons.

— On December 13th 2005, the 2nd regular Supervisory Board meeting of the company Poslovni sistem Mercator, d. d., took place. The Supervisory Board recalled the remaining Management Board members on the grounds of other economic-business reasons: Mr. Stanislav Brodnjak, Mr. Aleš Čerin, Mrs. Jadranka Dakič and Mr. Marjan Sedej. Furthermore, the Supervisory Board adopted the new Management Board Statute of the company Poslovni sistem Mercator, d. d., and appointed the new president of the Management Board, Mr. Žiga Debeljak, and other Management Board members: Mrs. Vera Aljančič Falež, Mrs. Mateja Jesenek and Mr. Peter Zavrl; their term began on January 1st 2006. Upon appointment to the Management Board, Mrs. Vera Aljančič Falež resigned her post as the member of the company Supervisory Board.

Marketing activities

— At the award ceremony of the 2nd Slovenian Festival of Communication Efficiency "Effie", held on January 20th 2005, Mercator was awarded the Bronze Effie Medal for its campaign "Zdravo življenje - Zdravo je pravo' ("Healthy Life - Healthy is the way to go").

— On February 1st 2005, Mercator introduced the green credit card Mercator Pika in the Croatian market and enabled payment by Mercator Pika cards in the Maximarket department store, as well as in retail units of Mobitel, the new "Pika" partner.

— On February 14th 2005, Mercator successfully organized the Sixth Marketing Days of Mercator, a traditional meeting of Mercator management with its strategic partners.

— In June 2005, Mercator introduced new benefits for the holders of golden Mercator Pika card, by enabling convenient shopping via telephone.

— On August 1st 2005, Mercator introduced the green credit card Mercator Pika in Serbia and Montenegro and Bosnia and Herzegovina; thus, the card became international.

Communication with employees

— The traditional Mercator Day, the central festivity of the Mercator Group employees, took place on June 18th 2005 in Bled. It was attended by 18,000 employees with their close family members.

— On December 17th 2005, the traditional meeting of Mercator employees, called "The ultimate party" ("Žur vseh žurov"), took place at the Ljubljana fair and exhibition center "Gospodarsko razstavišče".

Socially accountable action

— In line with our value of a socially accountable company, Mercator joined in January 2005 the Slovenian Red Cross campaign to raise aid for the deprived families in SE Asia.

— In April 2005, the business community proclaimed Mercator the most reputable company in Slovenia.

— In August 2005, Mercator joined forces with the Council of Republic of Slovenia for Safety and Education in Road Traffic to present an educational campaign "Lumpi's Safe Way to School". The campaign that has lasted for more than a year seeks to teach the children about the importance of appropriate conduct in road traffic and to warn others of the presence of children therein.

— In September 2005, Mercator started its central humanitarian project this year, called "Reading Brings Together"; the intent of the project is to spread the reading habits and culture among the young. The project will be carried on in 2006.

— On October 17th 2005, the Finance daily paper awarded Mercator's 2004 Annual Report the first prize and the title of the best Annual report among the 53 competing companies in Slovenia.

— On December 23rd 2005, Mercator signed the agreement on donation to the Marcus library in Ljubljana, thus extending the central humanitarian project of 2005 into the current year.

— In 2005, the Mercator Group invested SIT 822 million into corporate environment (especially employee education and meetings with various segments of the public) and SIT 707 million into its broad business environment (primarily sports and donation to societies, foundations and other institutions).

Financial operations

— On February 10th 2005, the bonds of the company Poslovni sistem Mercator, d. d., under the trading code MEO1, were listed on the free market of the Ljubljana Stock Exchange, d. d.

— On September 30th 2005, the shares of the company Poslovni sistem Mercator, d. d., were listed in the prime quotation of the Ljubljana Stock Exchange, d. d.

Issuance of new shares

— On its 23rd meeting held on July 19th 2005, the Supervisory Board of the company Poslovni sistem Mercator, d. d., unanimously adopted the proposal of capital increase by issuing new shares from authorized capital. Company registered capital can thus be increased by issuing up to 641,700 shares at the price of SIT 38,000 per share, which means an increase of up to SIT 24.4 billion.

— In September 2005, the selected shareholders, i.e. the company Kapitalska družba pokojninskega in invalidskega zavarovanja, d. d., Slovenska odškodninska družba, d. d., KD Group, d. d., and the company management, were invited to take part in the capital increase of the company Poslovni sistem Mercator, d. d.; all invited companies confirmed by the relevant deadline that they would take part in the capital increase which was completed on January 31st 2006.

— On October 27th 2005, the company Kapitalska družba, d.d., paid the sum of its capital increase share, SIT 4,064,100,000 for 106,950 new shares; on October 28th 2005, the company KLM, d. d., paid the sum of its capital increase share, SIT 1,546,600,000 for 40,700 new shares; On December 15th 2005, the company Slovenska odškodninska družba, d. d., paid the sum of its capital increase share, SIT 4,089,153,037.50 for 106,950 new shares.

Events affecting business operations

— On April 21st 2005, the Constitutional Court of Republic of Slovenia adopted the resolution that the Act amending the Trade Act, which restricts the retail facilities opening hours to ten Sundays per year, shall come into force on January 1st 2006.

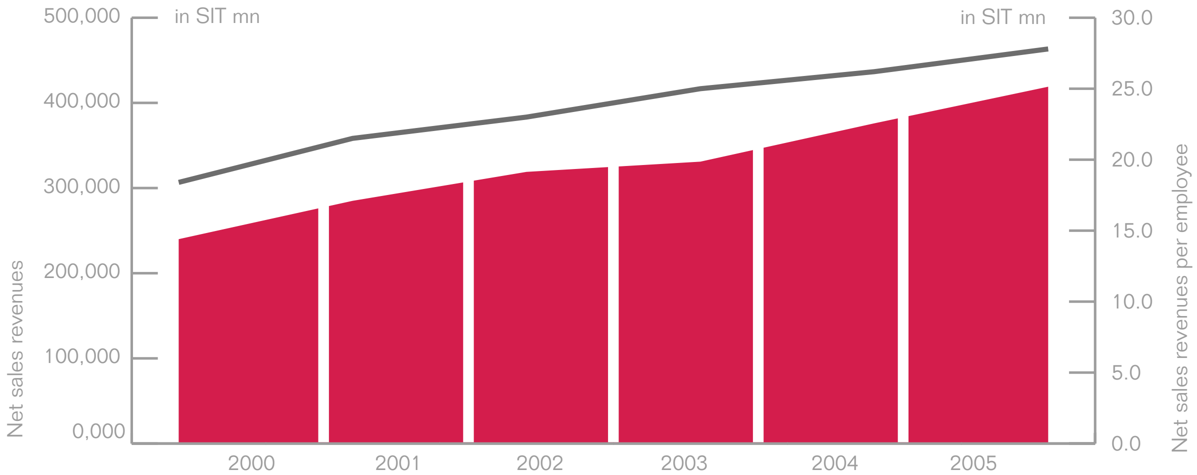
— On June 30th 2005, the Ljubljana Municipal Council approved the draft of the decision on physical plan for the expansion of Mercator Center in Šiška.

Financial Highlights of 2005

Item		Group Mercator
Year	**2005**	**2004**
Net sales revenues (in SIT mn)	419,067	376,969
Net profit/loss (in SIT mn)	3,265	5,012
Gross cash flow from operating activities (in SIT mn)	26,624	22,265
Capital expenditure (in SIT mn)	57,062	25,258
Long-term financial investment (in SIT mn)	9,498	3,683
Return on equity	2.7 %	4.5 %
Return on sales	0.8 %	1.3 %
Market share in Slovenia	45.0 %	41.0 %
As at	**Dec. 31st 2005**	**Dec. 31st 2004**
Number of employees	16,372	15,564
Number of companies in the Group	18	17

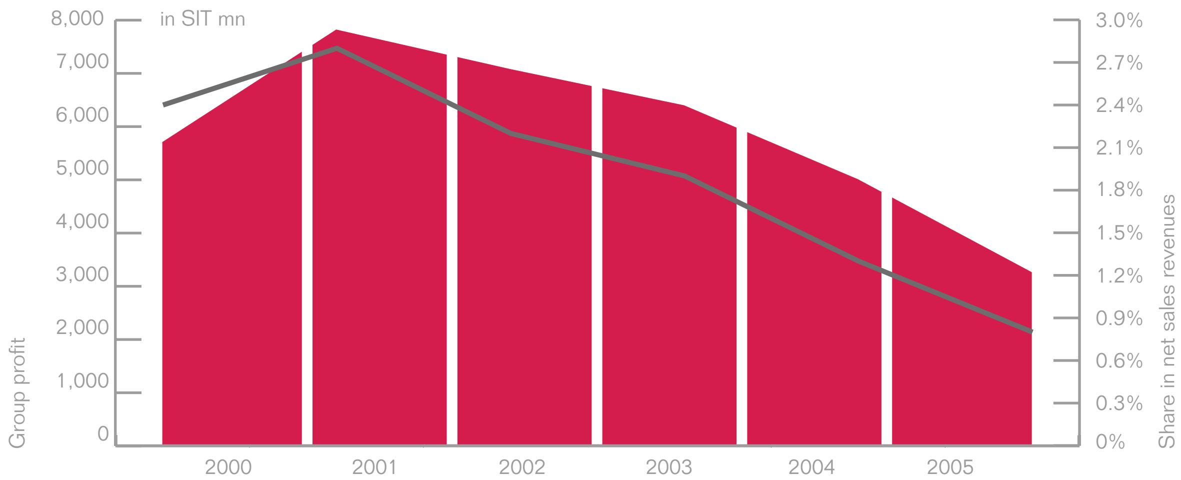
Development Indicators for the Mercator Group

Net sales revenues



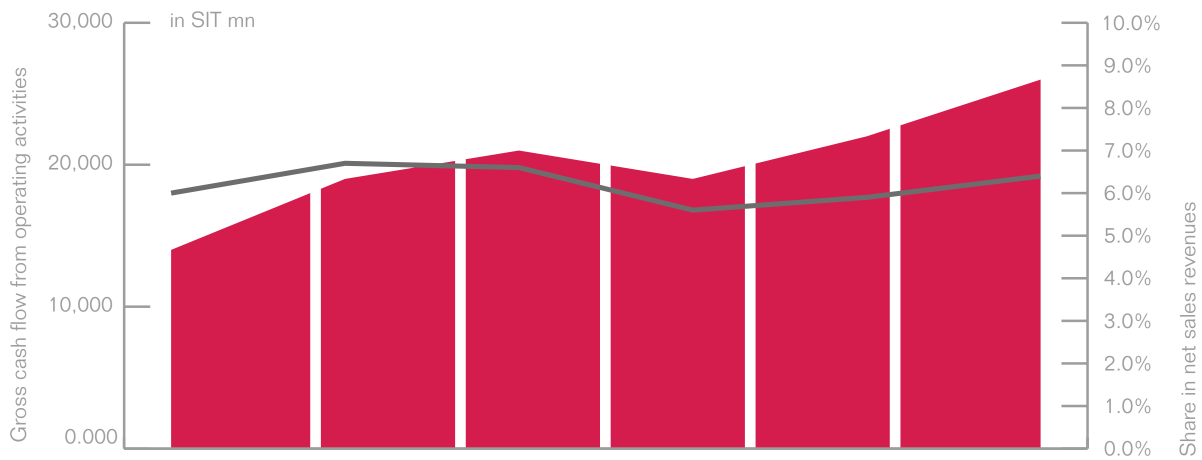
	2000	2001	2002	2003	2004	2005
Net sales revenues	240,040	285,675	319,777	331,502	376,969	419,067
Net sales revenues per employee	18.4	21.5	23.0	25.0	26.2	27.8

Group profit



	2000	2001	2002	2003	2004	2005
Group profit	5,710	7,824	7,082	6,401	5,012	3,265
Share in net sales revenues	2.4%	2.8%	2.2%	1.9%	1.3%	0.8%

Gross cash flow from operating activities

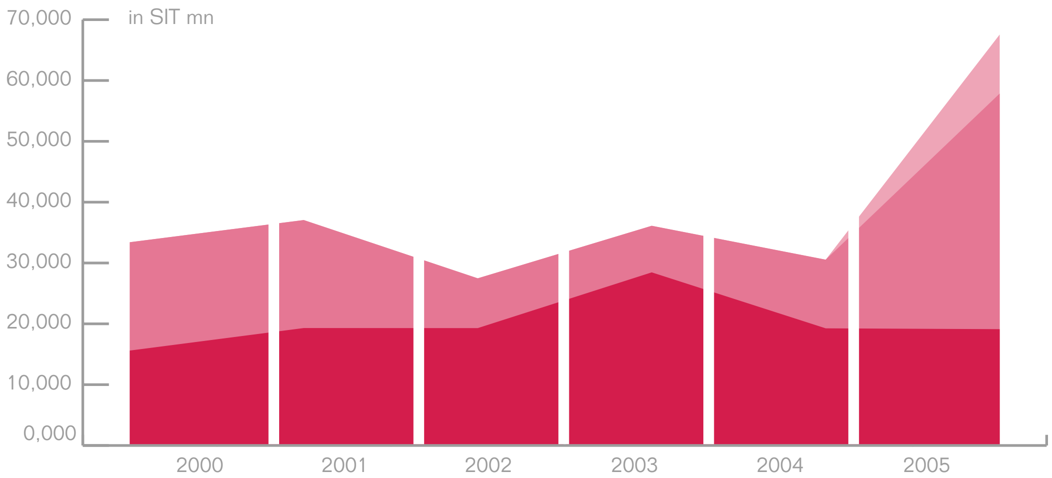


2000	2001	2002	2003	2004	2005	
14,296	19,105	20,952	18,630	22,265	26,624	Gross cash flow from operating activities
6.0%	6.7%	6.6%	5.6%	5.9%	6.4%	Share in net sales revenues

Capital expenditures and long-term financial investments

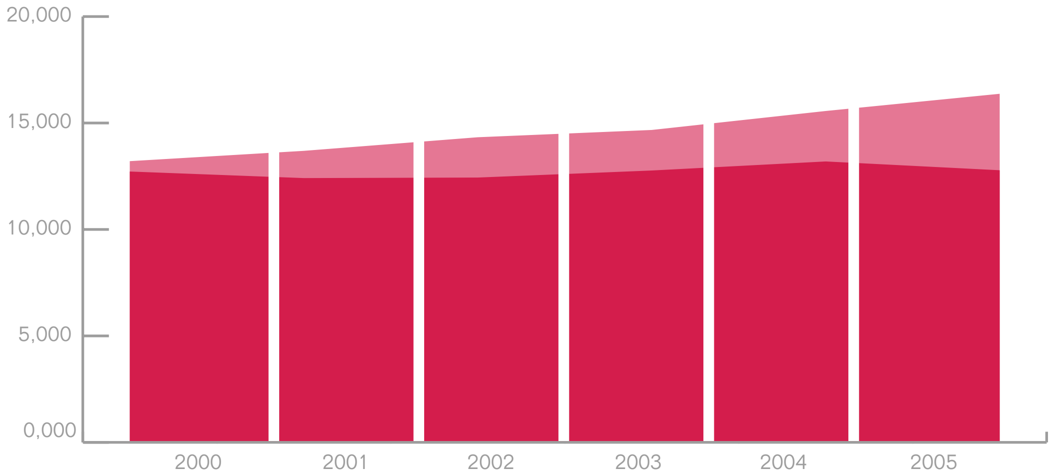
2000	2001	2002	2003	2004	2005	
26,887	30,659	24,962	28,913	25,258	57,062	Capital expenditures
6,527	5,438	1,235	5,759	3,683	9,498	Long-term financial investments

Investment and financing sources



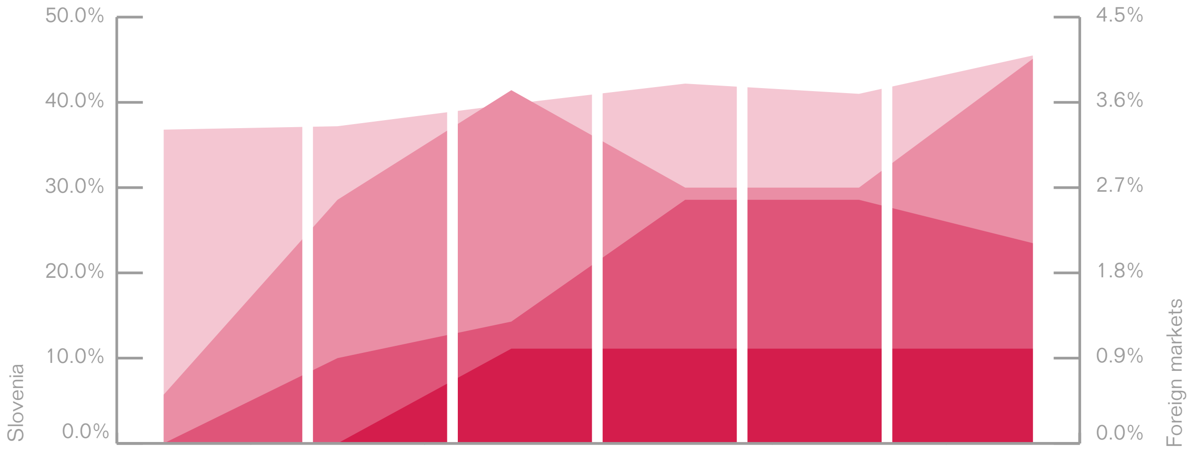
	2000	2001	2002	2003	2004	2005
Internal financing sources	15,602	19,307	19,295	28,459	19,258	19,122
External financing sources	17,812	17,752	8,185	7,657	11,287	38,734
Capital increase	0	0	0	0	0	9,700

Number of employees



	2000	2001	2002	2003	2004	2005
Slovenia	12,721	12,413	12,438	12,769	13,194	12,781
Foreign markets	487	1,279	1,893	1,904	2,370	3,591

Market share



2000	2001	2002	2003	2004	2005
36.8	37.2	39.8	42.2	41.0	45.0
0.4	2.0	2.9	2.1	2.1	4.0
0	0.7	1.0	2.0	2.0	2.0
0	0	1,0	1.0	1.0	1.0

Slovenia
Croatia
Bosnia and Herzegovina
Serbia and Montenegro

*Note: In 2005, Mercator holds around 45% market share in Slovenia, while the share in the Croatian market - including the acquired companies Era Tornado and Era Trgohit - is estimated at 4%. Mercator's market share in Bosnia and Herzegovina according to the analysis of the company GfK, amounts to 2% at the and of 2005. Mercator's market share in Serbia and Montenegro at the end of 2005 amounts to 1%.

Source: GfK, 1997-2005

Brief Background of the Group

The story of Mercator goes back to the year 1949, with the incorporation of the wholesale trading company Živila Ljubljana, the predecessor of today's company Poslovni sistem Mercator, d. d.

The year 1953 saw the commencement of business of the company named Mercator, a wholesale trading company with the head office in Ljubljana. Fundamental feature characterizing the Mercator development until the early nineties was a series of interest-based integrations between smaller local trading, industrial, agricultural, catering and service companies, whereby all merging members still retained their independence as legal subjects.

In the year 1990 Mercator was registered as the company Poslovni sistem Mercator, d. d., incorporated by the formerly allied companies by the non-redeemable transfer of capital to the parent company; that meant the commencement of its holding organization.

The year 1993 was marked by the commencement of privatization, with the public sale of shares: by its scope and the value of capital this was the largest privatization in Central Europe.

In October 1995 the company Poslovni sistem Mercator, d. d., was entered into the Court Corporate Register as a joint-stock company with private ownership.

The year 1997 signifies a milestone in the business of the company, as it had become one of the most successful companies on the territory of former Yugoslavia. The company Poslovni sistem Mercator, d. d., which had until the year 1997 operated at loss and had no real vision, appointed a new Board of Directors with Mr. Zoran Janković as the President. With the commencement of their term of office this management team adopted an ambitious strategic development plan: cut short the negative trends from the past, and create the best commercial trading company in the country, comparable to the largest European and global commercial trading chains.

The period 1998-2003 was marked with the processes of internal restructuring, and processes required for the integration of Slovenian alimentary and general commerce. These activities entailed economization and business efficiency, dedicated appearance on the market, and intensified development of retail network and marketing activities, comprising the aggressive capital integrations and mergers and acquisitions of trading companies, at first mostly in Slovenia, and later spreading to the neighboring markets with the incorporation of associated undertakings in Croatia, Bosnia and Herzegovina, and Serbia and Montenegro. Currently we are the leading retailer at the territory of former Yugoslavia.

The year 2004 saw the entry of Slovenia in the European Union. In spite of austere market circumstances, Mercator concluded the year with success, realized record revenue figures, increased market shares at all markets, and was ranked 32 in terms of revenues among all companies in ten new European Union Member States.

In the year 2005 two events stigmatized the events on the Slovenian market, with direct consequences on the operations of the Mercator Group: amendments of the Trade Act related to retail outlet Sundays & Holidays opening hours and the appearance of a foreign discount retail chain to the Slovenian market, increasing the competition on the market. During the year the company recorded changes in ownership structure, changed membership in Supervisory Board, and the appointment of new company Management.

Successful cooperation with the Slovenian Red Cross proves that Mercator tries to improve the quality of life also outside its markets. At the time of the catastrophic earthquake in Southeast Asia Mercator joined the international humanitarian aid and made a large donation.


SLOVENIJE

Report of the Management Board President

Dear Shareholders!

The year 2005 was a dynamic year for Mercator, and marked with changes both in the exterior and interior business environment. In spite of that, Mercator had successfully realized its mission and with its operations contributed to the increased satisfaction of its customers, business partners, associates and other interest groups.

The paramount element with the important impact on changes in the exterior business environment was the adoption of the Trade

Act. The amended Trade Act entering into force at the beginning of the year 2006 considerably reduces the opening hours of retail outlets on Sundays and holidays. Although the Federal Constitutional Court currently withheld the application of the Trade Act provision, the final outcome of this legal document is still vague. In Mercator we believe and hope that the final ruling of the FCC will provide our customers the freedom of choice whether and when to satisfy their shopping needs, and us retailers will make every effort to meet their exigencies, in agreement with our retail staff and with relevant adjustments in the opening hours of our shops. In addition to the described amendments in legal regulations, the year 2005 saw the appearance of a new foreign competitive player entering the Slovenian market with a chain of discount retail outlets. Counter measures to the expected new competition had already started in Mercator in the year 2004, with the development of our discount retail chain called Hura!, which will be aggressively developed in the future, offering our loyal customers the choice of shopping in discount retail shops.

In the year 2005 the focus of our attention was again the customer who with its loyalty to Mercator proves that we are on the right track. As the largest retailer on Slovenian market, and a retailer who has been successfully spreading to new markets we again proved that the wishes and requirements of our customers are by far our first priority, and that our retail services and selection of products are at the topmost level. In addition to this, in the year 2005 the Mercator Pika credit card has become international - the system accepts the Card on all markets where we are present. We have also strengthened the line of products under the Mercator brand, and we have introduced numerous new products. In the future we intend to continue devoting major attention to the development and enhancement of our selection of products, along with the most convenient bargain prices for our loyal customers.

The year 2005 will also be remembered for intensive investment activities. In Slovenia we opened new trade centers in Ajdovščina and Idrija, enlarged the trade center in Grosuplje, opened eight Hura! Discounts, and carried numerous other restructurings of retail outlets. In Croatia we opened new Mercator Center in Zadar, and also Mercator center Čačak in Serbia and Montenegro, as well as the trade center Dobrinja in Bosnia and Herzegovina. During the year 2005 the company took over the retail operations of Era in Croatia, and by the end of January 2006 also its wholesale and retail operations in Slovenia. By these development and investment projects the company further strengthened its market position in Slovenia, as well as in all new markets where we are currently present.

Long term partnership with our suppliers also remains one of our important competitive advantages. Our joint strategies and expectations have been upgraded in the year 2005 with the purpose of enhancing the satisfaction of our customers.

Mercator would definitely not be able to realize all its achievements without the loyalty and zeal of its employees. We are well aware that only well trained, professional and kind employees in all areas of operations can result in satisfied customers and outstanding business results.

In the area of social accountability in the year 2005 the company was involved in the projects carried out throughout the environment of its operations. In January we joined team activities of the Red Cross to collect help for the Southeast Asia disaster. In August in collaboration with the Council for the Safety and Education in Road Traffic we accompanied children in their project "Lumpi's safe way to school", and our central humanitarian action "Reading Brings Together" had a general purpose of spreading and enhancing the overall reading culture. In addition to the above, the company participated in numerous other areas, thereby reinforcing our accountable attitude towards the social and natural environment.

The Shareholder's Assembly held on August 30, 2005 appointed new Supervisory Board of the company, commencing their term of office upon the expiry of the preceding one, and at the year end appointing the new Management Board of Mercator, d. d.

We are entering the year 2006 with clear and focused strategy of further development of the Mercator Group. Our vision is to become the leading retailer of alimentary and daily consumption products for households (market program) in the region of Southeast Europe.

We see our mission also in creating new value for all our key partners and interest groups participating in the co-creation of business achievements: our customers, employees, business partners, owners, and broad social environment. For customers, we will create benefit with retail service excellence, top quality of goods, and competitive prices. To our employees we wish to provide safe and pleasant working ambient, and the opportunity of personal and professional advancement. We will enhance benefits for suppliers by collaborating in the development of high quality and original products, and by creating possibilities of growth both in Slovenia and on foreign markets. In addition, in all our areas of operations we will continue to cultivate responsible attitude towards the natural and social environment, and strictly follow the principles of corporate ethics and social values. And last but not least, we will create new value for owners with profitable business operations, providing growth, increasing cost efficiency, and improvements in the asset management efficiency.

In line with the strategic objectives in the period 2006-2010 Mercator will remain the largest retailer in Slovenia. In key new markets - in Croatia, Serbia and Montenegro, and Bosnia and Herzegovina - we wish to attain the leading market share, and the position of the first or the second retailer in the respective country. We plan to achieve this both by the continued development of our own network of retail outlets, and by entering into eventual strategic integrations with local trading partners.

Resolute and committed, we approach new possibilities that the future will bring. Supported by the trust that you, dear shareholders, vest in us, we shall fulfill our mission and attain our goals!

Ljubljana, March 28th 2006

Žiga Debeljak, M. Sc.B.A.
President & CEO

Supervisory Board Report

Activities of the Supervisory Board

In the year 2005 the operations of the company Poslovni sistem Mercator, d. d., the parent company of the Mercator Group, was supervised by the Supervisory Board in accordance with legal regulations and relevant company statutes and By-Laws. The Supervisory Board held seven regular meetings of which two were attended by new supervisors appointed during the year 2005. Several members of the Board representing both the capital interests and interests of employees terminated their term of office in October.

Until October 29th, the Supervisory Board consisted of the following supervisors: Mr. Janez Bohorič, Chairman, and members: Mrs. Vera Aljančič Falež, Mrs. Ksenija Bračič, Mr. Jože Cvetek, Mrs. Dragica Derganc, Mr. Matjaž Gantar, Mr. Vladimir Jančič, Mrs. Morena Kocjančič, Mr. Marjan Somrak, and Mr. Branko Tomažič.

In accordance with the resolution adopted by the Assembly the number of supervisors was increased from 10 to 12, with the following new supervisors - representatives of capital - appointed at the 11th regular annual meeting of the Shareholder's Assembly held on August 30th, 2005: Mr. Robert Šega, Mr. Matjaž Božič, Mr. Gorazd Čuk, Mr. Dušan Mohorko, Mrs. Mateja Vidnar, and Mr. Kristjan Sušinski. Representatives of the employees, namely Mrs. Vera Aljančič Falež, Mrs. Ksenija Bračič, Mr. Jože Cvetek, Mrs. Dragica Derganc, Mrs. Jelka Žekar, and Mr. Ivica Župetić were appointed at the Workers Council of the Group held on October 19th, 2005. All members of the Supervisory Board commenced their term of office on October 30th, 2005. Following her appointment as the member of the Management Board Mrs. Vera Aljančič Falež resigned as the company supervisor on December 13th, 2005.

Supervisory Board meetings in the year 2005 were held as follows: on February 22nd, April 12th, May 10th, July 19th, August 23rd, November 15th, and December 13th.

At these meetings the Supervisory Board was reviewing and discussing current business performance, asset management of the Company and the Group, current investment activities, acquiring sources of financing, and realization of resolutions adopted by the Supervisory Board.

Major resolutions adopted by the Supervisory Board

During the year 2005 the Supervisory Board discussed current business performance, among them the non-audited financial statements for the year 2004 for the company Poslovni sistem Mercator, d. d., and for the Mercator Group, and reviewed the business results of the company Poslovni sistem Mercator, d. d., and the Mercator Group for the periods I-III 2005, I - VI 2005 and I-IX 2005.

In addition to the above the Supervisory Board also discussed other current matters and adopted the following important resolutions:

— Determined performance related bonuses to the Management for successful work in the year 2004, and submitted the proposal for the appointment of merger auditor in the merger proceedings of the companies Mercator - Goriška, d. d., and Živila Kranj, d. d., to the company Poslovni sistem Mercator, d. d.;

— Reviewed and approved the Annual Report of the company Poslovni sistem Mercator, d. d., and of the Mercator Group for the year 2004 with the audited financial statements, and approved the proposal for the allocation of distributable net profit for the year 2004, acknowledged the Investment Report for the year 2004, and proposed the performance related bonuses to the Supervisory Board for successful work in the year 2004 which was later approved at the Shareholder's Assembly;

— Adopted merger reports for companies Mercator - Dolenjska, d. d., Mercator - Goriška, d. d., and Živila Kranj, d. d., to the company Poslovni sistem Mercator, d. d.;

— Acknowledged the conclusion of four preliminary agreements with the company Era, d. d., by which the company Poslovni sistem Mercator, d. d., acquired additional business space in Slovenia, in Croatia, and in Macedonia, adopted the resolution for capital increase of the company disbursed from approved capital, and approved the call of the 11th regular annual meeting of the Shareholder's Assembly;

— At the first regular meeting with new members, held on November 15th, 2005, the Board elected Mr. Robert Šega as Chairman of the Board and Mr. Gorazd Čuk as Deputy Chairman, and recalled Mr. Zoran Jankovič from the position of the President of the company Poslovni sistem Mercator, d. d. In addition the Board acknowledged the information regarding marketing strategies and successful business operations of Mercator compared to the largest European retailer chains and competitive retailers on the territory of Slovenia, Croatia, Serbia and Montenegro, Bosnia and Herzegovina, and Macedonia, acknowledged the results of the conducted survey regarding the satisfaction of the shareholders of the company Poslovni sistem Mercator, d. d., with the report regarding current process of capital increase, and adopted the amendment of Article 12 of the company By-Laws determining the share capital of the company;

— On December 13th, 2005 the Supervisory Board acknowledged Risk Management Report of the Mercator Group for the year

2005, adopted the Report of merger of the company Savski otok, d. o. o., to the company Poslovni sistem Mercator d. d., and acknowledged the takeover of retail operations of the Era Group and its impact upon the market share of the Mercator Group on the particular markets of retail operations. On this meeting the Supervisory Board recalled Mr. Stanislav Brodnjak, Mr. Aleš Čerin, Ms. Jadranka Dakič, and Mr. Marjan Sedej from their positions as members of the Management Board of the company Poslovni sistem Mercator, d. d., acknowledged and approved the text of the agreements regarding mutual relationships and cancellation of employment contracts for the recalled President and members of the Management Board, and appointed Mr. Žiga Debeljak as the President of the company Poslovni sistem Mercator, d. d., and upon his proposal appointed Mrs. Vera Aljančič Falež, Mrs. Mateja Jesenek, and Mr. Peter Zavrl as members of the Management Board.

Semi-Annual and Annual Report for the year 2005

On the regular meeting held on August 23rd, 2005 the Supervisory Board acknowledged the non-audited Semi-Annual Report of the parent company and of the Group for the period I - VI 2005. Summary of the non-audited semi-annual report was published by the parent company in line with the legal requirements and with the Rules and Regulations of the Ljubljana Stock Exchange.

On the regular meeting held on February 27th, 2006 the Supervisory Board reviewed and discussed the non-audited financial statements of the parent company and the Group for the year 2005 with brief explanations, and the parent company published the non-audited financial statements in line with the legal requirements and with the Rules and Regulations of the Ljubljana Stock Exchange.

On the regular meeting held on April 11th, 2006 the Supervisory Board reviewed and discussed the audited non-consolidated and consolidated Annual Report for the year 2005, audited by the auditing company PricewaterhouseCoopers, d. o. o., Ljubljana. The meeting of the Supervisory Board was attended by the certified auditor who supplied the requested verbal explanations to the Supervisory Board. On March 28th, 2006 the auditing company issued positive opinion to the non-consolidated and consolidated Annual Report of the company. The Supervisory Board had no comments to the Auditor's Report and approved it.

Consequently, the Supervisory Board had no comments or objections to the Annual Report of the company Poslovni sistem Mercator, d. d., and of the Mercator Group for the year 2005 submitted by the company management, and unanimously approved it at its regular meeting held on April 11th, 2006.

Proposal for the allocation of distributable net profit

By approving the Annual Report for 2005 the Supervisory Board also approved the allocation of distributable net profit in accordance with the competencies of the Management Board and the Supervisory Board.

Net profit for the year 2005 in the amount of SIT 1,250,975,458.42 was used for the allocation of reserve for own shares, while half of the remaining net profit for the current year in the amount of SIT 2,127,778,929.88 was allocated to other reserves from profit.

Proposed allocation of distributable net profit amounting on December 31st, 2005 to SIT 2,127,778,929.87 is as follows:

— Part of the distributable net profit in the amount of SIT 2,113,660,800.00 deriving from undistributed profit for the year 2005 shall be allocated for the payment of dividends in gross amount of SIT 600.00 per ordinary share;

— Remaining portion of the distributable net profit for the year 2005 in the amount of SIT 14,118,129.87 shall be allocated to other reserves from profit.

The Supervisory Board approved the above allocation of the distributable net profit, considering it to be in line with the strategic objectives, investment plans, and the dividend and fiscal policy of the Company and the Group.

The present Supervisory Board Report has been drawn in accordance with the provisions of Article 274.a of the Commercial Corporations Act, for the purpose of being used at the Shareholder's Assembly.

Ljubljana, April 11th 2006

Robert Šega, M.Sc.B.A.
Supervisory Board Chairman

General Information

Full name	**Poslovni sistem Mercator, d. d.**
Abbreviated name	Mercator, d. d.
Activity	G 52.110
	Retail in non-specialized
	food retail outlets
Identification number	5300231
VAT Tax Code	45884595
Court registry number	1/02785/00
Court registry date	12 October 1995
Share capital of the Company as at Dec. 31, 2005	SIT 33,561,540,000.00
Nominal value of one share	SIT 10,000
Number of shares quoted at the Ljubljana Stock Exchange as at Dec. 31, 2005	3,208,504
Number of shares entered in the Court Register as at Dec. 31, 2005*	3,356,154
Share listing	Ljubljana Stock Exchange
	Official market, trading code MELR
President of the Management Board and CEO	Žiga Debeljak
Management Board Members	Vera Aljančič Falež, Mateja Jesenek,
	Peter Zavrl
Chairman of the Supervisory Board	Robert Šega

* Following the issuance and payment of additional shares in the capital increase process, and its entry in the Court Register, the number of shares will amount to 3,590,844.

Organizational Structure of the Mercator Group

Group's Structure

On December 31st 2005, the Mercator Group, which is a group of related companies of Poslovni sistem Mercator, d. d., was composed of the following companies:

Poslovni sistem Mercator, d. d.

Subsidiaries

Trade in Slovenia		Trade in foreign markets		Non-trade	
Mercator - SVS, d. d.	100.0 %	**Mercator - H, d. o. o.**	99.8 %	**Pekarna Grosuplje, d. d.**	75.1 %
Alpkomerc Tolmin, d. d.	97.4 %	**Era Tornado, d. o. o.**	100.0 %	**Belpana, d. o. o.**	100.0 %
Emona Maximarket, d. d.	98.9 %	**Trgohit, d. o. o.**	100.0 %	**Eta, d. d.**	97.3 %
Mercator - Modna hiša, d. o. o.	100.0 %	**Mercator - S, d. o. o.**	100.0 %	**Mercator - Emba, d. d.**	69.2 %
Savski otok, d. o. o.	100.0 %	**Mercator - BH, d. o. o.**	100.0 %	**Mercator - Optima, d. o. o.**	100.0 %
		Mercator Makedonija, d. o. o.	90.0 %	**M Hotel, d. o. o.**	100.0 %

Particular companies of the Mercator Group had no branch offices as at Dec. 31st, 2005.

Group's Activities

The Mercator Group is composed of trade and non-trade companies, operating in production industry, catering and service industry in the year 2005. The company Poslovni sistem Mercator, d. d., is the parent company of a group of related companies (the Mercator Group) and performs a double role:

— Performing trade activities; and
— Carrying out holding company functions for the companies of the Group.

Trade operations

The principal and most extensive operations of the Mercator Group include wholesale and retail of consumer goods. The Mercator Group trade activities are distinguished by the highly diversified sales network, with various store formats in the range of alimentary stores including shopping centers, hypermarkets, supermarkets, department stores, self-service stores, Hura! discount stores, technical hardware stores, textile, cosmetics and sports stores. With diversified sales network and numerous complementary services, offered in our shopping centers, we wish to satisfy the needs, wishes and expectations of all our customers.

We are one of the largest and most successful retail chains in South-East Europe and the leading retail chain in Slovenia, and we have been improving our position on the markets of Croatia, Bosnia and Herzegovina, and Serbia and Montenegro. During the year 2005 we also entered the market of Macedonia. These are rapidly growing markets, where we mostly build large shopping centers in capitals and larger regional cities representing the biggest buying potential in relation to the number of inhabitants, with the objective of obtaining significant market shares in the shortest possible time, and becoming the first or the second retailer at each of these markets.

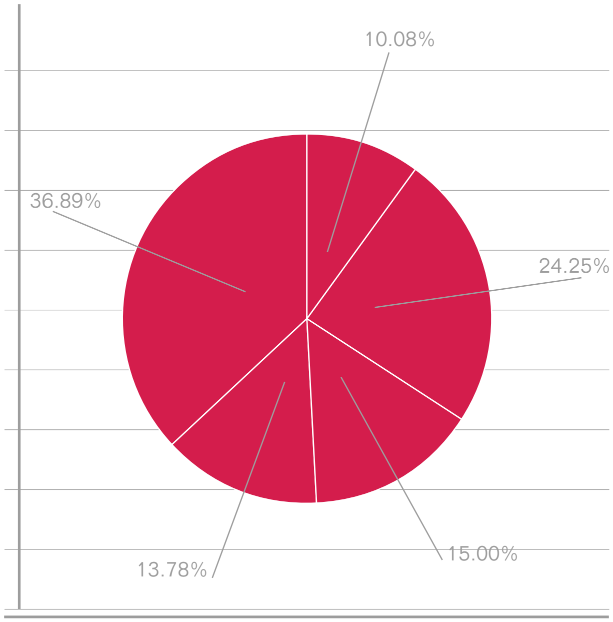
Non-trade operations

In addition to trade companies the Mercator Group is composed also of non-trade companies, operating in production industry, hotel & restaurant business, and service industry. The company Pekarna Grosuplje, d. d., is the leading Slovenian manufacturer of bread and fresh pastry and a 100% owner of the company Belpana, d. o. o., Zagreb, fabricating bread and fresh pastry in Croatia, mainly for the requirements of the Mercator retail network. The company Eta, d. d., produces sterilized and pasteurized garden products, mustard, dips and toppings, in addition to fruit processing, production of stewed fruits and fruit concentrates and frozen products. The company Mercator - Emba, d. d., deals with coffee roasting and packing, manufacturing instant cacao products, desert toppings, cereals, and packing of other products. The company Mercator - Optima, d. o. o., deals with architecture and engineering, and is closely involved in investment activities of the Mercator Group. The company M Hotel, d. o. o., carries on the hotel and restaurant business.

Ownership Structure

On December 31st 2005, the Share Register of the company Poslovni sistem Mercator, d. d., indicated 20,401 shareholders, or 1,458 less than the year before.

Ownership structure of the company Poslovni sistem Mercator, d. d., on December 31st 2005:



Investment funds 10.08%
Individuals 24.25%
Banka Koper, d. d. 15.00%
Slovenska odškodninska družba, d. d. 13.78%
Other legal entities 36.89%

Major shareholders

As at Dec. 31st 2005, the following ten major shareholders owned jointly 55.80 % of the company:

Banka Koper, d. d.	15.00 %
Slovenska odškodninska družba, d. d.	13.78 %
Infond holding, d. d.	7.21 %
Pivovarna Laško, d. d.	4.27 %
Triglav steber I, delniška investicijska družba, d. d.	3.34 %
Istrabenz, d. d.	2.97 %
Sava, d. d.	2.94 %
NFD 1 delniški investicijski sklad, d. d.	2.71 %
Poslovni sistem Mercator, d. d.	2.12 %
Electa, d. d.	1.46 %

As at Dec. 31st 2005, the members of the Management Board recalled during the year 2005 owned the following number of shares:

	Number of shares	Ownership share
Zoran Janković	14	0.00044 %
Stanislav Brodnjak	3,070	0.09568 %
Aleš Čerin	0	0.00000 %
Jadranka Dakič	0	0.00000 %
Marjan Sedej	6,060	0.18887 %
Total	**9,144**	**0.28499 %**

As at Dec. 31st,2005 the members of the new Management Board of the company Poslovni sistem Mercator, d. d., taking the office as at Jan. 1st, 2006 owned the following number of shares:

	Number of shares	Ownership share
Žiga Debeljak	1,100	0.03428 %
Mateja Jesenek	1,000	0.03117 %
Vera Aljančič Falež	30	0.00094 %
Peter Zavrl	60	0.00187 %
Total	**2,190**	**0.06826 %**

As at Dec. 31st 2005, the members of the Supervisory Board of the company Poslovni sistem Mercator, d. d., owned the following number of shares:

	Number of shares	Ownership share
Robert Šega	0	0.0000 %
Mateja Vidnar	0	0.0000 %
Dušan Mohorko	0	0.0000 %
Matjaž Božič	0	0.0000 %
Gorazd Čuk	0	0.0000 %
Kristjan Sušinski	300	0.0094 %
Ksenija Bračič	0	0.0000 %
Jože Cvetek	2,000	0.0623 %
Dragica Derganc	0	0.0000 %
Jelka Žekar	500	0.0156 %
Ivica Županić	0	0.0000 %
Total	**2,800**	**0.0873 %**

Corporate Governance

Corporate governance of the company Poslovni sistem Mercator, d. d., and the group of related companies is based on legal regulations, internal statutes and rules compiled in accordance with the ISO standards and the best practice terms and postulates. Poslovni sistem Mercator, d. d., has a two-tier governance system, which is at present mandatory in Slovenia. According to this system, a company is managed by a management board and supervised by a supervisory board.

Shareholder's Assembly

The Shareholder's Assembly is the body of the company where shareholders exercise their rights related to company matters. The Shareholder's Assembly of the company Poslovni sistem Mercator, d. d., is regularly called by the Management Board of the company, normally once a year. The call of the Assembly is announced not less than 30 days prior to the meeting in the newspaper Delo and in the SEOnet, the electronic information system of the Ljubljana Stock Exchange.

In addition to the time and place of the venue, the call for the meeting of the Assembly must contain details regarding the terms of the attendance of the Assembly, and execution of the voting rights, as well as the detailed agenda with the proposed wording of relevant resolutions to be approved. Voting right at the Assembly is granted to shareholders or their proxies holding relevant written authorizations.

The most important business transacted at the regular annual Shareholder's Assembly include the appointment of company supervisors, allocation of distributable net profit, discharge of the Management Board and the Supervisory Board responsibilities for the current fiscal year, remuneration of the Supervisory Board and the appointment of auditors.

The Shareholder's Assembly for the year 2005 approved the increase in the number of supervisors, and appointed new members of the Board, after the preceding members concluded their term of office.

Supervisory Board

The paramount function of the Supervisory Board of the company is the supervision of company management. Half of the members representing the interests of shareholders are elected by the Shareholder's Assembly, while the members representing the employees are elected by the Workers' Council of the Group in accordance with the Workers Participation in Corporate Governance Act.

Members of the Supervisory Board are elected for a four-year term of office and may be reelected. Pursuant to the legal regulations and the relevant Supervisory Board Rules of Proceedings the Supervisory Board must convene at least once quarterly, or not less than once semi-annually. The Supervisory Board of the company Poslovni sistem Mercator, d. d., holds not less than five regular meetings per year.

Methods of work, call of the meetings, and other matters relevant to the work of the Supervisory Board of the company Poslovni sistem Mercator, d. d., are defined by the company By-Laws and the relevant Rules of Proceedings. In the year 2005 the compensations for attendance at the Board meetings amounted to SIT 80,000.00 net for the supervisors and SIT 100,000.00 net for the Chairman of the Board. In addition, the company supervisors are also entitled to annual performance related bonuses determined and approved by the Assembly.

Members of the Supervisory Board

Prior to October 30th, 2005 the Supervisory Board of the company Poslovni sistem Mercator, d. d., consisted of the following 10 members:

— Representatives of shareholders - Janez Bohorič (Chairman), Matjaž Gantar, Vladimir Jančič, Marjan Somrak, Branko Tomažič;

— Representatives of employees - Ksenija Bračič, Jože Cvetek, Dragica Derganc, Morena Kocjančič, Vera Aljančič Falež.

After October 30, 2005, following the resolution of the Shareholder's Assembly the number of supervisors in the Board was increased from 10 to 12.

As of October 30th, 2005 the Supervisory Board of the company consists of 12 supervisors. As at Dec. 31st, 2005 the Board included the following supervisors:

Chairman of the Supervisory Board	Title and employment
Robert Šega	— Bachelor of Electrical Engineering, Master of Engineering
	— Financial Adviser, company Epakta, d. o. o., Škofja Loka

Members of the Board — representatives of shareholders	Title and employment
Matjaž Božič	— Bachelor of Engineering, MBA
	— Proxy - Vice-President of the company CDE
	New Technologies Inc. Ljubljana
Gorazd Čuk, Deputy Chairman	— Technician in Civil Engineering
	— Consultant to the President of the company
	Istrabenz, d. d., Koper
Dušan Mohorko	— LL.B
	— Independent Attorney at Law, Maribor
Kristjan Sušinski	— Bachelor of Economics
	— Vice-President for Finance, Istrabenz, d. d., Koper
Mateja Vidnar	— Master of Science in Economics
	— Management Board member, investment company
	Zvon ena holding, d. d., Maribor

Members of the Board - representatives of employees	Title and employment
Ksenija Bračič	— LL.B
	— General Administration Director, Mercator - SVS, d. d.
Jože Cvetek	— Bachelor of Economics
	— Finance & Accounting Director, Eta, d. d., Kamnik
Dragica Derganc	— LL.B
	— Legal Office Adviser, Poslovni sistem Mercator, d. d.
Jelka Žekar	— Bachelor of Economics
	— Marketing Director, Poslovni sistem Mercator, d. d.
Ivica Župetić	— Bachelor of Economics
	— Investment Adviser, Mercator - H, d. o. o.

Board Supervisor Ms. Vera Aljančič Falež resigned her term of office in the Supervisory Board on Nov. 13th, 2005 to start the term of office as the member of the Poslovni sistem Mercator, d. d., company management. The Worker's Council has not appointed a new supervisor so far.

Youth Association of Slovenia has been arranging the charity action called "We were all children once" for a few years now. With this kind of action Mercator enables memorable holidays to the children from socially endangered environment. Unforgettable holidays were colourfully described by participant Ana, who described to her mother all sorts of activities and skills that she learned there: swimming, modern dancing, canoeing, aerobics and numerous other activities.

Company Management

Žiga Debeljak
President & CEO
Vera Aljančič Falež
Management Board Member for Human Resources, Organization, Legal and General Affairs
Mateja Jesenek
Management Board Member for Marketing and Purchasing
Peter Zavrl
Management Board Member for Retail, Wholesale and Logistics

The company Poslovni sistem Mercator, d. d., is managed by the Management Board consisting of the President who in turn proposes the appointment of his management team. The Management Board of the company is appointed by the Supervisory Board for the term of office of five years with the option of unlimited reelection. The number of company managers, and their professional duties and powers are defined by the relevant resolution of the Supervisory Board upon the proposal by the President. The Management Board governs the company for the best benefit of the company independently and at personal responsibility.

Members of the company Management

During the year 2005 the Management Board of the company Poslovni sistem Mercator, d. d., consisted of the President, Mr. Zoran Janković (until Nov. 15th, 2005) and four members (until Dec. 13th, 2005): Stanislav Brodnjak, Aleš Čerin, Jadranka Dakič and Marjan Sedej.

Since January 1st, 2006 the Management Board of the company Poslovni sistem Mercator, d. d., consists of the president and three managers for the following five year term of office, as follows:

Žiga Debeljak

President & CEO

Master in Business Administration,
Bachelor of Science in Computers

Duties:

— Coordination of management and the Group;
— Development and Investments;
— IT;
— Finance, Controlling, Accounting, Internal Audit, Investor Relations.

Other functions:

— Member of the Slovenian Economists Association presidency;
— Member of the Slovenian Auditing Institute Expert Council;
— Vice President of the Young Manager Section at the National Manager Association;
— Supervisory Board member of the Ljubljana Stock Exchange;
— Supervisory Board member of the Medvešek - Pušnik, d. d., investment company;
— Member of the Monetary and Finance Institute Council at the Faculty of Economics in Ljubljana;
— Supervisory Board member of the YES, the Young Businessmen Association;
— Supervisory Board member of the MBA Alumni Association, Radovljica.

Vera Aljančič Falež

Human Resources, Organization,
Legal and General Affairs

LL.M

Duties:

— Management of human resources;
— Organization and quality;
— Legal affairs;
— General administration.

Other functions:

Lecturer at Institute for Labor at the Law School in Ljubljana.

Mateja Jesenek

Marketing and Purchasing

Master in Business Administration, Bachelor of Economics

Duties:

— Marketing of products and services;
— Market research and development;
— Purchasing and supplier relations;
— Public relations.

Other functions:

— President of the Slovenian Advertising Association (until 2005);
— Member of the Slovenian Advertising Chamber Executive Board (until 2005);
— Member of the Slovenian Advertising Festival - Organizational Committee (2002, 2003);
— Member of the Young Manager Section Management at the National Manager Association;
— Member of the YES, the Young Businessmen Association;
— Since 2006 member of the Trade Association Executive Board with the National Chamber of Commerce.

Peter Zavrl

Retail, Wholesale, and Logistics

Bachelor of Economics

Duties:

— Retail;
— Wholesale;
— Franchise system;
— Logistics.

Other functions:

— Member of committees and other bodies of the Trade Association with the National Chamber of Commerce
— Since 2006 President of Trade Association;
— Variety of functions in local community;
— Radio Club Kranj Supervisory Board Chairman.

Key terms and conditions for the employment of Management Board members

By the resolution of the Supervisory Board meeting held on December 13th, 2005 members of the Management Board of the company Poslovni sistem Mercator, d. d., were appointed with the term of office of five years, commencing on January 1st, 2006. All members of the Management Board of the company Poslovni sistem Mercator, d. d., concluded the employment contract for the period of five years, corresponding to their respective terms of office.

Monthly gross salary of the members of the Management Board is divided to fixed and variable part. Fixed portion of monthly gross salary for the Board President Mr. Žiga Debeljak amounts to EUR 15,000, and the salary for other members of the Board, namely Ms. Vera Aljančič Falež, Ms. Mateja Jesenek, and Mr. Peter Zavrl, amounts to EUR 12,000. Variable portion of basic salary is determined by the Supervisory Board in the span between 0 % and 30 % of the fixed part, and for the year 2006 amounts to 15 %. Members of the Management Board are also entitled to the performance bonus in accordance with the terms and conditions adopted by the Supervisory Board, and to relevant perks resulting from employment contracts.

Governance of Subsidiaries

The Mercator Group consists of the parent company Poslovni sistem Mercator, d. d., and subsidiary companies in which the parent company directly or indirectly holds the majority of shares or majority of voting rights. The parent company under a single leadership manages the subsidiary companies. Subsidiaries are organized and managed in accordance with mandatory provisions governing the procedures for single management determined by the relevant parent company bodies in accordance with the legal regulations.

The company Poslovni sistem Mercator, d. d., acting as parent company of the Mercator Group applies the governing principle of increasing the financial outcome in each particular subsidiary, as well as the entire Group, controls harmonized development of the Group, organizes optimized supply of goods and services for general consumption at all markets of the Group operations, enhanced competitiveness, efficient governance and coordination of the supply chain, joint appearance at domestic and foreign markets both in purchasing and sales, financing current operations and development of the Group with aggregate funding, and joint liquidity and financial hedging, with maximized profitability in the management of finances and resources.

Whilst in subsidiaries organized as limited liability companies the parent company Management Board performs the function of the Shareholder's Assembly, the subsidiaries organized as joint-stock companies are supervised by the Supervisory Board.

Audit

In today's circumstances of perpetual changes the effective and successful business decisions must rely on prompt and quality information and data. Providing relevant financial information falls into the duties of the Management Board, while the principal purpose of internal and external audit is reasonable reduction of exposure to risks, associated with the preparing of financial information.

These are provided by carrying out the following measures:

- Implementation of consistent conservative accounting policies at the level of the Group;
- Extensive disclosures and explanatory notes;
- Prompt preparation, detailed treatment, and reliable data contents, appropriate for reporting;
- Preparation of financial statements in accordance with Slovenian Accounting Standards (SAS) and International Financial Reporting Standards (IFRS) - from the year 2006 only in accordance with the IFRS; and
- Regular supervision of accounting and controlling processes and other business processes during the internal and external auditing procedures.

Internal Audit

In the Mercator Group an independent supportive Internal Audit Service was established back in the year 2000. It has been operating both within the parent company and at the Group level. The fundamental duty of Internal Audit is ongoing development and review of the internal control systems in terms of the management of operating risks and any other risks to which the Mercator Group is exposed.

The ultimate objective of the Mercator Internal Audit is to assist the top management and inferior level managements to enhance the management of the Mercator Group assets, improve quality, economizing and business efficiency by following the adopted strategy, business policies and financial plans.

The Internal Audit Service carries out regular and extraordinary audit reviews of particular areas of operations in the Mercator Group companies, and co-operates with external auditors. In accordance with the 2005 plan we carried out the audits of selected business processes with the emphasis on the improvement of cost effectiveness.

In the year 2006 we intend to continue the performance of internal auditing in accordance with the internal auditing standards, Internal Audit Rules and Regulations, and the Internal Auditor Professional Ethics Code. Priority assignments of the Internal Audit include the performance of the internal auditing of the optimization of the Group operations program, and the execution of pre-merger audits in subsidiary companies to be merged into the parent company during the year 2006.

External audit

In addition to regular annual audit of financial statements the external audit conducted by an independent auditing company provides professional advice and guidance for improving the internal controls system and management of all types of risks.

Since 1998, the external audit of the Mercator Group has been conducted by the internationally renowned auditing company PricewaterhouseCoopers, d. o. o. A long-term co-operation with the same auditors increases the efficiency and quality of audit, since the auditors are better acquainted with the business processes, character of operations and the associated risks. At the same time the company Poslovni sistem Mercator, d. d., has been implementing the recommendations of the Corporate Governance Code for Public Joint-Stock Companies with regard to the change of auditing partner leading the project and being responsible for the audit.

To ensure complete independence the Mercator Group co-operates with the auditing company PricewaterhouseCoopers, d. o. o., only in the audit of financial statements and annual reports.

Declaration of Conformity with the Joint-Stock Corporate Governance Code

The relevant Statement of Conformity with the Joint-Stock Corporate Governance Code relates to the year 2005.

The Management and the Supervisory Board of the company Poslovni sistem Mercator, d. d., hereby declares that the corporate governance system of the company Poslovni sistem Mercator, d. d., entirely complies with the Public Joint-Stock dated Dec. 14th, 2005, with the following digressions:

Provision 3.4.2 of the cited Code: Criteria for determining remuneration, compensation, and other benefits for the members of the Supervisory Board shall be determined by the resolution of the Shareholder's Assembly or by the relevant company By-Laws. The relevant amounts shall be determined by observing the criteria, such as:

— Scope of duties and responsibilities of the Supervisory Board members,
— Personal performance and activities of individual members of the Supervisory Board;
— Size of the company and complexity of its operations;
— General economic conditions in which the company operates.

The criteria for determining remuneration, compensation and other benefits for members of the Supervisory Board of the company Poslovni sistem Mercator, d. d., have not yet been specified in the Company By-Laws or by the resolution of the Shareholder's Assembly, but the extent of compensations are currently being governed by the relevant criteria for such payments adopted and applied by the relevant association.

2005
Business Report

President of the Paraplegic Association is thanking Mercator in his letter, for organizing all those tournaments, for participation of Slovenian groups on international contests and for the purchase of sport requisites. On the sport field, progress can be seen in conquering the title of the state champion and in addition to all that, the basketball on the invalidchairs is becoming more and more popular. We can say this is also happening because of Mercator's unselfish help.

Business Strategy of the Mercator Group

Business strategy for the next medium-term period

Following is a summary of business strategy of the Mercator Group, which were presented and adopted by the company Supervisory Board on December 13th 2005 upon electing the new Company Management.

Vision

To become the leading retailer with FMCG programme (market programme) in the South - Eastern Europe.

Mission

By way of our business operations, we create:

— benefit for the customers by providing excellent retail services, high-quality goods and competitive prices,

— benefit for the employees by providing a safe and pleasant working environment and a possibility of personal and professional development,

— benefit for the suppliers by taking part in the development of high-quality and innovative products and by providing the possibilities for growth in Slovenia and in foreign markets,

— benefit for the owners/shareholders by attaining a profitable growth of business operations, business efficiency and increasing the company market value,

— benefit for the broad environment by a responsible attitude towards our natural and social environment and by respecting the business ethics and social values in all fields of operation.

Corporate values

We are bound by trust and mutual respect.

Our values are:

— sound teamwork,

— sincere relationships,

— encouraging creativity,

— motivating the fellow workers.

Nobody knows the customer preferences better than we do. Our values are:

— unwavering education at home and abroad,

— constant transfer of knowledge,

— ensuring personal growth and development,

— excellent staff competitiveness.

Our operations are always diligent and transparent at all levels. Our values are:

— competitiveness as the foundation of any partnership,

— accessibility of key information,

— consistency and honesty.

We are expanding with a sound corporate culture. Our values are:

— training key human resources for assuming international tasks,

— understanding the differences and adjusting to local environment.

Strategic policies

1. Largest retailer in Slovenia:

To retain the leading market share of market program in Slovenia, primarily by the following activities:

a. developing and establishing partnerships for new trade and non-trade services, for particular target customer groups;
b. own private label products development and increasing the share of these products in total sales;
c. further development of customer benefit system in order to increase customer loyalty, and further development of direct product and service marketing;
d. selective development and reorganization of retail network by increasing the share of franchise stores in all markets;
e. competitive pricing policy, adjusted to various trade services;
f. providing educated, pleasant and motivated sales personnel.

2. Leading retailer in the neighboring markets of SE Europe:

To become the first or second largest retailer with market program in the markets of Croatia, Serbia and Montenegro and Bosnia and Herzegovina, especially by:

a. strategic partnerships with existing retail chains in target markets;
b. systematic development of retail network in key markets, which will enable taking advantage of regional synergies in logistics, marketing and other activities;
c. development and performance of regionally adjusted marketing activities and establishing regional partnerships in marketing and procurement;
d. development of the franchise system.

3. Entering other SE European markets:

To enter or enable the entrance to other markets in Southeastern Europe, where we could become one of the five leading retailers with market program; this will be attained by:

a. setting up a minimum business facilities to perform development activities (founding a company, key personnel);
b. according to investment possibilities, to gain quality locations for a focused development of our own retail network in the long term;
c. analyze the possibility of strategic partnerships that would enable quick acquisition of a significant market share.

4. Development of non-market programs:

To develop non-market programs that will:

a. enable reaping the potential of positive synergies with market program and/or
b. provide a concept for development of the second fundamental commercial program with a long-term potential of growth and profitability in the target markets.

5. Profitable operation:

Ensure profitable operation by:

a. measures for retaining the level of trade margins:
— systematic development of supplier relations,
— constant adjustment of the sales mix,
— joint product development with suppliers;

b. measures for cost rationalization and increasing the productivity:
— implementing the business operation optimization program for the Mercator Group,

— implementing a standardized integrated business information system,
— optimizing logistic infrastructure in Slovenian market and abroad,
— implementing the category management program.

c. measures for increasing the productivity of invested capital:
— investing the capital in a way that will increase the creative capacity and enable cash flow growth,
— improving management of net working capital
— optimizing finance sources and tax optimization
— sale of assets that are not relevant to business operation.

Strategic goals

1. Growth of net sales revenues from trade

a. average annual organic growth in EUR: 5 %;
b. additional growth by strategic partnerships.

2. Key market shares

a.	Slovenia	40 %;
b.	Croatia	12 %;
c.	Serbia and Montenegro	10 %;
d.	Bosnia and Herzegovina	5 %.

3. Investment and financing sources

a. annual investment in the amount of EUR 130 - 150 million;
b. issuing new capital for forming strategic partnerships/alliances.

4. Successful business performance and efficiency

a. to implement the general business operation rationalization program for the Mercator Group and attain an annual cost reduction of at least EUR 40 million from 2008 forward (disregarding the implementation cost);
b. to implement the Category Management program and save at least EUR 20 million per year from 2009 forward (disregarding the implementation cost);
c. growth of gross cash flow from operating activities should be 1 percentage point higher than net sales revenue growth; furthermore, gross cash flow should additionally increase by one third due to the effect of the General business operation rationalization programme and Category Management, or more in case of strategic partnerships;
d. to achieve at least 1% average annual growth of economic labor productivity in the period 2006-2010;
e. to achieve at least 1% annual productivity growth of invested capital in the period 2006-2010.

Market Circumstances

Adjusting to the stringent competition and market saturation

Trade globalization and consolidation

A characteristic of the markets for daily household consumer products, both in Western and Central Europe, is a high level of concentration and competition; therefore, international trade companies are looking for possibilities to spread to the markets of Southeastern Europe and Asia, where competition and presence of foreign retailers is gradually rising. Due to ever stronger competition, trends that are present in the entire European retail industry are starting to show in Mercator's key markets as well:

1. consolidation,
2. increasing customer price sensitivity or elasticity — increasing importance of private labels,
3. the need of retailers to differentiate — development of complementary services,
4. customer's requirement for convenience and comfort — development of convenience stores on one hand and discounts on the other,
5. development of technology that facilitates shopping at the point of sale, while enabling employees to work more efficiently.

We respond to market saturation in Slovenia by improving competitiveness of our offer and by developing the retail network, whereby we seek to retain the leading market share in market program; at the same time, we also allocate significant effort to continue our extending to the former Yugoslav countries.

The entrance of foreign retailers to Slovenian market, with hard discount stores in the last two years has rendered the pricing very aggressive and the entire situation in the market even more stringent. Mercator is, however, ready for competition growth in this segment; as early as 2004 we presented our Hura! discount stores.

Sunday opening hours

In April 2005, the Constitutional Court of Republic of Slovenia adopted the resolution that the Act amending the Trade Act, which restricts the retail facilities opening hours to ten Sundays per year, was to come into force on January 1st 2006.

In 2005, Mercator has closely analyzed the effects of closing our retail units on Sundays and holidays, on the level of the Mercator Group. We thus studied:

— effects on business operation regarding the sales volume,
— effects on business operation regarding the number of employees,
— reoccurrence of increased shopping abroad.

Considering the established consequences the Court decision would have had on Mercator's operations, we prepared measures that would enable us to continue our successful business performance. There are about 300 Mercator stores that are currently open on Sundays, but would have had to be closed.

However, on February 14th 2006, the Constitutional Court withheld the part of the Trade Act that restricts opening hours of stores selling alimentary and other essential consumer products to a maximum of ten Sundays per year. Thus, stores with essential consumer products shall remain open on Sundays and holidays without any restrictions, until the final Court ruling. However, this is only a partial solution to the problem, as we are still unable to offer our customers the entire sales mix and are restricted to only some product ranges. In Mercator, we strongly believe that administrative restriction of working hours is extremely inappropriate, as it infringes severely with the free economic action, as well as with the agreement between the social partners.

Preparation for the adoption of Euro

In 2004, Slovenia entered the ERM2 system of exchange rates, which is a "waiting room" for adoption of Euro as the national currency, which Slovenia is to do on January 1st 2007. As the adoption is a demanding project, Mercator assigned a special project team at the end of 2005. First, the emphasis lay on the preparation for double pricing imposed by the Double Pricing Act, passed at the end of 2005, which ordains that trade companies must state their prices both in Slovenian Tolars and in Euros. The purpose of this act is to familiarize the customers with the new currency and help them accommodate to adoption of Euro. In Slovenia, double pricing is obligatory as of March 1st 2006 and will last until June 30th 2007, giving the customers enough time to adapt.

We also started the activities required for a seamless transition to business operation in the new currency and for introduction of Euro banknotes and coins in the entire Slovenian retail.

The approaching Euro adoption can be sensed through the Group's financial operations as well, as the volume of Tolar denominated loans during the year, as well as in previous years, has gradually decreased. According to estimates, introduction of Euro will have a positive effect on Mercator's financial operations, as the conversion cost will decrease and the overseas and home transaction rates will be unified; furthermore, the payment procedures in Slovenia will be simplified.

General economic conditions

According to most recent estimations, Slovenia attained a 3.9 % GDP growth in 2005, which is 2.2 percentage points more than the Euro area average. Total increase of consumer price level in 2005 amounted to 2.5 %, which is 0.7 percentage points lower than in 2004. Decreasing inflation is a result of well coordinated macroeconomic policy of the government of Republic of Slovenia and the Bank of Slovenia, which were gradually reflected in lowering inflation expectations as well. The reason for a more restrictive macroeconomic policy is primarily the prerequisite of meeting the Maastricht convergence criteria in order to adopt Euro in 2007.

Croatia reached an important milestone in 2005, as the efforts of recent years resulted in the beginning of EU accession negotiations on October 3rd 2005. Croatian economy grew by 3.5 % which is 0.3 percentage points less than in the year before. The main cause for a lower economic growth is slower economic activity in the first half of the year; the situation improved in the second half, particularly after the beginning of EU accession negotiations. Inflation has been low for several years in Croatia; in 2005 it mildly rose to 3.2 %. Croatia's key macroeconomic problems remain high foreign debt, unemployment and foreign trade deficit. The HRK/EUR exchange rate has appreciated for the second year in a row. The exchange rate features a strong seasonal component: the tourist season sends the price of Croatian currency (HRK) to its annual high during the summer, with subsequent gradual decrease towards the end of the year.

Bosnia and Herzegovina continued its economic reform in 2005. The main reform goals are to simplify economic operations and increase productivity. Although some acts have already been adopted, their implementation is still sluggish, which restrains the country from reaching its full development potential. In 2005, the country was preparing for the implementation of the value added tax that came into force in the beginning of 2006. Economic growth in 2005 reached 6.5 %, which is 0.8 percentage point more than in the year before. Inflation has also increased, from 1.0 % in 2004 to 2.8 % in 2005.

Compared to 2004, the economic activity in Serbia and Montenegro slowed down. In 2005, the country managed to cut its foreign trade deficit, but inflation remained high at 17.7 %. Accordingly, Serbian central bank applied restrictive monetary policy and has set the goal to cut inflation to less than 10 % in 2006. 2005 was also a watershed year for Serbian tax system as the value added tax was implemented, which boosted revenue. Economic growth in 2005 reached 4.6 % which is 0.7 percentage point less than in the year before.

Competition in the industry of trade with predominantly alimentary products

In Slovenian market, Mercator held on to the position of the leading retailer with common household consumer products; it retained the highest market share which amounted to 45.0 % at the end of 2005. Largest three retailers in Slovenia represent 82 % of the market.

In Croatia, Mercator acquired in 2005 the companies Era Tornado, d.o.o., and Trgohit, d.o.o. Mercator's market share in 2005 reached 4 %. The concentration in Croatian retail market is increasing. Five largest retailers represent 46 % of the market.

Concentration in the market of Serbia and Montenegro is rather low as five leading retailers stand for approximately 17 % of the market.

Small stores are still the predominant form of retail outlets. In this market, Mercator has a 1% market share. At the end of 2005, we spread our presence in the Serbian market with a Mercator Center in Čačak and a supermarket in Zemun.

The market of Bosnia and Herzegovina also features low concentration, as the market share of five biggest retailers is estimated at 16.5 %. None of the companies can be described as the market leader. According to analysis by the company GfK, Mercator's market share in 2005 was 2.0 %. In 2005, we opened the Dobrinja Trade Center in Sarajevo.

Development and Investment

Extending our activities by investing SIT 57 billion into retail network

In 2005, the Mercator Group allocated SIT 57,062 million for capital expenditure (investment into property, plant and equipment); SIT 31,457 million (55.1 %) of these were invested abroad.

Mercator Group investment:

Country	Amount (SIT 000)	Share (in %)
Slovenia	25,605,325	44.9
Investment within trade operations	24,332,529	42.6
Investment within non-trade operations	1,272,796	2.2
Croatia	20,905,918	36.6
Bosnia and Herzegovina	3,253,522	5.7
Serbia and Montenegro	7,297,383	12.8
Total	**57,062,149**	**100.0**

In 2005, we continued to expand our retail network: we opened two Mercator centers and acquired the Era shopping center in Samobor, we opened three trade centers, expanded the Grosuplje Trade Center, opened eight Hura! discount stores and several other grocery and non-grocery retail units.

By building, acquisition and leasing commercial facilities we increased our capacity by a net of 69,034 m^2 in 2005.

Slovenia

— Trade center in Ajdovščina

The facility is located on a 24,600 m^2 estate; it has 7,513 m^2 of common area and a 3,905 m^2 garage in the ground floor. There are 155 parking spots in the garage and additional 215 parking spots outside. A 185 m^2 projecting roof and 1,440 m^2 secured area is used for warehousing and manipulation of construction material. The sales mix offers a 1,829 m^2 supermarket, Intersport, Modiana with a drugstore, technical apparel store, Santana coffee bar and 16 leased outlets with a total acreage of 1,158 m^2. The center was opened on June 30th 2005 and it expanded Mercator's capacity for both own operations and letting facilities out on lease by 6,249 m^2.

Expansion of the Grosuplje Trade Center

By expanding the trade center, the facility was extended from 1,326 m^2 to 2,885 m^2. The customers can also make use of a 4,250 m^2 garage with 144 parking lots, and the additional 20 parking lots outside the building. Additional area was allocated for expanding the supermarket which now extends over 1,488 m^2 of total area, while Intersport, Modiana with a drugstore and six shops to be let out on lease on the area of 220 m^2. The expanded center was reopened on September 9th 2005, three days before its 3rd anniversary. The center expanded Mercator's capacity for both own operations and letting facilities out on lease by 1,157 m^2.

Trade center in Idrija

The trade center spreads over 10,681 m^2 of land. The facility has 2,924 m^2 of common area. A projecting roof covering additional 487 m^2 has been built to enable sale of construction material, as well as a 1,255 m^2 warehousing-manipulation courtyard. There are 96 parking spots outside the facility. The trade center comprises a 1,197 m^2 supermarket, technical apparel store, Santana coffee bar and 8 lease shops. The center was opened on November 11th 2005 and it increased Mercator's capacity for own operations and letting facilities out on lease by 2,406 m^2.

Other openings

—Opening of eight Hura! discount stores: in Novo Mesto, Šempeter in Savinjska dolina, Gornja Radgona, Črnomelj, Žalec, Brežice, Dravlje in Ljubljana and Jesenice (a total of 5,618 m^2);

—opening of market program shops: in Vrhnika, Kočevje and Dravlje (a total of 1,210 m^2);

—opening of Intersport stores in Kranj (Savski otok) and on Šubičeva Street in Ljubljana (a total of 2,093 m^2);

—opening of furniture store in Kranj (area of 1,330 m^2).

Foreign markets

Mercator center in Zadar

The facility extends over 30,795 m^2 of land. It has 12,738 m^2 of common area and a 10,138 m^2 garage in the base floor. The garage offers 320 parking spots and there are additional 270 parking sports outside the facility. The sales mix includes a 4,199 m^2 hypermarket, Intersport, Fashion Avenue ("Avenija mode"), Sineqanone, technical apparel store, Santana coffee bar and 25 lease shops on the area of 2,061 m^2. The center was opened on March 23rd and it increased Mercator's capacity for own operations and letting facilities out on lease by 9,519 m^2.

Era center in Samobor

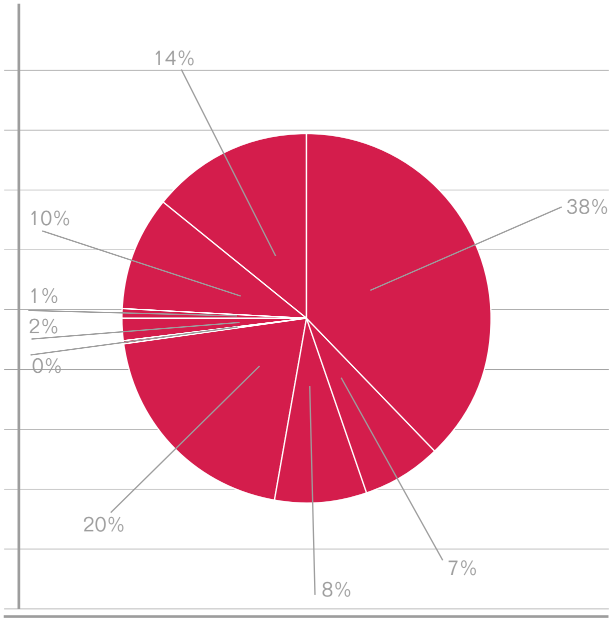
The facility has been merged with Mercator on September 19th 2005. It was built in 2004 and has 14,023 m^2 of total area and 430 parking spots outside the facility. The sales mix comprises a 3,509 m^2 hypermarket, a sport equipment shop Sport Mania, Pitarelo footwear shop, technical apparel store Adut, restaurant and a coffee bar; all will be transformed into standard Mercator units (hypermarket, Intersport, Modiana, technical apparel store, restaurant and Santana coffee bar). 1,850 m^2 is available for lease for supplementary services. The Era shopping center in Samobor increased Mercator's capacity for own operations and letting facilities out on lease by 11,240 m^2.

Mercator center in Čačak

The premise comprises 23,795 m^2 of landed property and it features 11,414 m^2 of common area and a 6,246 m^2 garage in the building base floor. The garage comprises 209 parking spots and there are additional 241 parking spots outside the building. Sales mix comprises a 4,106 m^2 hypermarket, Intersport, Modiana, Sineqanone, Beautique, technical apparel store, Santana coffee bar, a restaurant and 18 shops to let out on lease with a total of 1,255 m^2. The center was opened on December 2nd 2005 and it increased Mercator's capacity for own operations and letting facilities out on lease by 8,669 m^2.

Trade center in Dobrinja

The facility extends over 18,000 m^2 of land that also hosts a sports hall. It has 5,082 m^2 of common area and a 3,717 m^2 garage in the ground floor, offering 128 parking spots; there are additional 44 parking spots outside the garage. The sales mix consists of a 2,171 m^2 supermarket, Intersport, Modiana with a drugstore, Santana Coffee bar, a pizzeria and 12 lease shops with a total of 742 m^2. The center was opened on December 1st 2005 and it increased Mercator's capacity for own operations and letting facilities out on lease by 3,683 m^2.



Rentable stores for complementary offer	14%
Hard discounts	10%
Coffee bars Santana Coffee Shop	1%
Restorants	2%
Chemist's shops Beautique	0%
Intersport stores	20%
Technical stores	8%
Clothing stores	7%
Hypermarkets & Supermarkets	38%

At the end of 2005, there are 26 Mercator centers and 18 trade centers in all markets of Mercator's operations - not counting the Era shopping center in Samobor that does not yet have the Mercator image.

We have also acquired new locations (land or business premises) for building, expanding or redesigning shopping centers, Hura! discount stores, supermarkets and technical apparel shops.

in Slovenia:

premises in Lesce, Dobrova near Ljubljana and Krško, Kočevje, the Šarabon garage in Ljubljana, premises in Cerknica, Slovenj Gradec, Koper, Tolmin, Novo mesto and Maribor (Vema, Merkur).

abroad:

- Croatia - Koprivnica, Novigrad, Jankomir Zagreb, Velika Gorica;
- Serbia and Montenegro - Niš, Šabac, Leskovac, Valjevo, Kraljevo, Inđija;
- Bosnia and Herzegovina - Mostar;
- Macedonia - Skopje (fair).

We have also renovated and redesigned the existing retail network: we completely redesigned eight trade centers and transferred the online shop from supermarket on Slovenčeva cesta to a renovated and specially adapted unit in Parmova ulica in Ljubljana. We also performed minor renewals and purchased particular operating assets as well as computer hardware and software.

In 2005, the Mercator Group divested economically non-viable tangible assts and gained proceeds in total amount of SIT 2,464 million.

Marketing

Further monitoring of shopping habits and customer satisfaction, and responding by designing a high-quality competitively priced service, and developing modern sales methods and attractive product ranges for our customers.

As we are aware of the increasing importance of the quality of life, we base our marketing strategy on offering products and services that will enable our customers to spend as much quality time with their family as possible. It is our solemn vow that we offer our customers the highest value for their money in every moment.

In the future, we intend to approach the process of creating a relationship with our customers more intensively. In order to meet their requirements and preferences as closely as possible, we shall adapt particular elements of the marketing mix to particular target customer groups: families with children, retired persons, students and young employed persons.

The foundations of a long-term marketing strategy

Mercator's marketing strategy is based on designing a high-quality and price-competitive product range, which is upgraded by a high level of service; this way, we create added value for the customers and provide:

- the best offer of fresh products:
  - best daily supply of fresh fruit and vegetables at the best prices,
  - a range of health preserving products and
  - a range of ready-made products;
- the most appealing and fashionable range of non-alimentary products:
  - impulse products and
  - attractive products from our range called "Everything for Your Home";
- most interesting offer of season products:
  - low-priced purchase of season-related products;
- complementary supply of product ranges and services in shopping centers:
  - services (e.g. Mercator Pika card),
  - offering other complementary services in shopping centers.

In order to assure competitive prices and increase customer loyalty, several marketing activities are carried out within the market program, in order to:

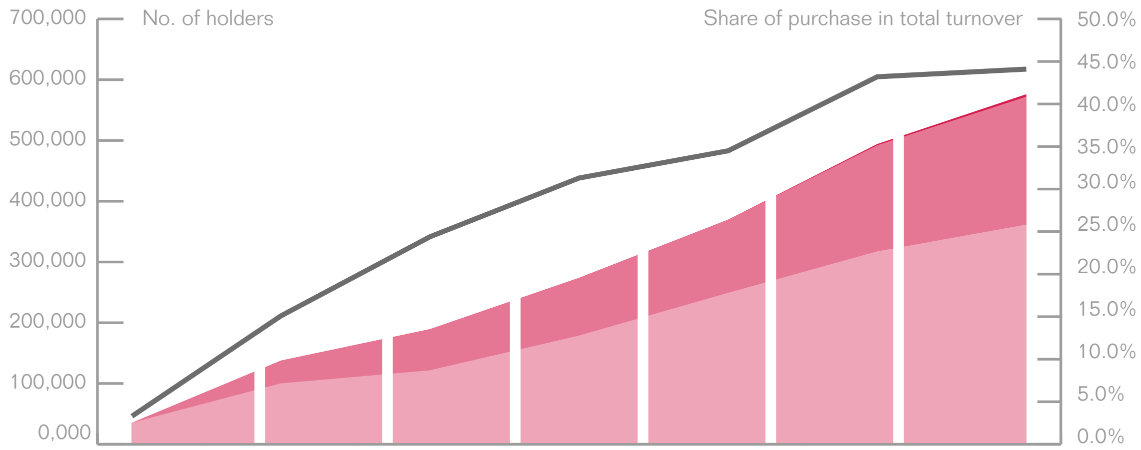
- increase customer loyalty - activities to spread the use and applicability of the Mercator Pika card and preparing benefits for its holders;
- offering products that provide highest value for money - products under the Mercator brand and products of the "Five a day" product range;
- customer education and increasing the Mercator brand reputation - "Mesec" and "E-Mesec" magazine;
- favorable daily purchases for our customers - we are both developing long-term sales promotion projects ("Every Day Low Prices", "National shopping baskets" - Slovenian, Croatian, Bosnian, Serbian) and short term sales boosting projects (regular campaigns/special offers, hypermarket special offers with "Doubtlessly the best price",

campaigns in all market program stores and all specialized stores, and co-marketing activities that can actively be developed with strategic suppliers).

Establishing relations with our customers

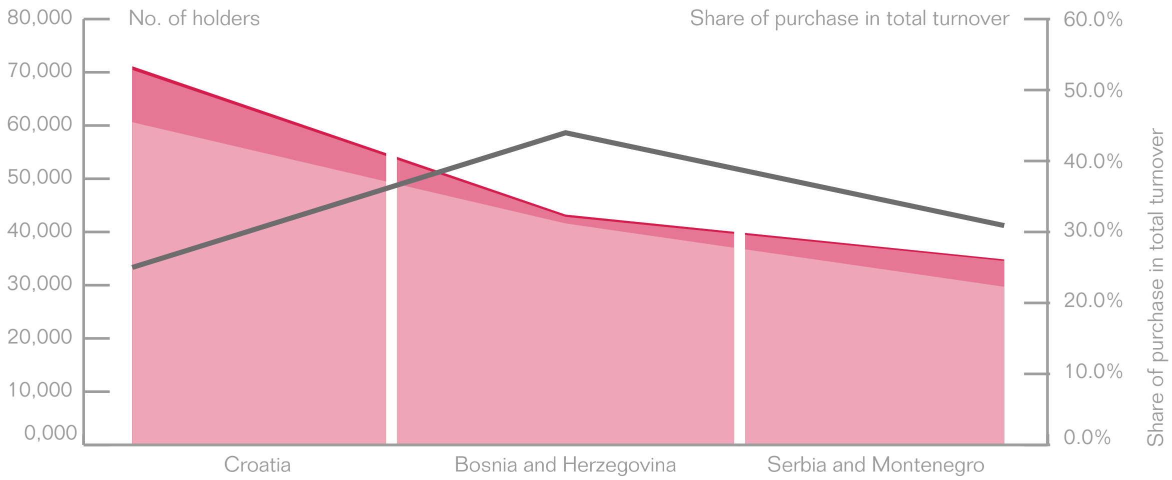
In order to offer extra value to our loyal customers in spite of harsh competition, we are developing a loyalty system of the Mercator Pika card as a part of our customer relation program.
On December 31st 2005, there were 573,573 holders of Mercator Pika card in Slovenia. 361,665 held the blue cash card, 210,450 were holders of the green credit card and 1,458 were holders of the gold credit card. On the same day, there were 70,516 holders of the Pika card in Croatia, of which there were 60,624 blue card holders, 9,824 green card holders and 68 golden card holders (the green and the gold card were introduced on February 1st 2005). In Serbia and Montenegro, there were 34,592 card holders on that day and there were 42,882 card holders in Bosnia and Herzegovina (green and golden card were introduced on August 1st 2005). Thus, there are already 721,563 holders of Mercator Pika cards in all markets combined. In 2005, the number of card holders rose by 100,264. This rise was propelled chiefly by intensified marketing activities and the introduction of international credit card in all markets of Mercator operation.

The number of Mercator Pika card holders and share of payments in total sales revenue in Slovenian market in the period from 1999 to 2005:



	1999	2000	2001	2002	2003	2004	2005
blue card	35,372	100,150	121,670	178,712	249,050	317,303	361,665
green card	-	37,539	67,786	95,206	120,596	174,872	210,450
gold card	-	-	-	-	-	436	1,458
Share of purchase in total turnover	3.3%	15.1%	24.4%	31.3%	34.5%	43.2%	44.1%

The number of Mercator Pika card holders and share of payments in total sales revenue in foreign markets as at December 31st 2005:



	Croatia	Bosnia and Herzegovina	Serbia and Montenegro
blue card	60,624	41,608	29,707
green card	9,824	1,231	4,857
gold card	68	43	28
Share of purchase in total turnover	25.0%	44.0%	30.9%

The following marketing activities were successfully carried out in the field of establishing customer relations in 2005:

- After the introduction of Mercator Pika card in all Mercator retail units in Croatia, expanding the operations abroad also comprised the unification of the Pika card system, including marketing activities and the uniform comprehensive image of communication. The same activities had to be carried out in Bosnia and Herzegovina and Serbia and Montenegro as well, where the green and the gold card were introduced on August 1st 2005.

- Redesigning the comprehensive graphical image of the Mercator Pika card, with the slogan "Because you get more"; thus, this image has been implemented to all markets of Mercator's operation.

- We have defined the rules for obtaining the golden card; every customer that met the criteria, was sent an invitation to obtain the Mercator Pika golden card.

- In 2005, "double points" were awarded to customers in all markets on 167 occasions.

- As the 12th benefit period in Mercator Center in Ljubljana and the 13th benefit period in Mercator Center in Maribor were concluded, the Pika Day events were successfully held, featuring a final award drawing; during the Pika Days, customers were awarded additional benefits: "double points", free gifts etc.

— The number of strategic partners in the Mercator Pika card system is constantly increasing; in 2005, the companies Mobitel, d.d., and Emona Maximarket, d.d., as well as the Hura! discount stores.

— As of April 2005, sales promotion activities for Mercator Pika card holders were regularly carried out for all Mercator product ranges; these were called Special Pika discounts.

— In cooperation with suppliers, partners in the Mercator Pika card system and product ranges in the Mercator Group, 61 individual sales promotion campaigns were carried out as the Special Pika discounts in 2005; these also took place in all foreign markets of Mercator's operations.

— In 2005, a free support telephone number 080 2 080 was successfully introduced for our customers.

— In December 2005, we introduced the e-coupons (electronic wallet) that enable adding credit to any Pika card.

In 2006, all activities in the field of customer relations will be aimed at establishing a comprehensive system for Customer Relationship Management (CRM).

In order to reach beyond expectations of the Mercator Pika card holders and to attain the success of its implementation, we plan to perform several activities; above all, we wish to upgrade the application range of the Pika card and extend it to complementary fields in all markets of Mercator's operations. The goal of all these activities is to make the Pika card the first in our customers' wallets.

Development of private label lines

The Mercator private label is a permanent strategic project that is represented across the entire Mercator retail network, in all franchise stores and in Cash&Carry stores. The fundamental characteristics of the Mercator private label products are solid, above average quality, favorable price and a recognizable graphical image of each product range. The project includes products from all categories or product groups.

In 2005, we continued to realize the following goals:

— reinforcing the reputation and distinctiveness;
— increasing the number of products in the private label product ranges;
— increasing the share of private label product sales in total sales;
— stimulating purchases by innovative communication;
— establishing and maintaining a dialogue with the customers - Mercator is a trustworthy partner.

In 2005, all Mercator private label products were developed within several product lines:

— **Generic products:**
the range includes daily consumer products for household; as it provides the best ratio between price and quality, it is suited for price-sensitive customers. At the end of 2005, the generic product range included 290 products. In 2006, the range will be expanded with products from all categories within the market and non-market program.

— **Total Body Care:**
these cosmetic products are intended for personal care of both men and women who are price sensitive and do not buy cosmetic products exclusively based on brand reputation. At the end of 2005, the range included 68

products; in 2006, it will be expanded with new products and the graphical image of some of the existing ones will be updated.

— **The M-line:**
this product range includes products (clothing, bedclothes, textile products for kitchen etc.) for daily use, intended for price sensitive customers. At the end of 2005, there were 178 products in the range. In 2006, the M-line will be enriched with new patterns and print colors throughout the year.

— **Lumpi:**
product range for children under the age of 10. At the end of December 2005, there were 236 products in this range. In September, we worked with the Council of Republic of Slovenia for Safety and Education in Road Traffic to present an educational campaign "Lumpi's Safe Way to School". All kindergarten children were presented with warning vests, children from junior classes of elementary schools were given special template rulers and every junior class received a poster describing the rules of safe conduct in traffic. We also organized testing ranges for safe driving in front of Mercator centers.

— **The Wishing Table:**
is a range of 89 products for everyone that wishes to live a full life and devote their leisure time to family, sports and friends. This range enables a simple preparation of a quality and tasty meal. The product range is developed by adding new products for fast preparation that only need to be added some water or heated in order to have a quality meal ready on the table.

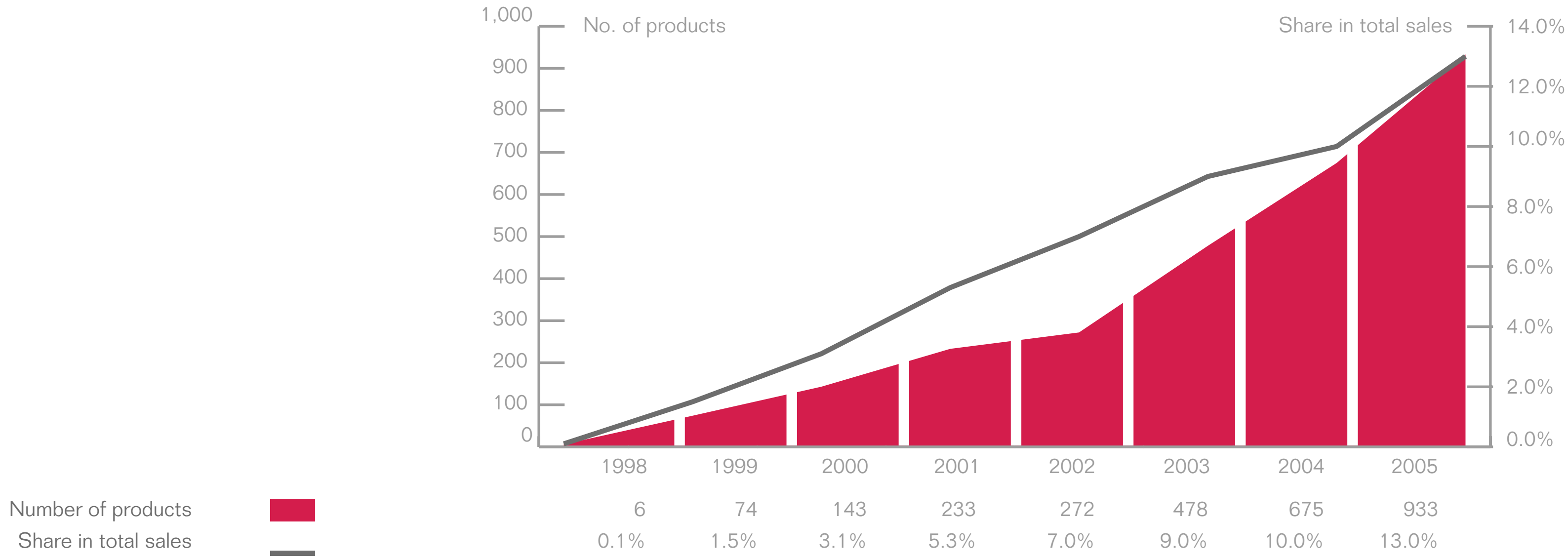
— **Healthy Life:**
selected products of the Healthy Life range follow closely the recommendations and contemporary findings regarding a healthy nutrition. Thus, the target customer segment for this range are people who pay attention to a healthy lifestyle and those that require special diet for medical reasons. In December 2005, the range included 72 products. In 2005, we performed several activities for general and expert community in order to present this range as a set of high-quality and trustworthy products. In cooperation with all Health Protection Institutes across Slovenia, we held cooking workshops with the Healthy Life products. In 2006, the range will be upgraded to include ecologically grown products.

On December 31st 2005, the Mercator private label included 933 products (with regard to various preferences about the taste, color, size and smell), 267 of which were developed in 2005.

The Mercator private label products are developed in all markets of Mercator's operations. In Croatia, 465 products were included in the private label products at the end of 2005; in Serbia and Montenegro, there were 486 and in Bosnia and Herzegovina, there were 650.

Another aspect of developing the Mercator private label products is the project "Five a day - let some color in your life", which is aimed at increasing the awareness about the positive effect that fruit and vegetables, if consumed several times a day, have on health and mood. In April we sponsored the regional contest for the new MTV Adria host. The main goal of this project was to encourage the consumption of fruit and vegetables among the youngsters.

Number of Mercator private label products and their share in total sales in Slovenian market:



The following projects are the key to increasing the distinctiveness of the Mercator private label in 2006, and will be backed by ample communication support: Lumpi, The Wishing Table, Healthy Life and generic products. Apart from this, we plan to maintain and increase the distinctiveness of other private label product ranges and to continue their development. The product ranges will be upgraded in a way that will provide the most price competitive offers while developing products with added value which will meet the preferences of specific customer segments. The aim of developing the private label product ranges is to offer products that provide "the biggest value for money".

Development of sales promotion projects

In 2005, we kept the established forms of both short-term and long-term sales promotion activities; some of them were somewhat updated or upgraded, and others that are particularly attractive for our customers were added. Special care was taken to improve the price competitiveness of the sales promotion campaigns and the choice of special offer products; these offers mainly included products of reputable brands at attractive prices, as well as contemporary, season-oriented non-alimentary products.

In all markets of our operations, our customers were treated to a very successful loyalty program that was carried out in cooperation with one selected supplier to enable our customers the purchase of attractive household products at very advantageous prices. In our hypermarkets and supermarkets we declared "Weekends of fruit and vegetables" when these products were offered at the best prices possible.

When designing short-term activities, special attention was paid to price competitiveness. The project "Doubtlessly the best price" was redesigned and included within the regular and hypermarket sales promotion activities. It was supported by product marketing with a new corporate identity in all markets of Mercator's operations. We increased the frequency of printing special offer flyers and spread their distribution. Together with the suppliers we redefined our common sales promotion activities and provided even more favorable prices of their high-quality products during our special offer campaigns.

The choice of products in other short-term sales promotion activities were adjusted to the characteristics of our customers. We extended the range of non-alimentary products in hypermarket type outlets and offered attractive and fashionable season-relative products. We also carried out specialized theme-oriented campaigns which were either season-relative (Spring in your home, It's Holiday) or aimed at a particular segment of our customers (All for our youngsters). Additional theme-oriented offers (e.g. vegetarian and special food, dairy drinks, breakfast, infant food, various sorts of tee etc.) became a regular category of every special offer flyer, when all products were offered at "incredible prices".

The number of products included in the project called "Every Day Low Prices" ("Trajno nizka cena") was increased and the offer of everyday low prices was segmented according to the size of the store; in hypermarkets, the offer was extended to the non-market program as well. The number of products was successfully increased in all markets.

Another group of projects that were further developed in all markets of our operations are the "Slovenian shopping basket" and other "national shopping basket" offers. The customers were offered selected high-quality products of Slovenian or other respective national manufacturers that have already convinced our customers with the best price/quality ratio.

In order to become the leading sports equipment retailer in all markets of Mercator's operations, the sales promotion activities of Intersport were focused on the selected brands (Crazy Creek, McKinley, Nakamura, Genesis etc.) that were presented to our customers in special catalogues. Apart from seasonal sales we offered several specially prepared campaigns ("Summer Fever", "Pay for 2 and get 3" etc.)

Distinctiveness of the Mercator technical apparel range was increased by a common special offer from all three product ranges (construction and installation material, furniture and equipment, household appliances and entertainment electronics). Furthermore, we worked with our suppliers to present specialized white goods programs and small household appliances, and organized a special sales promotion campaign each month.

In order to remain a leading and competitive textile retailer, the Mercator textile retail units offered theme-related sales promotion campaigns (Household Days, Easter Special) and discounts on particular product categories (bathing suits, bathing towels, clothing for children etc.) or on selected brands (Lisca, Beti etc.). Special sales promotion campaigns were also carried out in each store immediately after the opening, as well as in the newly designed "Outlet" stores. Two seasonal clearance sales were carried out, while other major activities include the "Linked purchase" campaign, where every customer that purchased more than SIT 10,000 worth of goods in any of the Mercator market program stores, was awarded a 10 % discount in the Mercator Modna hiša shops.

In 2005, sales promotion activities in Beautique outlets were carried out regularly, with their number differing according to the product range of a particular outlet. The most common type of sales promotion activities were gifts presented to the customers, with occasional offers of selected products at lower prices. Customers are informed of special offers and new products via direct mail and their purchases are additionally awarded with gifts.

In Hura! discount stores we sought to turn their customer's attention to their extraordinarily favorable price by local distribution of flyers and by organizing product presentation events. Apart from that, customers were offered various benefits at opening of new stores ("happy cashier", presents etc.).

As the new retailers entered the Slovenian market and the existing ones took an even more aggressive approach to pricing, further product-oriented activities and even more penetrating market communication will be a necessity. Thus, we plan the sales promotion campaigns in 2006 that will help Mercator attain the market position in line with the marketing orientation and policies set ahead:

- to be the first and most recognizable provider of special offer merchandise in all markets of our operations,
- to establish a perception with customers of a retailer with added value, or a retailer that simply offers more.

To attain these goals, the following guidelines will be observed in all markets of our operations in 2006:

- designing so-called specialized campaigns with interesting themes that will bring us even closer to customer preferences and requirements;
- including reputable brands in major price aggressive projects ("Doubtlessly the best price' and "Special Pika discounts") that will establish a perception of the first retailer in the market;
- organizing special price driven special offers of fruit and vegetables at weekends and other products according to the season;
- efforts to carry out attractive co-marketing activities with suppliers;
- awarding loyal customers with loyalty benefit programs.

Research and development of store formats

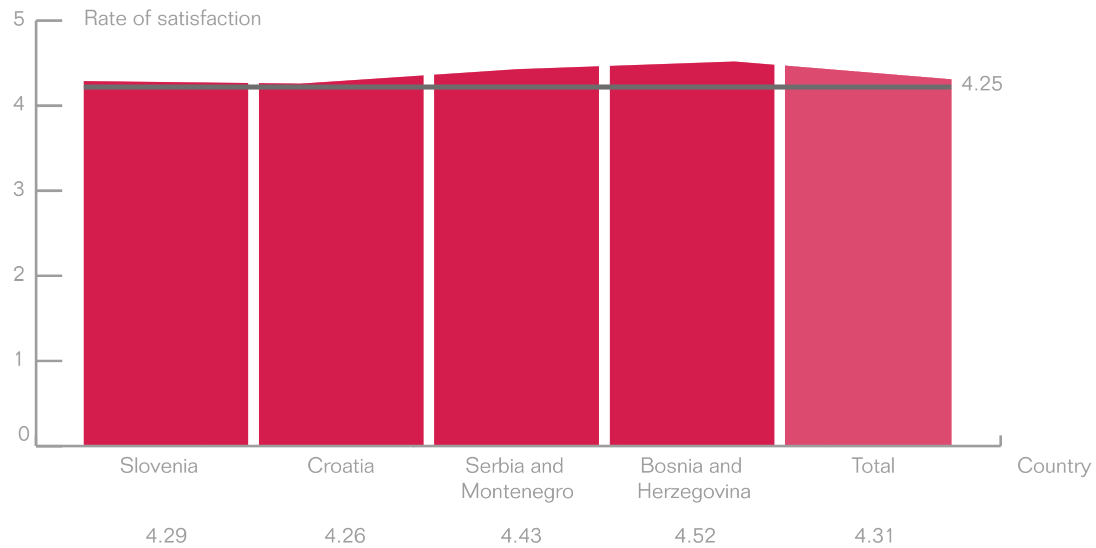
Customers

In line with the basic orientation of the Mercator Group, i.e. the satisfaction of people that make contact with Mercator, we regularly monitor shopping habits and customer satisfaction with particular elements of product ranges and services in our stores. This is the only way that enables us to upgrade our activities and take the role of the best neighbor. Within the strategic marketing plan, several marketing analysis and surveys are carried out in order to study and understand customer perception:

- Mercator private label reputation analysis,
- customer analysis (customer satisfaction, product and service quality, shopping customs and habits, monitoring customer feedback - comments, complaints and praises),
- product marketing surveys,
- marketing efficiency surveys,
- market and competition analysis surveys,
- surveys conducted to design marketing strategies and policies and the so-called ad-hoc surveys.

Customer satisfaction surveys that are conducted in all markets of our operations and in all Mercator programs show that our customers are satisfied with the offer and service in our outlets. In the market program, the set target level is exceeded in all markets of our operations.

The average customer satisfaction level in market program stores in 2005 (average estimation for stores of hypermarket, supermarket and superette type) - according to countries. We exceed the target value in market programme in all markets of our operations.



Note: The customers rated the satisfaction level with grades from 1 to 5, where grade 1 meant that the customer is thoroughly dissatisfied and grade 5 stood for high satisfaction. In case of Serbia and Bosnia and Herzegovina only hypermarkets were included in the survey.
Source: CATI, 2005

Development of store formats

Mercator Group is simultaneously developing a market product range, technical apparel product range (furniture, technical apparel, construction material), textile range, beauty range (clothing and fashion accessories, drugstore and perfume products) and the Intersport range (renowned brands of sports clothing, footwear and equipment). In order to meet the requirements and preferences of our customers, we are constantly upgrading our sales formats through technological improvements and customer friendly shopping environment. In line with the guidelines in Europe and around the world, we are also developing new store formats.

The structure of the Mercator Group retail units according to type of retail unit as at December 31st 2005:

Activity	No. of units	Net sales area in m²	Gross sales area in m²
Hypermarkets	30	84,348	129,486
Supermarkets	117	84,799	131,496
Superettes	333	76,636	136,472
Self - service stores	146	12,318	23,349
Cash & Carry	10	10,851	13,834
Department store	1	8,041	12,642
Hard discounts	12	6,419	8,989
Total FMCG programme	**649**	**283,413**	**456,268**
Technical and furniture programme	130	74,307	142,895
Technical programme	87	42,917	101,069
Furniture programme	43	31,389	41,826
Clothing and drug stores programme	156	47,051	56,964
Clothing programme	133	45,012	54,334
Drug stores and parfumeries	23	2,040	2,630
Intersport	39	14,514	18,811
Restaurants	70	16,192	21,703
Other	7	330	505
Total specialized programme	**402**	**152,395**	**240,877**
Total	**1,051**	**435,807**	**697,145**
Franchise stores	165	21,426	33,877
Total with franchise stores	**1,216**	**457,233**	**731,022**

Note: The chart does not include the web store of the company Mercator - SVS, d. d.

In 2005, the Mercator Group offered several product ranges to customers in all markets.

Market program

In the field of market program, we are developing hypermarkets, supermarkets and smaller neighborhood stores, convenience stores, Hura! discount stores and the online store.

— Hypermarkets are intended for the entire population, while the more narrowly defined target group are families with small or adolescent children. As the hypermarkets are generally located in shopping centers, our customers are able to do all their shopping in one place, spend free time and socialize, while children can enjoy in the "Lumpi" playrooms. At weekends, children workshops and shows are held in shopping centers.

At the end of 2005, the new sales concept of the hypermarket was introduced in Čačak. The concept is more customer-friendly, as departments in the hypermarket are designed to make customer's orientation much easier. Every category is presented at one location - in line with the Category Management process. It is also easier for a customer to seek help or advice for the purchase. The emphasis lies on non-alimentary and fresh product program. The new concept is also structurally oriented towards our target customer segments: young people, families with children and senior citizens.

— Supermarkets and neighborhood stores are located in larger residential and commercial areas and are intended for regular daily shopping.

— Convenience stores are developed in close city centers or commercial areas in the larger cities; they are designed for customers with a fast pace of life. Thus, the offer is based on fresh products and ready-made food.

— Hura! discount stores are aimed at customers with lower purchase power and customers that act very rationally. The discounts offer good-quality, but anonymous products at very low prices. The first Hura! discount store was opened in September 2004; by the end of 2005, 12 such retail units were opened. In 2006, we will continue to expand the hard discount stores in Slovenian market and analyze the possibilities of entering the Croatian market.

— Web store is designed for customers that prefer shopping from their home, either due to lack of time or the preference of comfort. in 2006, the web store for market program will be extended to other larger cities in Slovenia - currently, we are present in the extended Ljubljana area and in Maribor - and upgraded in line with the changing online shopping technology, making it even more customer-friendly.

Specialized programs

In 2005, we continued the specialization of our product ranges and the respective store formats, especially since we see the offer of various product ranges as one of Mercator's competitive advantages. We are tending towards standardization of store formats which will follow the market potential and specific customer requirements when shopping in stores of various formats.

Technical program

The technical apparel includes furniture and interior equipment, household and entertainment consumer electronics and construction and installation material. In 2004, the first technical apparel shopping center was launched in Slovenian market, namely the "M center of technical apparel" in Črnuče in Ljubljana; later that year, another one was opened in Osijek, and in 2005, three more were opened in Ajdovščina, Zadar and Čačak; thus, we are offering our customers a comprehensive range of technical apparel in one place. In 2006, we will continue to set up technical apparel shopping centers as well as individual outlets and supplementary offers in Mercator centers in all markets of our operations. We are also examining the possibility to upgrade the web store with non-market products from the technical apparel range.

Clothing and beauty program

Two main types of clothing outlets are being developed within the textile product range, with the brand names "Modiana" and "Avenija mode" ("Fashion Avenue"). As a part of the Modiana brand, the Modiana Outlet store format is being developed in some larger cities, where the collections from previous seasons are sold at low prices. In 2005, three Modiana shops were opened in Slovenia, namely in Ajdovščina, Grosuplje and Celje; in Croatia, we opened an "Avenija mode" store and a Sinequanone store in Mercator center in Zadar and one "Avenija mode" store in Velika Gorica; in Bosnia and Herzegovina, a Modiana store was opened in Dobrinja, and a Modiana store and Sinequanone were opened in Mercator center in Čačak. In the new stores, we applied the new concept (textile and drugstore products in one common outlet); thus, a drugstore department of Beautique was integrated. In 2006 we will continue to open stores according to the new concept; we will also open the first "Avenija mode" ("Fashion Avenue") store in Slovenia.

Intersport

Mercator is a license holder for Intersport in Slovenia, Croatia, Bosnia and Serbia. In Slovenia, Intersport has been present since 1999 and it is currently the second sports products retailer. Intersport's goal in Slovenian market is to approach the leading retailer as much as possible; in the foreign markets, we wish to become the first sports products retailer. In 2005 we extended the Intersport outlet network in Slovenia with new stores in Ajdovščina, Kranj, Grosuplje, Idrija and Ljubljana and with two franchise stores. In Croatia, we opened a store in Mercator center in Zadar, in Bosnia, a store was opened in Dobrinja and in Serbia, an Intersport store was opened in Mercator center in Čačak. In 2006, Intersport stores will be opened within Mercator centers and as individual stores in largest city centers, in all markets of our operations.

Product Category Management and Supplier Relations

Providing the right choice with strategic partnerships and performing the process of Product Category Management

Strategic partnership policy and purchasing of trade goods

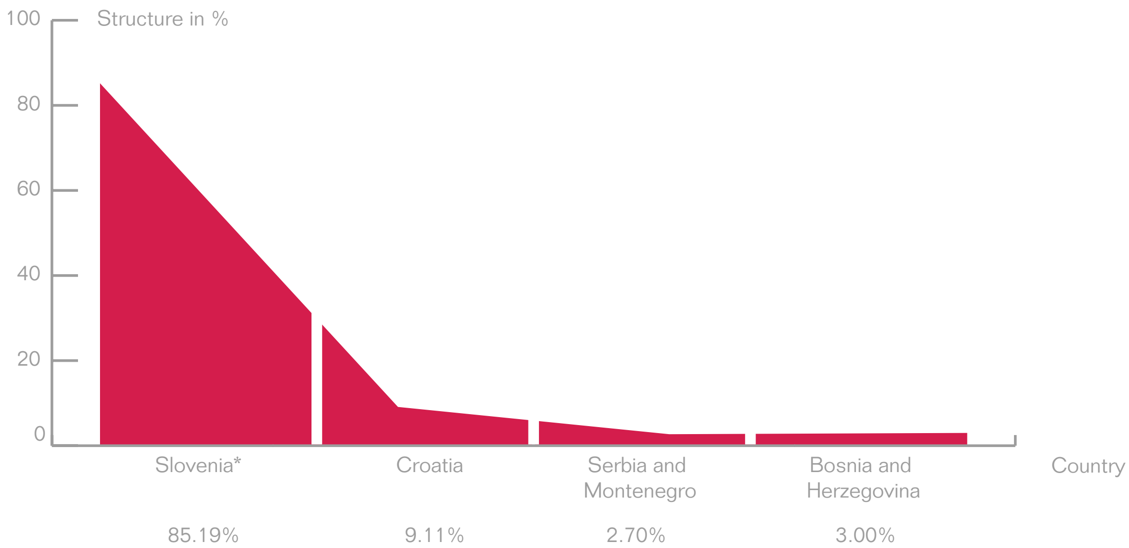
In the year 2005 we continued the policy of strategic partnership, representing the basis of our cooperation with major partners in the supply of trading goods. Operations extended over four markets, and - in addition to our dominant market program - management of several specialized branches, such as sports, clothing, and hardware, demands collaboration with such partners who are able to support us on multiple markets simultaneously.

In the year 2005 we followed the present objective of increasing the level of purchasing concentration, thereby arriving at the synergy of large scope, and consequently optimizing and rationalizing the supply processes, as well as sales processes. In the market branch in Slovenia our accomplished level of concentration is rather high already, with only 23 suppliers covering 50 % of purchasing, and 71 suppliers covering 75 % of the total foodstuff purchasing value. On other markets outside Slovenia, the level of supplier concentration differs from one market to another. Due to a variety of specific factors, such as measures for the protection of national production, veterinary and/or sanitary and health regulations, and also for some other impartial reasons, on the markets of Croatia, Serbia and Montenegro, and Bosnia and Herzegovina we are not reaching the level of concentration attained in Slovenia, but the situation has been improving each year.

Prior making decisions as to which suppliers we would cooperate in the year 2005, we performed the following:

— Reviewed results of operations for the past year in terms of volume and quality of meeting our orders on all markets where we cooperated with various suppliers, their representatives or distributors;

Structure of purchase by countries in 2005



* Including the anticipated direct purchasing by franchise units with the suppliers.

- Reviewed satisfaction of terms and conditions set by the ISO standards;
- Reviewed willingness of participation in the marketing promotion programs both within the strategic marketing promotional projects, and current market product projects;
- Verified readiness to follow the expansion of Mercator to new markets.

In accordance with the level of meeting the stipulated requirements we prepared a list of suppliers, selected for collaboration during the current year. The same criteria are used for checking the initiative for collaboration from new suppliers, received during the year and whose tender of products is deemed appropriate for the Mercator selection of goods.

Products from suppliers who are disposed to help us realize our marketing objectives have definite advantage in our purchasing policy. In the year 2005, we spent considerable effort and funds for the restructuring of sales promotion activities and active collaboration with strategic partners. The advantages of such cooperation are above all notable in benefits for our customers. The strategic project of Mercator brand name and the development of particular product groups within this project have a special place and represent a great challenge for our suppliers.

Realization of purchasing policy originates from the strategic assumption to give priority to Slovenian production and production from markets where Mercator is already present with its retail network - manufacturers from Croatia, Serbia and Montenegro, and Bosnia and Herzegovina, provided they all offer the same competitive terms and conditions.

Product Category Management

In the year 2005 we continued the activities in the process of product Category Management (PCM), along with further development of all functions required for the effective governance of particular product categories, with the emphasis on the development of a so called product merchandising. The Sales Promotion Department now features the function of a sales specialist, person responsible for product marketing at the level of particular sales lines and product categories.

Marketing policy was expanded to include above all the target and routine product categories for Mercator, with emphasis on fresh line of products, and seasonal and non-alimentary range in the supermarket program. In the year 2005 the assortment of these lines of products and product categories was extended, upgraded, and enhanced, and supported by the aggressive sales promotion activities and intensified market communication.

In the year 2005 we engaged eight new suppliers for joint management of eleven selected product categories.

In the year 2006 we plan to commence the comprehensive project of product category management. This project means acceleration of activities, and comprises systematic approach, starting with the extensive strategy of Mercator, from the evaluation of categories to the execution and optimization of product selection, positioning, pricing policy, and comprehensive promotional policy by particular product category.

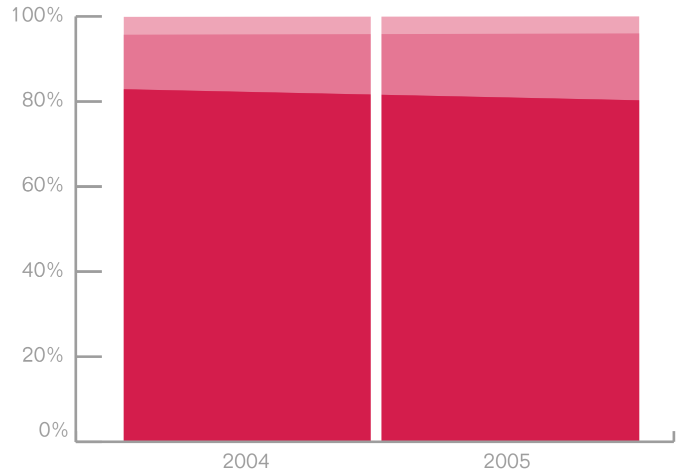
Sales

36-percent growth of net sales revenues on foreign markets

In the year 2005 the Mercator Group realized SIT 419,067 million of net sales revenues, which is 11.2 % more than in 2004.

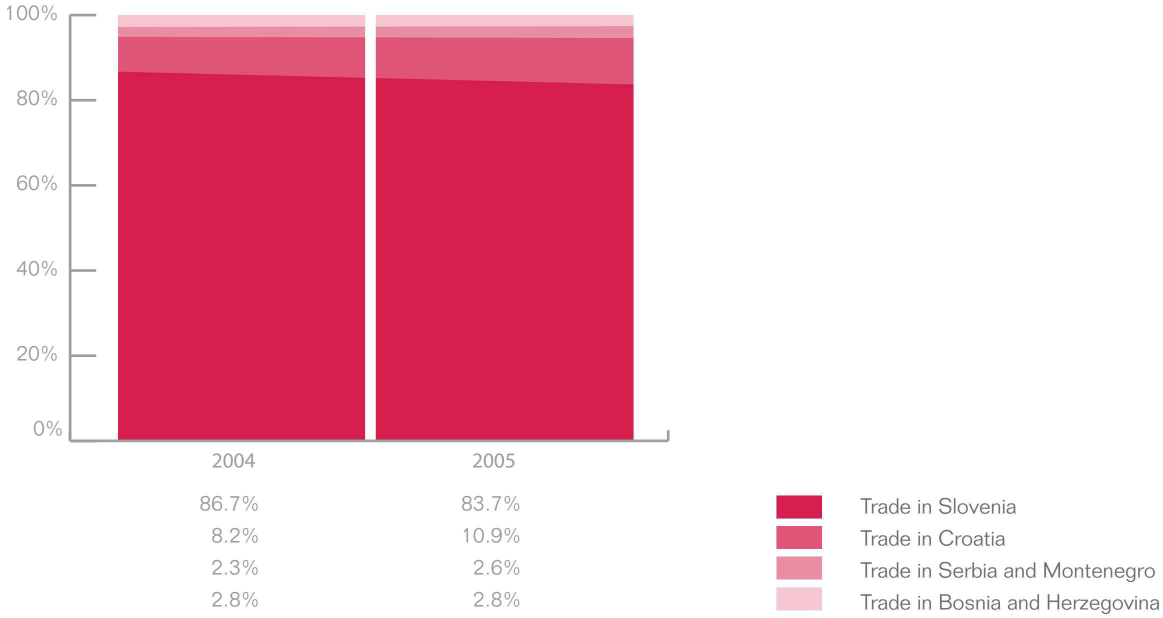
In the trading sector the Mercator Group realized 96 % of net sales revenues in the year 2005, of which 15.7 % was realized by the subsidiary companies abroad. Share of net sales revenues realized by non-trading companies of the Group amounts to 4%.

Net sales revenues of the Mercator Group by sectors



	2004	2005
Slovenia	83.0%	80.3%
Abroad	12.8%	15.7%
Non-trade	4.2%	4.0%

Net sales revenues of the Mercator Group by countries

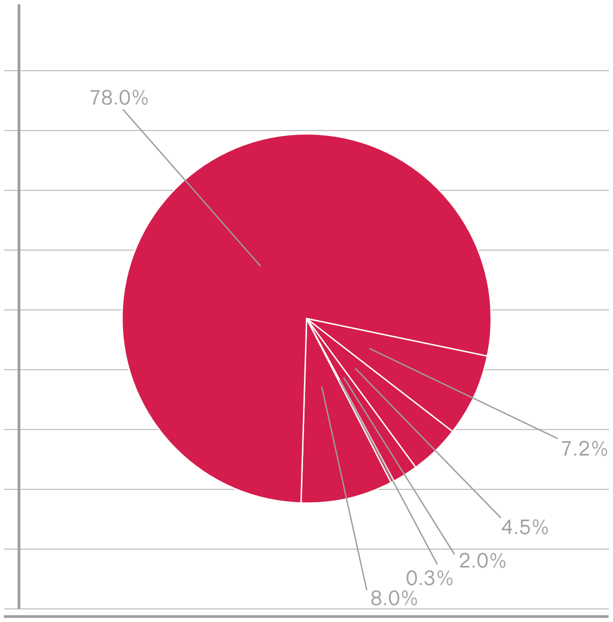


Trading companies in Slovenia recorded 7.4 nominal % increase in net sales revenues in the year 2005, mostly resulting from the opening of new retail outlets.

Trading companies abroad recorded 36 % nominal increase in net sales revenues in the year 2005 compared to the year 2004, which is the consequence of opening Mercator centers in Zadar and Čačak, shopping center in Dobrinja, opening and modernizing of other retail units, and takeover of Era retail network in Croatia in the last quarter of the year 2005.

Non-trading sector recorded increase in net sales revenues for 5.2 % in the year 2005 compared to 2004, and this growth is consistent with the overall increase of Mercator trading sector operations. Non-trading companies realize approximately half of net sales revenues by the sales within the Group.

Structure of net sales revenues in trading sector by particular product ranges



FMCG programme	78.0%
Technical programme	7.2%
Clothing programme	4.5%
Intersport	2.0%
Hura! discounts	0.3%
Other	8.0%

Integration of logistic operations, performing activities in the improvement of logistic services, and following modern concepts of logistics development

The entire logistic services in Mercator are performed by two companies (Poslovni sistem Mercator, d. d., and Mercator - SVS, d. d.), but at as many as 18 locations. We currently deploy 134,517 m^2 of storage space, of which 125,143 m^2 of own storage and 9,374 m^2 leased space, with 1,200 employed people performing logistic services in the year 2005.

Figures representing the extent of logistic services in the year 2005:
— Delivery of 500,000 tons of goods;
— Value of transported goods amounts to SIT 164,000 million;
— Performed 125,000 drives, and covered 12 million kilometers;
— Average stock of 52,000 products.

To arrive at such extend of operations we had to use the optimum level of scattered available resources, partly resulting from aggressive capital integrations in recent years. Dispersed warehousing locations all over Slovenia, different technical, technological, and storage possibilities, state of particular facilities, and different level of IT support impede realization of results which would be comparable to the analogous trading companies elsewhere.

In the year 2005 we continued the activities on the integration of logistic processes and the processes of the rationalization of operations. To that end we performed the following:

— Integrated the logistic services of the companies Mercator - Dolenjska, d. d., and Alpkomerc Tolmin, d. d., into other distribution centers;
— Performed preparations for the integration of warehouses of the company Mercator - Goriška, d. d.;
— Continued systematic collection of data, important for taking right decisions in logistic services;
— Settled relationships regarding delivery of goods by suppliers;
— Acquired feasibility studies for the long-term optimized solutions for the performance of logistic services;
— Within the operations optimization program, we performed activities participating to the long-term cost reduction (abandoning certain doubled controls, adjustments and upgrading IT support, etc).

Activities in logistic services within the logistic infrastructure optimization project in the future will also be aimed at pursuing the sophisticated concepts of logistic development:

— Continue the integration of warehousing and distribution operations;
— Upgrade and unify the existing IT systems for warehouse management and control, and implementation of paper-free logistic operations;
— Introduce planning of transport routes and vehicle tracing system (optimization of delivery times, routing and vehicle usage, with the end objective of effective transport cost management);
— Continue activities on the final consolidation of logistic operations in the Mercator Group at one central location, or at several optimized locations in Slovenia;
— Set up systematic monitoring of logistics services level, with the purpose of enhancing the overall quality of logistic services.

Human Resources

Improving associate satisfaction by enhancing approaches to human potential issues

The following focal points highlighted the management of human resources in the year 2005:

- Opening of new retail outlets in Slovenia and on foreign markets;
- The company Poslovni sistem Mercator, d. d., assumed the employees from the merged companies Mercator - Dolenjska, d. d., and the Mercator - Goriška, d.d.;
- Croatian companies Era Tornado, d. o. o., and Trgohit, d. o. o., were incorporated in the Mercator Group;
- The parent company initiated staffing activities related to the annexation of employees from the companies Alpkomerc, d. d., Emona - Maximarket, d. d., Mercator - Modna hiša, d. o. o., and Era Velenje, d.d.;
- We adopted the code determining corporate values, culture of behavior, and performance standards that have to be followed and respected by the entire Mercator staff, and we performed training of employees at all levels and working posts;
- In spite of large inflow of staff into the parent company, the evaluation of employee satisfaction and general atmosphere at work indicated very high score.

Overview of the Mercator Group staff

At the end of 2005 the Mercator Group employed 16,372 employees, of whom 9,458 in the company Poslovni sistem Mercator, d.d. Compared to end of 2004 the number of employees in the Group increased by 5.2 %, mainly in trade segment, as a result of opening new sales units. The number of employees in non-trade segment increase by mere 0.8 %.

In 2005 the Mercator Group recorded 2,340 new recruitments, while 1,532 people terminated their employment and 1,561 employees fluctuated among the companies of the Mercator Group.

The company Poslovni sistem Mercator, d. d., recruited 2,064 people in the year 2005, of which 1,554 people came from associated undertakings, and 510 people represent fresh recruitment. Seven associates were transferred to other companies within the Group, and 623 people terminated their employment with Mercator.

	No. of employees based on hours worked in 2005	No. of employees as at 31 Dec. 2005	No. of employees as at 31 Dec. 2004
Poslovni sistem Mercator, d. d.	9,216	9,458	8,024
Mercator — SVS, d. d.	1,469	1,491	1,545
Mercator — Dolenjska, d. d.	-	-	810
Mercator — Goriška, d. d.	-	-	712
Živila Kranj, d. d.	-	-	179
Alpkomerc Tolmin, d. d.	156	152	184
Emona Maximarket, d. d.	372	394	407
Mercator — Modna hiša, d. o. o.	527	544	597
Savski otok, d. o. o.	0	0	-

	No. of employees based on hours worked in 2005	No. of employees as at 31 Dec. 2005	No. of employees as at 31 Dec. 2004
Trade in Slovenia	**11,740**	**12,039**	**12,458**
Mercator — H, d. o. o.	1,531	1,842	1,516
Era Tornado, d. o .o.	188	636	-
Trgohit, d. o. o.	53	42	-
Mercator — S, d. o. o.	379	565	374
Mercator — BH, d. o. o.	457	506	480
Mercator Makedonija, d. o. o.	0	0	-
Trade abroad	**2,608**	**3,591**	**2,370**
Total trade	**14,348**	**15,630**	**14,828**
Pekarna Grosuplje, d. d.	248	241	240
Belpana, d. o .o.	0	0	0
Eta, d. d.	265	272	293
Mercator — Emba, d. d.	125	125	117
Mercator — Optima, d. o. o.	37	39	33
M Hotel, d. o. o.	63	65	53
Total non - trade	**738**	**742**	**736**
TOTAL MERCATOR GROUP	**15,086**	**16,372**	**15,564**

In the movements of Mercator human potential in the future we expect the following:

- Decrease in human resources in the Group trade segment in Slovenia in the administrative departments and logistics, slower growth in the FMCG program and a slightly higher growth in specialized chains;
- Increase in human resources in the Group trade segment on new markets in all areas of work, especially resulting from further investments in the expansion of retail network;
- Stagnation in human potential in the Group non-trade segment, except for the anticipated recruiting in the company Belpana, d.o.o., resulting from the expansion of manufacture in the company Pekarna Grosuplje, d.d., in Croatia.

Demographic and educational structure of employees

The Mercator Group

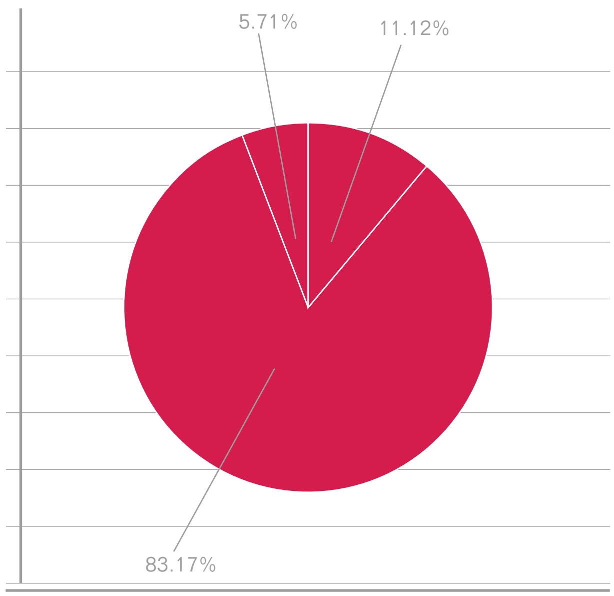
On December 31st, 2005 the educational structure of employees in the Mercator Group was as follows:

- The first group (I. - III. - primary school level) comprised 1,821 employees or 11.1 % of the total;
- The second group (IV. and V. - secondary school level) comprised 13,616 employees or 83.2 % of the total; and
- The third group (VI. or over - two year college and university degrees) comprised 935 employees or 5.7 % of the total.

As at Dec. 31st, 2005 the average educational level of employees in the Mercator Group (measured on a scale of 1 to 8, where 1 means "I.": primary school education and 8 - "VIII." - university degrees) was 4.27.

Structure of employment by education in the Mercator Group as at Dec. 31st, 2005

Trade in Slovenia	Trade Abroad	Non - trade	
9.2 %	11.4 %	40.8 %	I. - III.
85.8 %	82.1 %	46.2 %	IV. - V.
5.0 %	6.5 %	13.0 %	VI. +



I. - III.	11.12 %
IV. - VI.	83.17 %
VI. +	5.71 %

Structure of employment by education in Poslovni sistem Mercator, d. d., as at Dec. 31st, 2005

A	B	C	D	E	F	G
5.4 %	0.53 %	6.66 %	6.58 %	5.4 %	39.6 %	8.99 %
93.43 %	91.05 %	87.94 %	85.53 %	93.43 %	57.06 %	58.90 %
1.17 %	8.42 %	5.40 %	7.89 %	1.17 %	3.34 %	32.12 %

A. FMCG programme
B. Intersport programme
C. Technical programme
D. Hura! discounts
E. Total Retail
F. Total wholesale and logistics
G. Other

I. - III.
IV. - VI.
VI. +

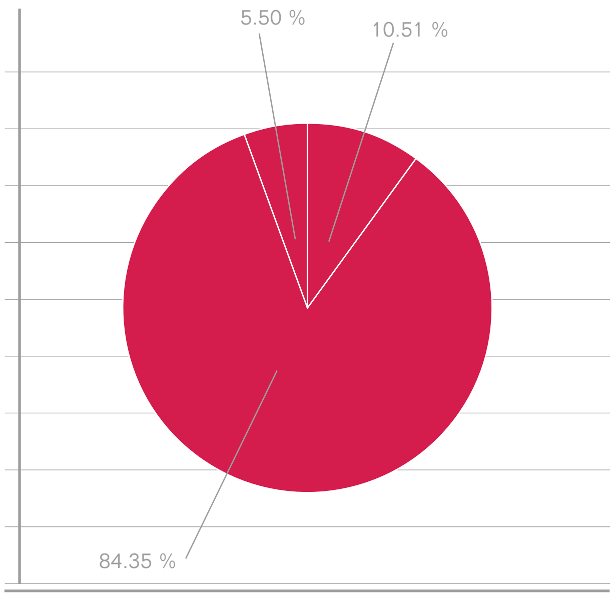
Poslovni sistem Mercator, d. d.

By the end of year 2005 the educational structure of employees in the company Poslovni sistem Mercator, d. d., was as follows:

— The first group (I. - III. - primary school level) comprised 960 employees or 10.2 % of the total;
— The second group (IV. and V. - secondary school level) comprised 7,978 employees or 84.3 % of the total; and
— The third group (VI. or over - two year college and university degrees) comprised 520 employees or 5.5 % of the total.

As at Dec. 31st, 2005 the average educational level of employees in the parent company (measured on a scale of 1 to 8, where 1 means "I.": primary school education and 8 - "VIII." - university degrees) was 4.19.

I. - III.	10.15 %
IV. - VI.	84.35 %
VI. +	5.50 %



Absenteeism

In 2005 the Mercator Group recorded total sick leave hours of 1,918,273, of which 958,335 hours were charged to the Group member companies and 959,938 hours to the National Health Insurance Institute. The absenteeism rate in the Mercator Group was 5.52 % which is 0.3 percentage points less than in the year 2004.

In 2005 the company Poslovni sistem Mercator, d.d., recorded total sick leave hours of 1,214,750, of which 608,065 charged to the company and 606,685 to the National Health Insurance Institute. The absenteeism rate in the parent company was 6.27 % which is 0.48 percentage points less than in the year 2004.

Education and training

During the year 2005 various forms of training and education were attended by the 32,407 participants, of which 24,276 from the parent company. In total, the Mercator Group carried out 165,596 hours of training and education, or an average of 10.1 hour per employee. The parent company carried out 109,736 hours of training and education, which is 11.6 average hours per employee.

In addition to the functional training and education, the Group also monitored the progress of 162 trainees and 388 employees attending the external study programs, we awarded scholarships to 46 high school and university students, trained 21 beginners in our retail and production units, and provided 979 high school and university students and holders of our scholarship with on the job training practice. Trainees, scholarship holders, and beginners at mandatory practical training were supervised by 425 tutors, performing 225,182 tutoring hours.

Employee motivation

In addition to meeting the regular commitments towards our employees, it is our wish to provide the Mercator employees the opportunities for their personal and professional development. To this end we hold annual interviews with the purpose of contributing to better communication, development of positive attitude, and discovering potentials and objectives of each employee.

Our staff is additionally motivated by the Mercator awards for exceptional achievements, awards for life achievements, cash awards and awards for active involvement in preparing the internal training and education programs and materials, including the possibility of obtaining an internal instructor's certificate.

In the year 2005 for the fifth consecutive year the Mercator Group paid for its employees in Slovenia in premiums within the supplemental collective pension insurance plan, carried out by the Pokojninska družba A, d.d., aimed to improve the employee long-term social security.

Employee satisfaction

In April 2005 the company carried out the sixth consecutive survey of employee satisfaction, conducted by the Centre for Public Opinion Pooling at the Faculty of Social Sciences in Ljubljana. Comparison of survey results for the years 2004 and 2005 indicates increased average satisfaction in the year 2005 with the average score level of 4.03, which is 0.01 more than in the year 2004 (4.02).

Organization and Quality

Reorganization of operating activities through standardization and rationalization

In 2005, several activities were carried out in the field of quality control.

— Standardization of operations to increase business efficiency

Standardization of operations increases its transparency, simplifies communication both within the Mercator Group and with business partners, and reduces costs at the systemic level. The Mercator Group is performing an optimization program for its operations, which is focused primarily on the restructuring of business processes and redesigning the information technology network; the program involves the entire operation of Mercator.

In 2005, we carried out some organizational changes by merging the operations of the companies Mercator - Dolenjska, d.d., Mercator - Goriška, d.d., Alpkomerc Tolmin, d.d., and particular operations of the company Era, d.d. Organizational changes involved the retail function, where the standards for determining the minimum and correction number of employees per each outlet were set, and the typical workplaces were standardized. Other activities were also aimed at raising sales productivity, inventory optimization, warehousing and transport, support process rationalization and implementation of IT support.

A register of organizational units, which includes the entire Mercator Group, was kept and regularly updated to suit the requirements of our operations; furthermore, a catalogue of workplaces was kept for the parent company; extending the catalogue to all trade companies of the Mercator Group is one of our pending tasks.

— Maintaining and upgrading the quality systems

As early as 2000 our parent company was awarded the ISO 9001 certificate of quality; however, we were as aware then as we are today, that this was not a goal, but only a foundation for constant improvement and a starting point on our way to business excellence. In 2005, we took part in a competition for the Business Excellence Award of Republic of Slovenia (BEARS). Based on the application and a visit by a jury, the ruling of BEARS committee was that the company Poslovni sistem Mercator, d.d., had qualified into the final round; after scoring the most points among the finalists, we received the BEARS Award for 2005.

The activities for obtaining the ISO 9001 certificate were successfully performed in the company Mercator - S, d.o.o., Serbia and Montenegro. We prepared the documents and compiled the required records, as well as performed an internal evaluation.

We introduced a new application for managing documents in the Mercator standards library. The application enables a simple and quick access to documents for all trade companies of the Mercator Group, as well as to numerous individuals that access the library via Mercator intranet.

In 2005, all regular external evaluations in the trade companies that are certified according to the ISO 9001 quality management system were successful. The parent company also passed the QWeb, Release 1.2 and One Star Level evaluations.

In 2006, external evaluations will be performed in all companies that are certified for ISO 9001 quality management system; additionally, QWeb external evaluation will take place in the parent company. Certification of business operation and acquiring the ISO 9001 certificate are planned for the company Mercator - S, d.o.o. The procedure for management in inconsistency, recommendations and praises will be upgraded by an innovation system and a full IT support. Moreover, we will engage in upgrading the ISO 9001 system with other, more narrowly focused standards.

— Preventing and eliminating inconsistency

Our preventive action continued in 2005 by further systematic and independent revision of complying with legislation and Mercator standards in all outlets and warehouses; thus, we are ensuring both the quality of goods and efficient performance of business processes.

On Group level, we performed more than 1,500 regular and random internal inspections. We regularly monitor the functioning of inspection services and closely observe any legislative changes referring to the trade industry and trade activities. We carried out a series of educational programs for retail and logistics employees, regarding the obligatory legislation and Mercator Standards and methods of compliance with them, as well as the functioning of the HACCP and DHP systems. We were closely involved in designing the Guidelines of Sound Hygienic Practice for trade activities according to the HACCP system principles; the Guidelines were accepted on the level of the Republic of Slovenia. We also compiled a Manual of Sound Hygienic practice according to the HACCP system principles, for trade activities of the company Poslovni sistem Mercator, d.d.

In 2006, further regular internal inspections will be performed according to the schedule of inspection and inspection service monitoring. The implementation is planned of an internal control system for safe food based on the Sound Hygienic Practice standard following the HACCP system principles for trade activities; we also plan to compile a document on Sound Hygienic Practice according to HACCP system principles for manufacturing plants and catering services. We will devote our efforts to education regarding the obligatory legislation, particularly the internal control for ensuring the safety of food. We shall also perform internal evaluations according to ISO 9001 and provide efficient control of inconsistency, recommendation and praise by resolving them with a system of corrective and preventive measures.

Socially Accountable Action

Refining the socially accountable activities with enhanced attention for the requirements of our environment

Integration into the social environment

Active communication with the local and wider social environment is becoming an increasingly important prerequisite for a long-term growth and a successful development of any contemporary corporation. Any enterprise should be aware of its dependence on the environment in which its operations take place and should therefore constantly develop and improve permanent relations with various groups of stakeholders.

For Mercator, the deepening of a permanent and sustainable socially accountable role is embedded in our daily operation, whereby we engage in a variety of activities that prove our integration into the natural and social environment that we operate in. We are convinced that our relationship towards the environment is of crucial importance for following and realizing the business strategy we have set for ourselves. Our social accountability is perhaps most notably displayed by our central humanitarian campaign that takes place every year, as well as numerous sponsorships and donations to support sports, culture, education and medical institutions; thus, our help is lent in all markets of our operation to those that need it the most.

In 2005, our central humanitarian campaign was dedicated to improving the culture of reading habits among the young with the project called M book ("M knjiga"). By donating a collection of 12 books by the most popular Slovenian writers to 500 libraries in elementary schools and to 60 public libraries across Slovenia, we improved the accessibility of quality intriguing literature with contemporary relevance for our youngsters. This year, the campaign will be continued and upgraded by a competition called "Odpete knjige" (meaning "Books sung out"), which will promote the combination of reading and music and unleash the imagination and creativity of the participants.

Socially accountable action is also taken in cooperation with some of our suppliers. In October 2005, we signed a three-year agreement with the company Pejo Trading, to start our third joint humanitarian campaign "We were all children"; the goal of this campaign is to enable holidays to the children whose parents cannot afford it. So far, free holidays either at the seaside or in skiing resorts were enabled to 600 children; in the following three years, a week of fun will be delivered to 900 more children who would otherwise be deprived of it.

The charity campaign "For Triglav" joined us last year with the company Procter&Gamble, to donate SIT 15 million to the Alpine Association of Slovenia, thus improving the safety of hikers and mountaineers and helping preserve the natural environment in the Triglav area. The humanitarian campaign "For pure child wishes" was carried out in cooperation with Henkel Slovenia and Slovenian National TV station and resulted in presenting 15 Slovenian kindergartens with funds to purchase outdoor playing facilities in the total value of SIT 15 million.

In January 2005, Mercator joined the Slovenian Red Cross activities for aid to the victims of the disastrous earthquake in Southeastern Asia; in December, we donated sleeping bags for the victims of earthquake in Pakistan.

We also took part as the central sponsor in a humanitarian campaign by the Slovenian Friends of the Youth Association which was carried out through the TV show called "Home Again". From February 20th to June 19th, we contributed SIT 16 million for the deprived families.

At the beginning of the 2005/06 school year, we cooperated with the Slovenian Council for Safety and Education in Road Traffic to present for the second year in a row the educational campaign

“Lumpi’s Safe Way to School” that seeks to teach the children about the importance of appropriate conduct in road traffic and to warn other participants of the presence of children on the roads.

Mercator was also the general sponsor of the traditional 10^{th} Ljubljana Marathon that took place on October 22^{nd} and 23^{rd} 2005, featuring 5,300 contestants from 23 countries. We also cooperated with the Paraplegic Association of Ljubljana Region to sponsor the wheelchair basketball team.

In 2005, we lent our support once again to the project foundation “Have fun but use your head” and the project “Golden Season Ticket” of Cankarjev Dom, and we again awarded the best high school graduates in the Golden High School Graduates project.

In recent years, Mercator has used electronic greeting cards for New Year’s, while the funds that would have been used to purchase regular cards were donated to charity, thus trying to make holidays more pleasant for those in need. In 2005 we donated these resources to the Ljubljana Clinic Center where they were allocated for the purchase of required medical equipment. In June 2005, Mercator was the largest donator to contribute funds for organizing the program of “Pediatric Clinic presentation day”.

In 2005, we also engaged in several other humanitarian activities, sponsorships and donations to help where it was most needed, thus creating benefit for our broad environment through a display of responsible attitude towards natural an social environment and by respecting social values in all fields of our operation.

We intend to continue our active cooperation in numerous socially accountable activities that feature some common characteristics, such as being pan-Slovenian, caring for the quality of life, identifying Mercator with a message, and contemporary relevance; thus we will play a part in satisfying the needs of the environment in which we are present.

Environment protection activities

In Mercator, we believe that a company’s business success is based on economic rationality, a balanced development and the integration into the natural and social environment. Therefore, we follow the principle that a company will be more efficient in the long term if it integrates care for clean technology, ecologically sound products and care for the environment into the strategy of its own development. We are aware that managing our environment is a process that involves constant adaptation to new market and legislative requirements, as well as to numerous changes in the environment itself. We strive to improve the environmental aspects of our operations, and to manage rationally and economize with energy, raw materials and other natural resources, since our operation has a significant impact on the environment. In every market of our operation, we cooperate with the local community to establish a comprehensive environmental action based on the idea of sustainable development.

We seek to reduce the quantity of waste by reducing material consumption and motivating material reuse and recycling by separate collection of all types of waste; we are also implementing a new waste packaging treatment system and performing employee training and education regarding environmental issues. In our waste treatment processes, we comply strictly with the relevant legislation and we prepare our operation for the forthcoming legislation of the European Union. We employ only those companies for waste removal and disposal that have acquired the official authorizations by the Slovenian Environmental Agency. As the co-founder of the company for waste packaging treatment SLOPAK, we have been actively involved since 2002 in establishing an efficient system of waste packaging collection and recycling in Slovenia. Since 2004, we have been performing a system of centralized waste packaging treatment, which means that separate collection at the point of occurrence or emergence and own transportation to waste packaging collection sites are seen as ways of boosting transport efficiency and increasing the share of waste packaging that is recycled, while at the same time providing some relief in the sense of air pollution. Among the registered obligors in 2005, Mercator collected the largest volume of waste packaging in Slovenia. In 2005, we introduced separate collection of waste office paper, printer cartridges and toners in some office buildings of Mercator Group trade companies. We collected and recycled 36,340 kg of waste office paper, thus saving almost 600 trees from being felled. As the co-founder of the company for waste electric and electronic equipment treatment ZEOS, we actively participated in 2005 in the preparation of a new system of waste electric and electronic equipment treatment in Slovenia, which will start operating in 2006. In 2005, we prepared a project of power usage rationalization, with which we regularly check and analyze the consumption at particular points, as well as propose corrective measures to reduce power consumption.

In order to motivate our employees for a responsible attitude towards the environment, we used the Mercator company magazine to acquaint them with the problems of waste creation, the issues regarding its treatment, relevant legislation and the principles of responsible action. Furthermore, we cooperated with our suppliers to organize numerous activities to convey the sense of responsibility for the environment to our customers as well. We took part in the organization of a competition in collecting waste paper packaging for liquids, called "Čisto okolje, veliko dobre volje" ("Clean environment, good will"). 3,000 students of "Eco-Schools" who took part in the competition collected a total of 4,531 kg of waste cardboard or paper packaging for liquids and learned a lot about separate waste collection and environment protection.

Our non-trade companies are also involved in environment protection.

— In line with our awareness of the importance of a constant care for the environment and responsibility for reducing negative effects on physical or natural environment, the company Pekarna Grosuplje, d.d., continued to display an accountable attitude towards the environment in 2005. Although the operation of a bakery presents a lesser burden for the environment, we attentively control and reduce our effect on it. In 2005, we complied fully with the environment protection requirements. We successfully continued the project of exploiting the thermal energy of smoke gasses from bakery ovens and collecting excessive warmth from refrigerating appliances to heat sanitary and technological water, thus providing for the entire requirements for warm water without any further heating. Furthermore, we replaced three obsolete baking rotary ovens with the most contemporary cutting-edge ones, thus achieving a 30 % energy saving per unit of product. Multi-level regulation of burners on the main baking oven was replaced by continuous regulation to reduce the emission of harmful substances into the air, to improve efficiency and prolong the useful life of both the burner and the boiler. By connecting additional power consuming units to the peak power consumption balancing device we attained better regulation results and reduced the peak electric power consumption. We have also built a new collection plant for waste paper and foil, which enables quality sorting, pressing and storing of waste packaging materials; moreover, separate waste collection significantly lowered waste transportation and disposal costs. We also carried out several educational events for particular groups of employees, regarding waste and dangerous substance treatment and environment protection.

— The company Eta, d.d., has always devoted significant effort to establish a favorable relationship with its narrow and broad environment. These activities were carried out in 2005 as well, taking the form of various forms of aid and cooperation in sports, culture, education and humanitarian campaigns. In this way, we developed our distinctiveness in narrow and broad environment, business and social. The same attitude and active policy have been adopted by our company and in this way we seek to stimulate a sense of loyalty to Mercator, by improving working conditions and the social security of employees. We take the environmental aspects into account in our investment decisions and this principle will continue to apply in the future. Results of such business policy are reflected in significant savings and reduced energy consumption and harmful emissions; all this considerably reduces pollution.

— The company Mercator - Emba, d.d., continued its activities in narrow and broad social environment, that were set ahead in the medium-term business plan. Among the most important guidelines of this document were efficient use of energy and increasing the share of renewable energy sources, reducing the quantity of waste packaging, waste and emissions, ecological design of new products and safe and health-friendly work of all employees, who are regularly informed of the importance of quality and of the goals and purposes of environment protection. Environmental action is increasingly becoming an obligation, demanded by our customers. In the first half of the year, we successfully passed the Social Accountability Audit, performed by McDonald's auditing jury, who among other aspects evaluated employee satisfaction and health, working conditions and company policy towards the broad social environment. We have completely restored the fire emergency lighting; we renovated the working facilities and updated the automatic equipment for manufacturing and packaging of desert toppings. We take care of the facility surroundings and provide more pleasant, safer and health-friendly working environment. We continued the separate collection of waste packaging, office paper and other types of waste. We only employ one company for waste packaging disposal and recycling, which reduced collection, sorting and transport costs for manufacturing sanitary waste. We started to upgrade the coffee manufacturing plant, as the new, environment-friendly technology will reduce gaseous emissions.

— In the company Mercator - Optima, d.o.o., the care for environment begins as early as in the phase of designing a facility; it continues into the construction engineering phase, where project documentation is strictly observed. When designing new facilities, particularly shopping centers, we observe the trends and guidelines that prevail in the world, especially regarding the rationalization of space and energy, contemporary technology and the use of natural materials for construction. More and more often, separate waste collection and presses for waste packaging pressing are already implemented into our design solutions.

— In 2005, the company M Hotel, d.o.o., displayed its care for the environment in a similar manner as in the previous years. We collected the waste separately - glass, paper, waste oil and organic waste - and we used an environment-friendly sanitary waste collection container. The kitchen is operating in close and diligent compliance with the HACCP directives.

Information Technology

Kick business process IT support - off and redesigning the support function information system

The mission of performing the IT-related activities is providing IT support for business processes with information technology and application solutions that will enable high-quality management and steering of these processes.

Development strategy which defines the orientation of IT system development follows the strategy of the Mercator Group and the requirements of key areas (procurement, accounting, finance, controlling, marketing etc.). It is based on the fundamental orientation towards providing information support on the transaction level by introducing batch solutions. We wish to focus our own development on the fields that are not appropriately supported by batch solutions and to the fields where we expect to generate some competitive edge. Purchased solutions and our own developments are being integrated into a common architecture.

In 2005, redesigning activities took place in the following key fields:

— IT support for support processes:
 — we concluded the selection of a batch solution for support processes;
 — we created and implemented a data warehouse for transaction data regarding the Mercator Pika Card;
 — we developed IT support for the introduction of electronic coupons on the Mercator Pika card;
 — we unified the IT support for employee compensation accounting;

— IT support for optimization programs:
 — we developed IT support for the logistic infrastructure optimization program,
 — within the market program inventory optimization we developed IT support for automatic goods ordering in retail units,
 — we concluded the centralized tender for computer equipment supplier.

— IT support for management and decision-making:
 — we upgraded the data warehouse of goods transactions,
 — we developed IT support for centrally managed Intersport clearance sales,
 — we developed IT support for inventory clearance and delivery frequency analysis for retail units
 — we included all outlets that joined the common procurement during the year, into the goods transaction data warehouse.

— IT support for warehouse operation and logistics:
 — we carried out a pilot project and selected a system for optimizing the transport route planning;
 — we developed IT support for providing the goods for own consumption/usage;
 — we developed IT support for analyzing incomplete deliveries by our suppliers;
 — we completed the server and database consolidation in SDC Ljubljana.

IT support for retail:

- we developed interfaces for unified purchase IT system on all POS systems;
- we continued to include outlets into the unified purchase (so far 246 units have been included)
- we have set up the electronic sale of MOBI cards in 9 test outlets.

infrastructure and security:

- we preformed regular control over the operation of computer systems,
- we implemented automatic upgrading of operating system and application upgrading,
- with regard to information security, we continued our work on the projects of establishing a comprehensive document on data and information security policy, data encoding, developing relations with external service providers (POS systems) and implementing efficient anti-virus solutions.

At the same time, we upgraded and extended the project of IT support for teamwork, as we expanded the Lotus Notes messaging system and the use of team time schedules and electronic bulletin board, and implemented electronic clearance of cost accounts in four sectors; we also replaced the ISO documentation IT support.

46 new wholesale suppliers were included into the computer data exchange project in 2005; currently, the system comprises 158 wholesale suppliers.

All new solutions for support of operations are developed uniformly for all trade companies. Therefore we continued in 2005 to implement solutions such as controlling, human resource information system, organization unit codebook and Mercator Pika card IT support, in the trade companies and new markets as well.

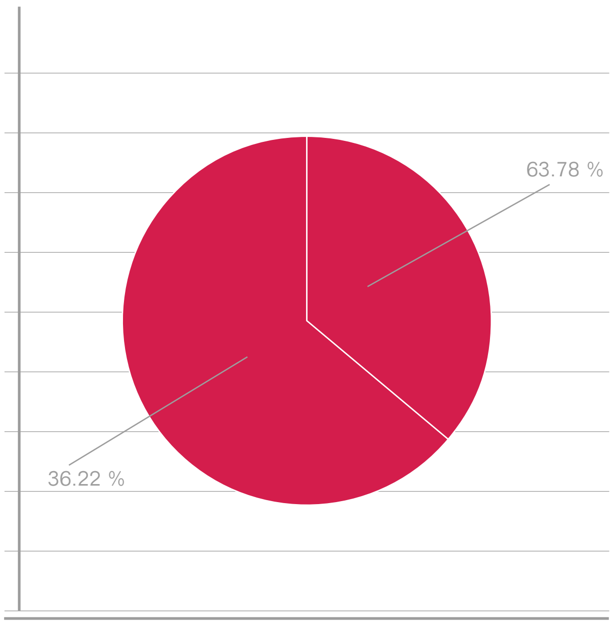
In 2006, we are also planning to select a standard project solution for supporting the flow of goods. The program of redesigning the IT system also includes establishing standardized batch solutions in all fields of operation; their main advantage is complete data integration.

Financial Operations

Acquiring favorable financing sources to support development activities

Due to the growth of sales volume and carrying out the investment activities plan in Slovenia and in foreign markets, financing liabilities including the financial leasing liabilities rose by 44.47 % in 2005, compared to the year before.

Ratio between non-current and current financial liabilites of the Mercator Group as at December 31st 2005



36.22 % Current financial liabilities
63.78 % Non-current financial liabilities

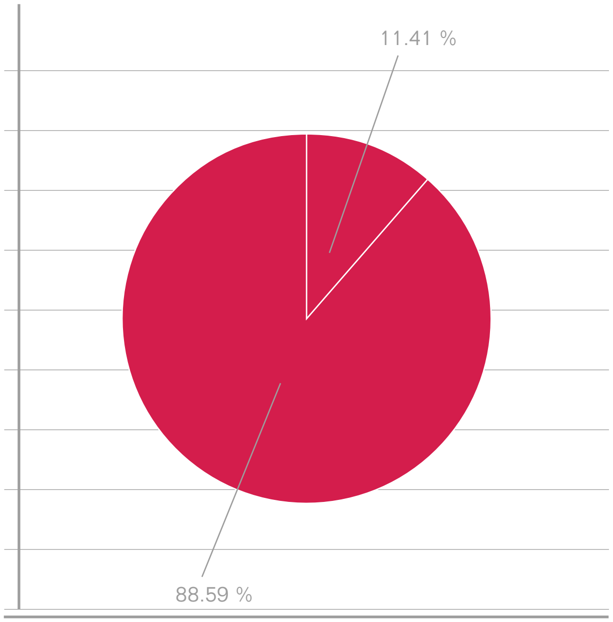
At the end of 2005, the Mercator Group reached a capital structure ratio between E&D of 1 : 1.23 (last year, the ratio was 1 : 1.04); the ratio is a quotient between equity, comprising share capital presented in financial statements and long-term provisions, and debt capital which comprises long-term and short-term financing liabilities and long-term business liabilities from financial leasing. The ratio shows that the volume of debt capital somewhat exceeded the volume of equity, indicating that the Mercator Group deviated temporarily from its strategic target capital structure, according to which the ratio of equity to debt should be 1 : 1.

At the end of 2005, coverage of long-term assets (the ration between of long-term assets and long-term sources/liabilities) amounted to 85.9 %, which is almost the same as in the previous year, when this rate amounted to 86.1 %.

In line with the planned goals, the share of short-term liabilities in total liabilities decreased, as short-term sources were successfully replaced by long-term ones, thus improving the maturity structure of liabilities/sources and additionally reduced the already low level of exposure to refinancing risk. At the end of 2005, long-term financial liabilities accounted for 63.78 % of total financial liabilities, and short-term liabilities represented the remaining 36.22 %.

In 2005, we took on both short-term and long-term bilateral loans in order to refinance the existing liabilities and to finance new investment activities. We cooperated successfully with almost all Slovenian banks and with most of European banks that operate in Central and Southeastern Europe and who list retail among their target industries. We have also successfully cooperated with banks in Mercator's foreign markets, where we obtained financing resources from foreign banks and their local subsidiaries that are financed from abroad, primarily to finance our investments in Serbia and Montenegro and in Bosnia and Herzegovina. At the end of 2005, Mercator Group (including the banks from syndicate loans) cooperated with 38 banks from 13 countries.

Ratio between financial liabilities in Tolars and foreign currency of the Mercator Group as at December 31st 2005



11.41 % Financial liabilities in Tolars
88.59 % Financial liabilities in foreign currency

In 2005, we employed financial leasing to finance the construction of Mercator Center in Zadar, while other leasing agreements were not entered into. At the end of 2005 and in the beginning of 2006, we also took over rights and liabilities from leasing agreements of the company Era, d.d. The volume of financial leasing will assumingly increase in the future, mostly in Croatia, but later on in Serbia and Montenegro and in Bosnia and Herzegovina as well.

Mercator bonds that were issued at the end of 2004 and by which we additionally diversified financing sources, improved the maturity composition of sources/liabilities and reduced exposure to interest rate risk, were listed in 2005 in the free quotation of the Ljubljana Stock Exchange with the code MEO1. New issues of bonds are planned for the future, depending of course on the financing conditions and market demand.

Following the tendency to improve the maturity structure of financing sources, and due to favorable financing conditions with other sources, we did not use the short-term Euro commercial paper in 2005. These securities are otherwise an element diversification of financing sources and represent an important Mercator's liquidity reserve.

By December 31st 2005, the invited investors paid for 254,600 shares.

Company	Number of shares authorized	Number of shares paid up until Dec. 31st 2005	Percent of shares paid up Dec. 31st 2005	Sum paid up (in SIT)
Kapitalska družba, d.d.	106,950	106,950	100%	4,064,100,000.00
Slovenska odškodninska družba, d.d.	1,060,950	106,950	100%	4,089,153,037.50
KD Group, d.d.	106,950	0	0%	0.00
KLM, d.d.	320,850	40,700	13%	1,546,600,000.00
TOTAL	641,700	254,600	40%	9,699,853,037.50

By a registration with the Court Register held by the Ljubljana District Court, the company Poslovni sistem Mercator, d.d., increased the company share capital by SIT 1,476,500,00.00, or by 147,650 new shares.

Shareholder Relations

In the second half of 2005, we started the capital increase procedure for the company Poslovni sistem Mercator, d.d. The management and the company Supervisory Board adopted on July 19th 2005 the resolution on increasing the company share capital based on approved capital by issuing up to 641,700 new registered shares with a nominal value of SIT 10,000.00 per share and a sale price of SIT 38,000 (the price applied until October 31st 2005; after this date, it was increased by accrued interest according to a 5 % annual interest rate). The entire amount of newly issued shares was offered to previously selected and well-informed investors in procedure of non-public offer; a half of the entire issue of new shares was offered to the Kapitalska družba, d. d., (for Pension and Disability Insurance), d.d., Slovenska odškodninska družba, d.d., and the company KD Group, d.d.; the other half was offered to the company management at that time via the company KLM, d.d.

Monitoring and improving shareholder satisfaction

Key information for the shareholders

On December 31st 2005, the share capital of the company Poslovni sistem Mercator, d.d., was divided into 3,208,504 shares. By the end of 2005, the 147,650 new shares that were issued during the capital increase, paid for and duly entered into the court register, were not listed in the share register with the KDD (Central Securities Clearing Corporation). The shares of the company Poslovni sistem Mercator, d.d., are listed in the First Quotation (official market) of the Ljubljana Stock Exchange, with the code MELR.

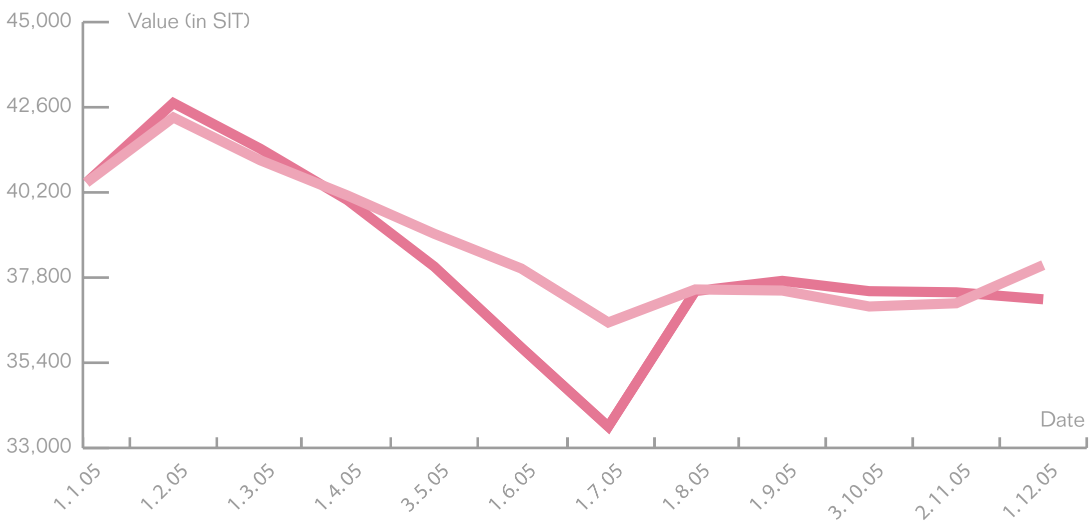
Nominal value of each share is SIT 10,000.00. From December 22nd 1997, when Mercator shares were listed on the "A" quotation of the Ljubljana Stock Exchange (share price: SIT 4,296) until December 31st 2005 (share price: SIT 36,859), the value of Mercator share rose by 757.9 %.

Pursuant provision of the Securities Market Act and Rules and Regulations of the Ljubljana Stock Exchange, the company was regularly informing the public with regard to business results and other important events.

Shareholder Information	Dec. 31 2005	Dec. 31 2004	Index
Number of shares registered in Court Register	3,356,154	3,208,504	104.6
Market capitalization (in SIT 000)	118,262,891	128,485,056	92.0
Market value per share (in SIT)	36,859	40,045	92.0
Book value per share (in SIT)	34,199	29,232	117.0
Annual low (in SIT)	33,532	32,591	102.9
Annual high (in SIT)	42,721	43,275	98.7
Weighted average market price, excluding block and cross trades (in SIT)	38,222	39,440	96.9
Earnings per share (in SIT)	1,641	1,589	103.3
Price / earnings ratio (P/E)	22.47	25.21	89.1
Capital yield (in %)	- 7.96	22.61	-
Dividend yield (in %)	0.79	1.53	51.9
Total yield (in %)	- 7.17	24.14	-

Movement of share market price

The following graph shows the movement of the average price per MELR share in 2005, compared to the movement of SBI20 index:



For comparability, the movement of SBI20 index is adjusted to set the ratio between MELR price and SBI20 to 8.25 during the entire period; this is the value that this ratio reached on January 1st 2005.

On December 31st 2005, the share of foreign investors in the company Poslovni sistem Mercator, d.d., amounted to 6.63 % and has increased by 3.59 percentage points compared to the end of 2004.

Shareholder satisfaction

In 2005, we cooperated with the Faculty of Social Sciences of University of Ljubljana to perform the fifth consecutive survey on shareholder satisfaction. The survey was performed in compliances with the ISO 9001 standard requirements, which comprise monitoring of satisfaction for all interest group within the company. The goals of the shareholder satisfaction survey were oriented towards acquiring an assessment of shareholder satisfaction, comparison of satisfaction among particular years and towards discerning the weak elements of the company as perceived by shareholders, as well as improving these weak points.

Shareholders attributed the highest grade to the company public image, expansion strategy by takeovers in home market and the business results. The lower part of the list features share price adequacy, share price movement compared to other investment opportunities, profit per share and share price movement compared to the movement of other share prices.

The average evaluation score for share market price movement compared to investment into other shares or to other investment opportunities has fallen in 2005. This result can be attributed to the fact that in the period between two Shareholder's Assemblies, the price of the Mercator share has risen considerably at first, only to start falling in the beginning of 2005; however, the movement of Mercator share price was similar to other share price movements (SBI20).

In the future, we wish to improve the fields that scored a lower grade and maintain the high level of elements that received high grades: we will continue to support the public image by socially accountable action, we will inform the shareholders via our website, and we will continue to attain good business results, which should propel the rise of share price, considering the adopted strategy.

Dividend policy

The company Poslovni sistem Mercator, d.d., set up its dividend policy based on shareholder expectations, company capital structure, investment policy and tax considerations. At their 11th regular annual Assembly on August 30th 2005, the shareholders adopted the resolution to allocate a part of the balance sheet profit from 2004 in the amount of SIT 1,020,304,272.00, which is derived from other revenue reserves (more precisely, from net profit from 1998 and 1999), for the payment of dividends in gross amount of SIT 318.00 per regular share. Thus, gross dividend in 2005 saw a deviation from the established Mercator dividend policy, due to tax considerations.

On the main performance Mercator gave to each golden graduate the USB key. This modest attention was described by golden graduates as an extra stimulation to all the good high school students and to the future hard-working students, hoping that all next generations will also appreciate Mercator's efforts.

Risk Management

Managing key risks defined for the year 2005

Mercator Group is exposed to various risks that are present in the environment of its operations, on a daily basis; therefore, risk management has been one of the key concerns for a long time. Managing risks in line with the adopted company business policy is becoming an increasingly important part of the entire management process.

In 2005, the Risk Management Committee has compiled the third Annual report for the management and the Supervisory Board of the company. The report for 2005 does not follow the standardized reporting methodology from previous years, as it includes the management of pre-defined key risks. For clarity and straightforwardness, a document called "Risk Register" was prepared within the risk management process, which summarizes all risks that have been defined so far, regardless of their relative importance. With the use of Risk Register and reports from previous years, the user can effectively and transparently monitor the management of particular types of risks.

The strong development role in the industry and the ability to anticipate the directions of development in the business environment enabled Mercator to realize the strategy of expanding to foreign markets. Both active and proactive risk management also affects the company's competitive position and consequently the company market value.

Business risks

In 2005, we continued the in-depth analysis of business risks, defined in 2003 and 2004. Special attention was paid to those risks that were assessed as key risks. For these, a more detailed analysis was conducted, according to particular product range or program (market product range, technical apparel range, textile, Intersport, Hura! discount product range); furthermore, risk analysis was performed within each program according to particular market of Mercator's operations - Slovenian market and foreign markets (Croatia, Serbia and Montenegro, Bosnia and Herzegovina). We have also assessed particular business risks in potential markets that are studied for entrance or launching in the future.

The following key risks were recognized within the business risks in retail:

— referring to the growth of market share and sales:

1. marketing mix competitiveness risk:
— risk in the process of non-competitive prices,
— risk in the process of non-competitive sales promotion projects,
— risk of determining an optimal choice of products for the customers,
— risks in the process of entrance of new competitors;

2. risk of growing number of customers:
— risk of inappropriate or non-timely withdrawal of unsafe products from retail network and warehouses,
— risk of effect on the service level (of employees) on the growth of number of customers,
— risk of unpredictable events on the number of customers,
— risk of forming supplementary offers in shopping centers;

3. risk in the field of performed investments:
— risk of delayed opening of shopping center,
— risk of buying land "on stock",
— risk of the construction cost exceeding the planned cost,
— risk related to realized sales volume (efficiency) of the completed investments,
— risk of investment efficiency monitoring (cost and revenue related to particular investment),

- risk of delayed appointment of the project group for analyzing the entrance into the new markets,
- political and land- or region-related risk;

— referring to the purchase process:
- risk in the performance of purchase policy with a focus on home suppliers in particular markets of our operation,
- risk of increasing bargaining power of Slovenian suppliers due to concentration and mergers in alimentary industry,
- risk of bargaining power towards multinational suppliers compared to foreign competition,
- risk in the purchase process due to responsibility for products that we purchase;

— risks in the process of price difference realization in retail.

The following key risks were determined in the wholesale:

— risks of marketing mix competitiveness:
- risk in the process of non-competitive prices;

— risks of a growing number of customers in wholesale:
- risk in the process of non-competitive service,
- risks due to non-payment.

Since every risk that is defined above as a key risk, appears as key risk in the long-term as well, the treatment and analysis of every particular risk also includes studying its behavior in the long run. Hence, the defined key risks will continue to receive special attention by our risk management team in the future.

Financial risks

In the Mercator Group, we followed closely the adopted policy of financial risk management, and performed appropriate measures and activities to maintain the susceptibility to particular financial risks at an acceptable level.

— Interest rate risk that occurs due to the possibility of growing financing cost with sources that are tied to a variable interest rate, is appropriately controlled. The policy of interest rate risk management includes analysis of increased exposure in case of net hiring of new sources at variable interest rate, insuring a part of financial liabilities with appropriate derivatives and the possibility to issue debt at a fixed interest rate. In line with our close observation of macroeconomic situation and the expectations on future movement of interest rates, we estimate that interest rate risk remains at a moderate level, despite the interest rate growth that reoccurred at the end of 2005. It was this growth that put us into the position of net receiver after all completed transactions for interest rate risk prevention.

— The fact that Mercator operates in an international environment gives rise to the exposure to exchange rate risk. As Slovenia entered the ERM2 and set out to adopt the Euro in 2007, the exposure of Slovenian currency, Tolar, compared to Euro, dropped to a negligible level. The risk however remains concerning the Croatian Kuna (which features a strong seasonal component) and Serbian Dinar (depreciation of local currency), primarily due to greater volatility of these currencies compared to Euro. Moreover, the present exchange rate dynamics are such that most of the negative exchange rate differences occurring in Serbia, that follow from an uneven company currency balance, have a directly negative effect on the company business results. In spite of this, we estimate the exchange rate risk at the level of the Mercator Group as reasonably low and the movement of relevant exchange rates as rather predictable, despite volatility. So far, the Mercator Group is not using any currency derivatives to hedge such risks.

— **Credit risk** in retail is kept at a negligible level due to on-the-spot payment in cash or by charge cards; in wholesale and non-trade activities, the performed analysis shows the risk to be reasonably low. Mercator's wholesale customers are well dispersed and diversified which eliminates the dependence on any particular customer, and we also constantly monitor customers that are unreliable with their payments and check the credit rating or financial soundness of all potential wholesale costumers whenever possible. In new markets, uninsured sales are restricted as much as possible. The measures that are planned in case of increased risks mostly include more stringent control of unreliable costumers, more active procedures for claim recovery and if necessary, establishing a professional credit rating service that would systematically evaluate and monitor credit risk. Based on the analysis of disputed or non-recovered claims that was performed in 2005, we established that the credit risk is actually declining, mostly due to the decreasing trend in the share of disputed claims; we interpret this as additional proof of efficient credit risk management.

— **Liquidity risk** is estimated as low, as it is decreased by revenue from retail operations that provide regular cash inflow and represent the major portion of all revenues from operating activities. In case of a significant increase in the exposure to this type of risk, which is currently considerably low, we have prepared measures like hiring new revolving loans and current accounts with commercial banks, the possibility to temporarily freeze the premature payments and new issues of short-term trade bills in the Euro market, temporary freezing some of the investment projects and accelerated disposal of commercially obsolete property. Should any further increase of exposure to this risk occur, it would doubtlessly be perceived in time, due to the cash flow management system that takes part in balancing liquidity and in decision-making regarding liquidity measures, as well as in reporting and predicting cash flows.

— Exposure to **inflation risk** is assessed as low, since inflation in Slovenia, Croatia and Bosnia and Herzegovina is low and recent forecast do not include any increases. This however does not apply for Serbian market, where inflation was high in 2005. The relatively small size of the subsidiary in Serbia and Montenegro and the routine of appropriate transfer of each increase of purchase prices to sales prices help decrease this risk as well. It is therefore our estimation that the susceptibility to exposure risk remains low.

Operational risk

Operational risk relates to the decrease in economic utility for the Mercator Group as a consequence of inappropriate planning, performance and control of business processes and activities. In 2005, the operational risk management was focused primarily on risks that were defined as key risks in the following processes:

— **process of governance:**
- risk relating to company governance,
- risk relating to shareholder links, and strategic partnerships and takeovers,
- risk of insufficient flow of information,
- risk relating to measuring, analysis and improvement;

— process of legislation management:

- risk relating to managing legislation and implementing regulation acts,
- risk relating to the protection of Mercator trademarks,
- risk relating to protecting commercial/business secrets;

— process of standardization and quality management:

- non-process operation and inadequate communication between particular functions,
- documenting business events in hard copy,
- risk relating to the required redesigning of IT support;

— process of manufacturing in trade companies:

- risk relating ensuring safe food;

— process of purchase and replenishing of inventories:

- inadequate database updating,
- incomplete deliveries from suppliers and incomplete deliveries from distribution centers to retail and to customers,
- incomplete deliveries of goods during special offers or incomplete deliveries of goods of the Mercator private label;

— process of retail:

- risk relating to the influence of Act on Sunday opening hours of retail outlets,
- risk of influence of flexible working hours of retail operations;

— process of human resource management:

- inadequate planning of human resource potential;

— process of investment and facility renovation:

- risk relating to the start of operation of investments (facilities);

— process of facility, equipment and machinery maintenance:

- risk relating to maintenance after completion of investment and start of regular operation;

— process of development and maintenance of information technology network (hardware and software):

- faulty operation of applications - software due to the change,
- risk relating to unauthorized data exposure/disclosure;

— accounting processes:

- risk relating potential errors found by revenue service inspection - Croatia, Bosnia and Herzegovina, Serbia and Montenegro,
- risk relating to increased tax burden due to legislation changes;

— controlling processes:

- fire safety risk, earthquake risk, risk with an economically viable effect of acquiring particular types of insurance - responsibility insurance; risk due to changed insurance terms,
- risk relating to cost inefficiency of operation,
- risk relating to material cost - electric power and other forms of energy,
- risk relating to maintenance costs and transport services.

We intend to include the operational risks in the business process documentation in the form of organizational regulations and work instructions.

The internal audit service has an important part in operational risk management. By checking the operation of internal control, especially in the fields of critically defined risks, it increases the risk management efficiency and thus boosts the company's value added. In the future we will attempt to effectively link the fields of internal audit and risk management, and define the internal audit approach more intensively on risk assessment; this means that on one hand, that risk evaluation submitted by the Risk Management Committee will serve as the basis for prioritizing the internal audit tasks, while on the other hand the internal audit will check or control the risk management system itself in the Mercator Group.

Stakeholder Communication

Improving relations with all segments of the public, as a reflection of awareness of the importance of communication, resulted in the competition for most reputable company

In Mercator, we foster the development of economic and social aspects of our environment. We seek to contribute to the friendliness and sound organization of environment for customers and employees alike and to increase the quality of goods and services offered. Communication is employed as a vehicle to establish and strengthen permanent relations with all segments of the public that are in contact with Mercator: our customers, employees, shareholders and the financial community, business partners, media and local and broad social environment.

Through an honest dialogue we reinforce the trust of the public and improve the distinctiveness of the Mercator brand, as well as contribute to the growing reputation of the company. The recent survey on "Company Reputation" (performed by Kline & partners), which included 200 companies from various industries in 2005, showed that Mercator was considered the most reputable company in Slovenia by the business/professional community; according to the general public, it was ranked fourth.

Mercator's reputation is solid and has been stable in recent years. We will continue to devote business and marketing effort to preserve and promote those characteristics of the company that were characterized as the most important by both segments of the public with regard to company reputation: quality of goods/services offered, clear vision and governance excellence, financial efficiency and care for the employees.

Communication with Customers

The customers are in the focus of our daily operation; in order to develop and maintain a genuine and successful relationship with them, based on respect and mutual trust, we engage in active communication with them. This way, we are learning of their requirements and wishes and successfully adapt to them; the customers who are pleased and feel comfortable in Mercator's company, are happy to return to us.

We seek to additionally develop our advantages, and to eliminate potential weaknesses at the same time; thus, we always listen to praises, complaints and suggestions of our customers who can reach us by electronic messages, letters, telephone calls, and through the book of complaints and praises which is available in all our outlets. Consistent and timely response to the opinion of the customers we preserve their satisfaction, improve it and thus strengthen their loyalty. Received suggestions are at the same time generators of numerous new approaches that are introduced into our operation.

The Mesec magazine which has been published for seven years in Slovenia and since 2003 in Croatia is a special vehicle of maintaining the communication link with our customers. The magazine presents the new features and products in Mercator's outlets, current projects that are preformed or prepared, and advice on more healthy, full and quality lifestyle. The readers are also informed of events in Mercator, while special coupons enable even more favorable shopping. All letters from our readers referring to the content of the magazine are read and the best among them are awarded. In 2005, the Mesec magazine was sent four times to 500,000 households in Slovenia and in Croatia.

In order to further approach our customers, we upgraded the Mesec magazine in 2005 and designed a website titled e-Mesec (www.mesec.mercator.si). The website visitors can view the entire contents of the magazine, as well as some additional topics containing clear and interesting news, presentation of current events and invitations to the company.

In Mercator, we are aware that the sales personnel is the most closely involved with our customers, as they meet with them on daily basis. Therefore we organized in 2005 for the first time the contest for "The Best salesman/woman" according to our readers. In September issue of the Mesec magazine, on a special flyer and in the Consumer Guide we encouraged readers to vote for the salesman or saleswoman whose smile, advice or help made shopping in our outlets most pleasant. According to received votes we selected and awarded 17 salesmen and saleswomen; awards were also received by the customers selected in the final drawing.

Mercator also shares the joy of its jubilees with its customers. At openings and birthdays of our outlets, we offer special discounts and additional benefits, while holders of the debit and credit card Mercator Pika, which went international in 2005 as its use was expanded to all markets of our operations, are awarded double points for their purchase during selected days.

The efficiency of market communication in the project "Healthy life - healthy is the way to go", we were awarded the bronze Effie medal, which reassures us that the communication campaign has reached its purpose, namely efficiently presented Mercator and its message to the customers. Moreover, Slovenian PR Association awarded us in November 2005 with the Prizma ("The Prism") award for excellently performed communication support of our central humanitarian campaign "The House of Shelter" (2004).

Communication with Employees

We are aware that customer satisfaction depends heavily on the satisfaction of our employees who are in daily contact with them; therefore, we devote special attention to internal communication and attempt to reach our employees through various channels.

Every month, all employees have the opportunity to meet personally with the Mercator Management Board members during the "Day of Open Doors", and talk to them about their wishes and problems or present suggestions and proposals to improve working conditions.

Mercator's internal company magazine "Mercator journal" has been published for more than 40 years - in 2005 it reached almost 24,000 copies - and apart from all the employees of the Mercator Group, it is also read by Mercator retirees and scholarship recipients. The magazine's mission is spreading Mercator's vision, goals and values among the employees and improving their loyalty; therefore, the contents of the magazine are used to regularly inform the employees of the important events and decisions of the management and to announce numerous current and future projects in Mercator. The magazine is suited to provide interesting content for any reader.

Every year, the traditional festivity called "The Mercator Day" is held as the concluding event to the sports competitions that feature employees from all Mercator companies and markets of operation. The festivity is intended for socializing, relaxation and entertainment of employees along with their close family members. In 2005, over 18,000 of us gathered in Bled.

Good temper and quality entertainment were provided in 2005 on the New Year's employee meeting as well - The Ultimate Party, held on December 17th 2005 at the Ljubljana fair facility "Gospodarsko razstavišče" was attended by nearly 10,000 people that, among other things, bade farewell to the previous Mercator management.

An important motivational project for the employees was the competition of retail units in the arrangement of the fresh product range departments. In 2005, the competition was held for the sixth time and after the spring and autumn evaluation, 31 outlets were selected among the 152 participants, to be awarded.

Efficient internal communication in Mercator also takes trough the internal web pages, where the employees are additionally informed in order to perform work processes and tasks even better.

The satisfaction of employees with internal communication is measured each year in a "Satisfaction survey". The already high level of employee satisfaction in the previous years has increased further in 2005.

Communication with Shareholders and Financial Community

Our efforts for highly professional communication with shareholders and other segments of the financial community were proven in 2005 by the nomination of the IR Magazine for the best Slovenian company in the field of financial community relations.

In our relations with the financial community, we applied the policy of active communication with the present and potential investors. Our shareholders and other members of the financial community were informed of business results, plans and other important aspects of our operations through the electronic information system of the Ljubljana Stock Exchange, the SEOnet. Due to the listing in the first quotation (official market) of the Ljubljana Stock Exchange, we published in 2005 the business results and price-sensitive information in English as well, thus taking another step towards the international financial community which could previously obtain information on Mercator only through direct contact.

In 2005, we met with representatives of various institutions (banks, investment funds etc.) who were submitted both publicly disclosed information as well as additional information on the past operations of Mercator and development plans. Presentations that were submitted to analysts and investors at these meetings were also published on our website. We regularly respond to all questions raised by the media.

In accordance with the public information requirements we regularly update our website which also features all announcements from the SEO-net system and from printed media.

Our Annual report is another important vehicle of performing the planned financial community communication. We regularly monitor any changes in legislation and guidelines regarding the preparation and the contents of the Annual Report. We are particularly proud of the 2004 Annual Report, as it was awarded the first prize in the best annual report competition organized by the Finance daily paper.

Communication with Business Partners

Successful operation in a competitive and quickly changing environment requires active communication with our business partners; hence, we seek to systematically develop deepened and permanent relations. By submitting timely information regarding the future plans and goals, they are motivated and prepared for new challenges and cooperation. Strategic partnerships facilitate the realization of our strategy and attaining our goals. This way, we gain better acquaintance of our customers and consequently perform better at meeting their requirements and expectations.

Mercator's development plans, with a special emphasis on procurement and marketing orientations, were presented in 2005 to our suppliers at the traditional Marketing days, as we met on Valentine's Day and considered together the situation of alimentary or food processing industry today and in the future. To please all participants, solidly attended traditional meetings with suppliers will be organized in the future as well.

Communication with Media

We seek to establish and maintain honest and professional relations with media representatives, based on respectable cooperation and mutual trust; such relations will contribute to maintaining a positive image of the company in the media.

In 2005, we had contact with the media at numerous formal and informal events, we responded actively and timely to their questions, and informed them of important events, decisions and changes with our public announcements and additional material. The interviews and statements additionally proved the transparency of our operations.

The year 2005 saw a record number of media coverage, as 23,131 articles were published that were directly or indirectly related to Mercator, which is 12,453 announcements more than in the year before.

Financial Ratios and Business Performance of the Mercator Group

Further activities for rationalization and establishing a strategic program of business operation

Business Operations Analysis

In 2005, the Mercator Group continued to consolidate and rationalize its business operations, paying special attention to:

— Consolidation of operating activities - Back in 2004, the company Poslovni sistem Mercator, d. d., took over the retail and wholesale operations of the company Živila Kranj, d.d.; in 2005, it did the same with the retail and wholesale operations of the companies Mercator - Goriška, d.d., and Mercator - Dolenjska, d.d. In December 2005, we merged all three companies to the controlling company.

— Establishing capital ties - In 2005, the Management Boards of the companies Poslovni sistem Mercator, d.d., and Era, d.d., Velenje, signed the agreements on the acquisition of Era trade network in Croatia, the acquisition of Era retail and wholesale operations in Slovenia and the purchase of land estate in the Skopski sejem (Skopje Fair) complex. In September 2005, the company Poslovni sistem Mercator, d.d., acquired a share in the company Investment International, d.o.o., with headquarters in Skopje, thereby obtaining another land estate in Skopje, for the expansion of trade operations in Macedonia. In October 2005, the company Poslovni sistem Mercator, d.d., purchased a 51 % share of the company Savski otok, d.o.o., and in December 2005 it purchased the first part of retail, wholesale and technical apparel outlets of the company Era, d.d., in Slovenia.

— Strategic optimization programs - in 2005, we have set the foundations for four strategic optimization programs:

- optimization of the Mercator Group operations in order to increase efficiency and reduce the operational costs;
- redesigning the information system in order to provide information support on the level of transaction by implementing batch solutions;
- optimization of logistics facilities, in order to make a long-term influence on decreasing the costs of logistic operations;
- category management, in order to optimize the choice of products, positioning and pricing policy and round the sales promotion policy according to product categories.

In 2005, the net sales revenues of the Mercator Group amounted to SIT 419,067 million, which is 11.2 % more than in the year before and 9.3 % more than planned for this year.

The net profit of the Mercator Group in 2005 amounted to SIT 3,265 million, which is 34.9 % less than in 2004 and represents 64.9 % of the plan for 2005. One important factor of a lower net profit in 2005 was the effect of impairment of some of the tangible assets and Era companies in Croatia. The category of the Mercator Group profit for 2005 and 2004 is therefore not entirely comparable and it is more appropriate and meaningful to compare the regular business result of the Mercator Group according to gross cash flow from operating activities, which is net of all relevant non-cash categories that influence the net profit/loss. In 2005, the Mercator Group attained SIT 26,624 million of gross cash flow from operating activities, which is 19.6 % more than in 2004.

The value of non-current assets of the Mercator Group at the end of 2005 was increased by SIT 65,558 million compared to the year before, primarily due to investment into development of retail network, value increase based on assessed fair value and inclusion of the Croatian companies Era Tornado, d.o.o., and Trgohit, d.o.o., in the Mercator Group.

Compared to the beginning of the year, the asset composition changed as the value of current assets was increased by 16.2 %. The increase is mostly a consequence of trade and other receivables that represented 10.4 % of all assets at the end of 2005 and have increased by nearly SIT 7,036 compared to the beginning of the year. The main factor of this increase is the inclusion of the companies Era Tornado, d.o.o., and Trgohit, d.o.o., into the group, as the wholesale operations represent a larger part of their activities.

Share capital and long-term provisions represent 36.9 % of all liabilities, which has slightly decreased compared to 2004.

In 2005, trade and other payables have increased compared to the year start by SIT 8,258 million.

Financial liabilities rose compared to the beginning of 2005 by SIT 48,009 million. In the composition of financial liabilities, the long-term financial liabilities represent 63.8 % and the short-term financial liabilities stand for 36.2 %, which implies an improved composition compared to 2004.

Financial Ratios

	Mercator Group 2005	2004
Profitability ratios		
Return on equity	2.7%	4.5%
Return on sales	0.8%	1.3%
Financial structure ratios		
Capital and long-term provisions to total liabilities	36.9%	39.5%
Financial liabilities to total liabilities	45.4%	40.9%
Financial liabilities / capital and long-term provisions	123.0%	103.5%
Long-term coverage of fixed assets	85.9%	86.1%
Operating efficiency and productivity ratios		
Revenues per employee per work hour (in SIT 000)	27,779	26,187
Added value per employee per work hour (in SIT 000)	5,398	5,419
Gross cash flow from operating activities / sales	6.4%	6.9%

All profitability and productivity ratios are calculated based on the average value of each item in the balance sheet for the relevant year. Financial structure ratios are calculated as at December 31st. Value added has been calculated as the sum of gross cash flow from operating activities and labor costs.

Operation of the Mercator Group Companies

Mercator - SVS, d. d.

In 2005, the company performed minor renovations of the retail units, carried out the divestment of the commercially superfluous property, discontinued non-profitable retail units and conceded some to franchise hire. In the second part of the year, the company started the wholesale supply to a part of Mercator sales units in Dolenjska region with all product categories and with delicatesse and frozen program in Koroška and Celje regions. The company management signed in December 2005 an agreement on the takeover of ten outlets of the company Era, d.d., which were gradually merged by the end of January 2006. Investment activities were focused on acquisition of land and buildings for construction of new shopping or trade centers, while in November, the designing of the plan of construction works for Mercator center Pobrežje in Maribor was completed; the construction works are planned to begin in the first part of 2006. After the end of business year, the company sold five paper mills to the company DZS, d.d. In 2006, the company will follow the strategy of the Mercator Group development.

Emona Maximarket, d. d.

Business operation of the company Emona Maximarket, d.d., in 2005 was focused on the transfer of retail activities to the parent company Poslovni sistem Mercator, d.d., which will improve business efficiency of the entire Group. Investments were concentrated on renovation and the purchase of equipment for improvement and adaptation of retail units to Mercator standards. The company sold a part of the building at Trg Republike 1 to the parent company. In 2006, the merger of this company with the controlling company is planned.

Alpkomerc Tolmin, d. d.

Operations of the company Alpkomerc Tolmin, d.d., was directed in 2005 towards the transfer of retail and wholesale activities to the parent company. The company invested in renovation of the outlets and the construction of new ones which should be opened in 2006; on the other hand, divestments from commercially unviable and superfluous property took place. After the end of business year, the company sold the Kanin hotel in Bovec. According to the plan, the company shall be merged with the parent company in 2006.

Mercator - Modna hiša, d. o. o.

In 2005, the operation of the company Mercator - Modna hiša, d.o.o., was oriented towards transferring the retail activities to the parent company for operations in textile product range. In this year, the company opened three outlets an renovated one; operation of 12 non-profitable outlets was discontinued. An important strategic policy is a development of our own retail brand "MH design' which features our own design. In 2006, the company shall be merged with the parent company.

Savski otok, d. o. o.

The company Savski Otok, d.o.o., a real-estate brokerage and management company, was founded by the company Živila Kranj, d.d., in 2003, with a 49% ownership share; the remaining share was owned by two Austrian partners. In 2005, the company Poslovni sistem Mercator, d.d., purchased the remaining 51 % share of the company, thereby becoming the 100 % owner. In 2006, the company will be merged to the parent company.

Mercator - H, d. o. o.

In 2005, the company opened new and renovated outlets (Mercator Center in Zadar, convenience store in Velika Gorica, Supermarket in Srednjaci in Zagreb), acquired the companies Era Tornado, d.o.o., and Trgohit, d.o.o., and purchased the trade center Samobor from the company Era, d.d. In order to accommodate these investments, the parent company Poslovni sistem Mercator, d.d., performed a capital increase of the company Mercator - H, d.o.o., in the sum of SIT 20,146 million. Activities for acquiring new landed property and documentation required for construction of new retail units were also carried on. The company introduced the green Mercator Pika charge card in all points of sale in Croatia. Among the important events following the end of business year are the substitution of company director in January 2006 (Mr. Stanislav Brodnjak was replaced by Mr. Alan Kričković), and the formal merger of the subsidiaries Era Tornado, d.o.o., and Trgohit, d.o.o., to the company Mercator - H, d.o.o. In 2006, the company will continue to follow the goals, set in the medium-term development plan of the Mercator Group. Thus it will continue to build up its position in the market by further sales revenue growth and by opening outlets with new store format, as well as by potential strategic alliances with similar companies; at the same time, the company will allocate considerable attention to profitability of operations through optimization and consolidation of all business processes and control over all types of costs.

Mercator - S, d. o. o.

The beginning of 2005 in Serbia and Montenegro was characterized by the introduction of the value added tax; given the short transition period, the company Mercator - S, d.o.o., had several operational problems. However, the company was active in 2005 in other fields as well. They continued to expand their retail network and opened a Mercator Center in Čačak and a supermarket in Zemun in December. The number of customers, the number of Mercator Pika card holders rose by 40 %. In August, the green Mercator Pika charge/credit card was introduced as well. Due to requirements for additional resources, the company Poslovni sistem Mercator, d.d., performed in 2005 a capital increase in the company Mercator - S, d.o.o., in the amount of SIT 1,462 million. In 2006, the company is planning to open a smaller shopping center in New Belgrade, wile a lot of effort will be devoted to the startup of outlets that were opened in 2005. By fall 2006, the company intends to acquire the ISO 9001 quality certificate.

Mercator - BH, d. o. o.

Mercator has been present In Bosnia an Herzegovina for five years and during the celebration of the fifth anniversary, the customers received the better part of the attention; in 2005, the company enabled them the use of the green Mercator Pika charge card, while special attention was paid to the municipality of Novi Grad, as a sports hall was presented at the opening of the new Trade Center in Dobrinja. Apart from investing in this trade center, the company continued the activities for acquiring new land and the documentation required for construction of new trade centers. The parent company performed a capital increase in this company in 2005, in the amount of SIT 3,799 million. After the end of business year, the composition of the company Supervisory Board changed; as of January 1st 2006, the tax legislation has also changed as value added tax was introduced. In 2006, the company plans to open a trade center in Mostar and to commence the construction of a Mercator Center in Banja Luka.

Pekarna Grosuplje, d. d.

The company Pekarna Grosuplje, d.d., finished the 2005 business year very successfully, as the year saw breaking of record highs in all fields of operation. The company increased both net sales revenue and net profit. According to the volume of manufacturing and sales, the company confirmed the second place in Slovenian market among the manufacturers of bread and pastry, and kept the leading position in the segment of products that are finalized in outlets; it has also increased its export to Croatia by 61 %. In 2005, the company invested in research and development of new products and in the improvement of the existing ones, as well as in the improvement of technological procedures. Apart from these investments, the most important ones were the purchase of land for construction of a new production plant and setting up a contemporary plant for production of leavened puff pastry. Due to stringent competition and connections with the Mercator Group, a much slower sales growth is planned for 2006, while with some retailers even the reduction is expected. In spite of the reduction in disposable investment funds, the company is planning to increase its market share in Slovenia, as investment activities will be aimed primarily at improving equipment for finishing bread products at the point of sale, i.e. in the outlets.

Eta, d. d.

In spite of increased sales volume, both in terms of quantity and value, and in spite of retaining the leading market share in Slovenia and increasing the exports by 28 %, the company finished the 2005 business year below expectations. A negative net business result (net loss) is partly a consequence of current operations, although the changes in accounting policies for inventory valuation also affected it. The company continued to reduce the number of employees and to increase productivity. In the R&D field we allocated our efforts to development of new products; also important were the investments into equipment that improves productivity, increases capacity and maintains the level of quality. Further development of the company is expected to take the course of rationalization and specialization of production processes, considerable increase of revenues and value added per employee, entering new markets and gaining new customers. The key objective of the company operations in 2006 is to achieve a positive net business result.

Mercator - Emba, d. d.

Changed operating conditions as a consequence of Slovenia's admission to the European Union were reflected on the company Mercator - Emba, d. d., even more in 2005. On one hand, the pressure of competition - multinational companies present in the European market - in the home market has increased due to the abolishment of tariff protection; on the other hand, competitive edge in the markets of former Yugoslavia was reduced as the bilateral trade agreements were cancelled. In spite of harsh conditions, the company considerably increased its sales, both in terms of quantity and in terms of value; in foreign markets, the sales were increased by 44 %. Development of own products was also continued as 18 new products were launched, of which five were intended for company's own brand and two were developed for the Mercator brand. The investment performed in 2005 was mostly aimed at improving the technological processes of producing coffee, desert toppings and at improving logistics. In 2006, the company is planning further investment in upgrading the equipment. It will continue to expand the chain of Santana Coffee Shops in Slovenia and abroad, it will perform the external certification fo the ISO 9001:2000 quality system; one of the priority tasks will be reducing all operating costs, as these have grown considerably faster than revenue in 2005.

Mercator - Optima, d. o. o.

In 2005, the company participated in construction and renovation of more than 30 facilities, which took place within the Mercator Group in 2005. The most investments were still carried out in Slovenia, where investment in medium sized and smaller facilities were predominant, apart from Hura! discount stores. In Croatia, the company took part in construction of the Mercator Center in Zadar, which was opened in March, as well as in designing several smaller outlets (three trade centers were opened in the beginning of December, namely in Dobrinja, Čačak and Zemuno). In 2006, the company is planning to carry out more projects, especially within the investment activities of the company Poslovni sistem Mercator, d.d.

M Hotel, d. o. o.

In 2005, the company included into its operations the activities of hotels Bor and Planika that were acquired from the company Živila Kranj, d.d. Apart from the acquisition of these hotels, the company also took over in 2005 the employees, the number of which rose from 53 to 65. Consequently, the company increased its net sales revenue, but decreased the net business result, primarily because of poor performance by these hotels. Investment activities were aimed at restoring and upgrading capacity, as well as the purchase of computer equipment, software and other equipment. In 2006, the company is planning to sell the hotels Bor and Planika and to invest into more economic use of energy, motion surveillance systems and other equipment.

Events Following the Business Year-end

— On January 1st 2006, the new Management Board of the company Poslovni sistem Mercator, which includes the President Mr. Žiga Debeljak and three Board members, Mrs. Vera Aljančič Falež, Mrs. Mateja Jesenek and Mr. Peter Zavrl, assumed its five-year term.

— As of January 1st 2006, based on the resolution adopted by the Shareholders Assembly on August 30th 2005, and pursuant the Commercial Code, the company Poslovni sistem Mercator, d.d., prepares its Annual Report solely according to the International Financial Reporting Standards.

— In January 2006, Era retail and wholesale network in Slovenia was effectively merged with the Mercator Group.

— On January 31st, the company KD Group, d.d., paid its capital increase sum of SIT 4,115 million for 106,950 new shares; the company KLM, d.d., paid a part of its entitled capital increase sum, in the amount of SIT 800 million for 20,790 new shares. January 31st 2006 was set as the payment deadline for new shares. All invited companies, except for KLM, d.d., paid for the entire sum of offered shares. In line with the Supervisory Board resolution, the company Poslovni sistem Mercator, d.d., offered the remaining shares (259,360 shares) to other investors, in relevant proportionate shares, which means 86,453 shares per investor. Since the investors waived their preemptive right to acquire the shares, these remain unsold.

— The company Poslovni sistem Mercator, d.d., has already started the proceedings for entering new shares into the court register, whereby it is estimated after consideration of required approvals and administrative procedures, that the shares will be issued with Central Securities Clearing Corporation or will be listed on the Ljubljana Stock Exchange organized market in April 2006. After the completion of the capital increase, the company Poslovni sistem Mercator, d.d., will have a total of 3,590,844 ordinary shares.

— In January 2006, we started to upgrade our customer loyalty program. The project comprises devising a strategy of the Mercator Pika loyalty program, with a primary goal to design a comprehensive CRM (Customer Relation Management) system and include new benefits for the holders of Mercator Pika charge card.

— In January 2006, we have upgraded the image and the contents of the company journal, giving it a new name - Časomer.

— On February 14th 2006, the Constitutional Court withheld the part of the Trade Act that restricts the opening hours of grocery stores to a maximum of ten Sundays per year. This means that until the final court decision on the constitutionality of this Article, the Sunday opening hours for stores with grocery program remain unrestricted.

— We spent the Valentine's Day, February 14th 2006, with our suppliers from Slovenia, Croatia, Serbia and Montenegro and Bosnia and Herzegovina, as we organized the Seventh Mercator Marketing Festival. We have presented our strategic policies, marketing strategy and procurement policy.

— On March 16th 2006, the 6th Banking Festival was held. There, we met with our financial partners who contribute significantly to realization of Mercator's development goals. The purpose of the meeting was the presentation of strategic policies for the new medium-term period.

Mercator donated a part of resources for buying the rescue engine and its equipment to the Rescue Station of the main Slovenian hospital. The project leader returned thanks for donation in the name of all his co-workers. With this donation they intervened for 548 times in the year 2005 and they saved many lives.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Plans for 2006

In 2006, the Mercator Group intends to perform the following activities for realization of the five strategic goals:

1. The largest retailer in Slovenia:

- We will continue to expand our retail network in Slovenia by opening a Mercator center in Maribor - Pobrežje and by opening trade centers in Cerknica, Lesce, Krško and Bohinjska Bistrica.
- We shall allocate SIT 24,465 million for capital expenditures (investment into property, plant and equipment).
- We will expand the web store delivery area for market program in Slovenia, and should the economic feasibility calculation prove positive, extend the web store by adding non-market program products from Mercator's technical range.
- We will update the Mercator websites by separating corporate and customer related contents and setting up personalized web pages for holders of the Mercator Pika charge card.
- The Business Mercator Pika card will be introduced; the card is intended for enterprises and their purchases in the Mercator retail network.
- We will spread intensively the number of products in the Mercator brand product ranges and continue to develop the existing product ranges in order to provide the most competitive offers in terms of price, and to meet the preferences of specific customer segments.
- The holders of Mercator Pika credit card will be enabled a wider applicability of the card, since its operation will be expanded to telecommunications (mobile phones, internet access etc.) and to complementary product ranges and services.
- From March 1st 2006, all prices in retail units will be given both in Slovenian Tolars and Euros.
- We will continue to set up the new "store concept" of hypermarkets that was first introduced in Čačak, in all newly opened or renovated Mercator centers.
- We will carry out our central humanitarian campaign aimed at motivating people for quality life and development of reading habits.

2. Leading retailer in the neighboring markets of SE Europe:

- We shall build or start building shopping centers in Zagreb, Rijeka and Novigrad in Croatia, Mostar in Bosnia and Herzegovina and New Belgrade in Serbia and Montenegro.
- We shall allocate SIT 14,770 million for capital expenditures (investment into property, plant and equipment).
- We will study the possibilities of establishing strategic partnerships with local retail chains in Croatia, Serbia and Montenegro and Bosnia and Herzegovina.
- Special attention will be paid to a proactive performance of market analysis for potential locations to place in foreign markets where Mercator sales ranges/programs could be launched; we shall also perform in-depth studies of potential micro-markets for expanding the Mercator retail network, especially in capital cities of the countries that we are already present in.
- We will continue to adapt our marketing activities to regional and local requirements and promote customer loyalty through the Mercator Pika charge card.

3. Entrance to other SE European markets:

- We will study and analyze the opportunities to expand our operations in the Macedonian market.

4. Development of non-market product range:

- As a part of the trade consolidation and business rationalization processes, we shall transfer in 2006 the activities of the companies Emona Maximarket, d.d., Mercator - Modna hiša, d.o.o., to the controlling (parent) company and also formally merge them to the controlling company.
- We will look for a potential strategic partner for individual non-market product ranges, particularly one with access to global supply sources; this way, Mercator's competitiveness in this field would be further increased.
- We will continue to seek even greater synergy effects between non-market and market programs.
- We will introduce the concept of Category Management.

5. Profitable operation:

- We shall perform four strategic optimization programs:
  - optimizing the operation of the Mercator Group,
  - redesign of the information system,
  - optimizing logistic infrastructure,
  - category management.
- Efficient performance of activities required for adoption of EURO.
- We shall ensure revenue growth.
- We shall improve our working capital management.
- We shall disinvest from commercially unviable or unnecessary business and financial assets.
- We will increase our capability to generate cash flow and create value for the owners.

A Summary of key information regarding the planned operations of the Mercator Group in 2006 according to the International Financial Reporting Standards:

- In 2006, the Mercator Group is planning SIT 465,362 million of net sales revenues, which is 11.0 % more than in 2005. The planned growth of net sales revenues will be attained ecpecially by the planned opening of new Mercator centers in Maribor, Zagreb and Rijeka, and new trade centers in Cerknica, Lesce, Krško, Bohinjska Bistrica, Novigrad, Mostar and Novi Beograd. Furthermore, the increase will be fueled by the opening of shopping centers in Čačak, Dobrinja and Zemun at the end of 2005, and by taking over the Era retail and wholesale operations in Slovenia and in Croatia.

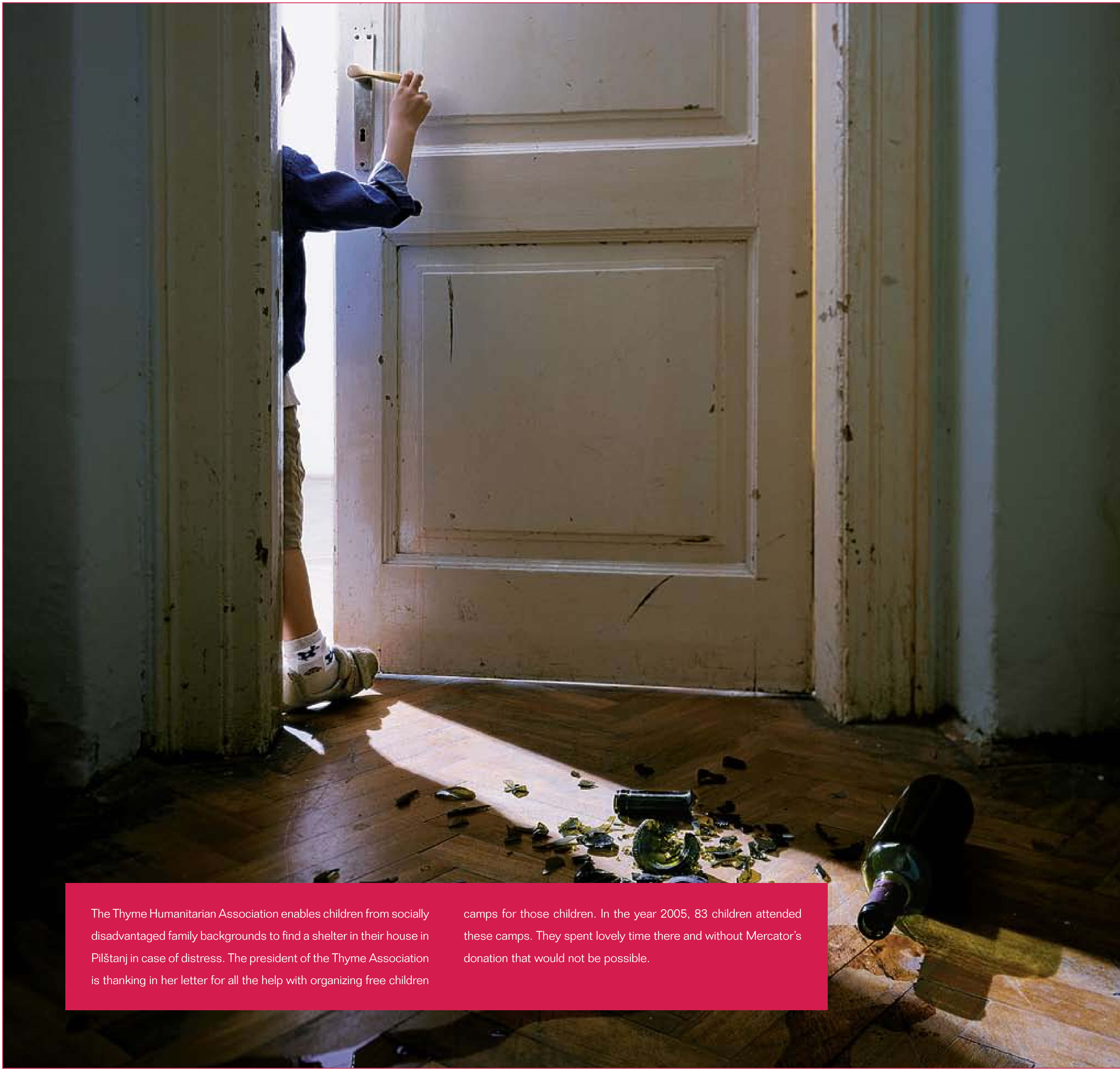
- Net profit before taxes of the Mercator Group for 2006 is planned to attain SIT 9,143 million, which is 85.4 % more than in 2005, while net profit is planned at SIT 6,135 million, which is 87.9 % more than in 2005.

- In 2006, the gross cash flow from operating activities is also planned to increase compared to 2005, by 12.7 %, to reach SIT 30,016 million.

- The Mercator Group will continue to expand and both update and upgrade its retail network and to invest into distribution centers and information technology. SIT 40,181 million have been allocated for investment activities in 2006, of which 63 % will be invested in Slovenia and 37 % will be invested abroad.

- In line with planned activities, we intend to increase the number of employees, which should rise from 16,372 to 17,643 by the end of the year; 13,870 workers will be employed in Slovenia.

2005
Financial Report



The Thyme Humanitarian Association enables children from socially disadvantaged family backgrounds to find a shelter in their house in Pilštanj in case of distress. The president of the Thyme Association is thanking in her letter for all the help with organizing free children camps for those children. In the year 2005, 83 children attended these camps. They spent lovely time there and without Mercator's donation that would not be possible.

Principal Accounting Policies

Basis of preparation

The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). The consolidated financial statements are prepared under the historical cost convention except as disclosed in the accounting policies below. Unless otherwise stated the amounts in these financial statements are expressed in millions of Slovenian tolars.

Consolidation

Subsidiary undertakings, which are those companies in which the Group, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which effective control is transferred to the Group and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealised gains and losses on transactions between Group companies have been eliminated. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus cost directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

A list of the Group's subsidiaries is set out in Note 31.

Revenue recognition

Sales are recognised upon delivery of merchandise and products and customer acceptance, if any, or performance of services (mainly rental income and marketing support revenues), net of value-added tax and discounts, and after eliminating sales within the Group. Revenue from the sale of the goods is recognised when significant risks and rewards of ownership of the goods are transferred to the buyer.

Other revenues earned by the Group are recognised on the following bases:

- Interest income – as it accrues unless collectability is in doubt in which case the amount is written down to recoverable amounts and interest income is thereafter recognised based on the rate of the interest that was used to discount the future cash flow.
- Dividend income – when the Group's right to receive payment is established.

Investments in associated undertakings

Investments in associated undertakings are accounted for by the equity method of accounting. These are undertakings over which the Group has between 20% and 50% of voting rights, and over which the Group exercises significant influence, but which it does not control.

Equity accounting involves recognising in the income statement the Group's share of the associates' profit or loss for the year. The Group's interest in the associate is carried in the balance sheet at an amount that reflects its share of the net assets of the associate and includes goodwill on acquisition.

Foreign currencies

a) Functional and presentation currency

Items included in the financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Slovenian Tolars (SIT), which is the Company's functional and presentation currency.

b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on debt securities and other monetary financial assets measured at fair value are included in foreign exchange gains and losses. Translation differences on non-monetary items such as equities held for trading are reported as part of the fair value gain or loss. Translation differences on available-for-sale equities are included in the revaluation reserve in equity.

c) Group companies

Income statements and cash flows of foreign entities are translated into the Group's presentation currency at average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation of the net investment in foreign entities and of borrowings are taken to shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Intangible assets

a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net assets of the acquired enterprise at the date of acquisition. Goodwill on acquisition of subsidiaries is included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

b) Patents, trademarks and licenses

Expenditure on acquired patents, trademarks and licences is capitalised and amortised using the straight-line method over their useful lives, generally over 5 years. The carrying amount of each intangible asset is reviewed annually.

Where an indication of impairment exists, the carrying amount of intangible assets is assessed and written down immediately to its recoverable amount.

Investments

The Group classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired.

a) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. Investments that are acquired principally for the purpose of generating a profit from short-term (less than one year) fluctuations in price are classified as trading, and are included in current assets. These assets are carried at fair value, and realised and unrealised gains and losses arising from changes in the fair value of trading assets are included in the income statement in the period in which they arise.

b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as "trade and other receivables' in the balance sheet.

c) Held-to-maturity investments

Investments with fixed maturity that the management has the intent and ability to hold to maturity are classified as held-to-maturity and are included in non-current assets; during the period the Group did not hold any investments in this category.

d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories; during the period the Group did not hold any investments in this category.

Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Property, plant and equipment

Land and buildings are shown at fair value, based on periodic, but at least triennial, valuations by external independent valuers, less subsequent depreciation for buildings. Other tangible assets are measured at cost less accumulated depreciation.

Increases in the carrying amount arising on revaluation of land and buildings are credited to other reserves in shareholders' equity. Decreases that offset previous increases of the same asset are charged against fair value reserves directly in equity; all other decreases are charged to the income statement. Each year the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost is charged directly to fair value reserve in equity.

The useful life and the residual amount (value) of the important tangibles is annually reassessed by an internal commission of accounting and investment experts following examination of the events and indices that may require reassessment for a certain asset.

Depreciation is calculated on the straight line method so as to write off the cost or revalued amount of each asset to their residual values over their estimated useful life as follows:

Buildings	20 - 40 years
Office equipment	3 - 10 years
Plant and machinery	10 - 15 years
Leasehold improvements	3 - 8 years

Land is not depreciated as it is deemed to have an indefinite life and construction in progress is not depreciated until put into use.

Where the carrying amount of an asset is greater than its estimated recoverable amount it is written down to its recoverable amount.

Gains and losses on disposal of property, plant and equipment are determined by reference to their carrying amounts and are taken into account in determining operating profit. When revalued assets are sold, the amounts included in other reserves are transferred to retained earnings.

Borrowing costs relating to the financing of the construction of property, plant and equipment are expensed as incurred.

Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

Impairment of long lived assets

Property, plant and equipment and other non-current assets that are subject to amortisation or depreciation are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows.

Inventories

Inventories are stated at the lower of cost or net realisable value, using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads, but excludes interest expense. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. Trade receivables to subsidiaries are not revalued. The amount of the provision is recognised in the income statement.

Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise cash in hand, deposits held on call with banks, and investments in money market instruments, excluding bank overdrafts. In the balance sheet, bank overdrafts are included in borrowings under current liabilities.

Cash and cash equivalents are carried in the balance sheet at cost.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. Provisions are not recognised for future operating losses.

Deferred income taxes

Deferred income tax assets and liabilities are calculated using the liability method. This method focuses on temporary differences between carrying amounts of assets or liabilities in the balance sheet and their tax bases. The result of identified temporary differences are deferred taxes, which from the accounting point of view represent unchanged liability for tax payment on one hand and deferred income tax liability or asset to the Government and larger or smaller net profit on the other. It has to be taken into account at the recognition of deferred income tax assets, that they are recognised only in the case, when we are quite certain, that the Group will have enough taxable income in the future to remove these assets.

Retirement benefit obligations

In accordance with the IFRS the balance sheet must disclose retirement benefit obligations, which in Mercator Group refer to liabilities representing provisions for employees, loyalty bonuses in line with the Branch Standard Worker's Contract, and legally determined retirement bonuses in the amount of two average monthly salaries in Slovenia. The basis for determining the amount of obligations are actuarial calculations.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings.

Leases

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of finance cost is charged to the income statement over the lease period.

Plant and equipment acquired under finance leases are depreciated over the useful life of the asset.

Share capital

Ordinary shares are classified as equity. Incremental external costs directly attributable to the issue of new shares, other than in connection with a business combination, are shown as a deduction in equity from the proceeds. Any excess of the fair value of consideration received over the par value of shares issued is recognised as a share premium.

Treasury shares

Where the company or its subsidiaries purchases the company's equity share capital, the consideration paid including any attributable incremental external costs net of income taxes is deducted from total shareholders' equity as treasury shares until they are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in shareholders' equity.

Dividends

Until formal approval is obtained in the annual general meeting, proposed dividends are treated as retained earnings.

Segment reporting

Business segments provide products or services that are subject to risks and returns that are different from those of other business segments. Geographical segments provide products or services within a particular economic environments that is subject to risks and returns that are different from those of components operating in other economic environments.

Comparatives

Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

Financial risk management

Financial risk factors

The Group's activities expose it to a variety of financial risks: credit risk, interest rate risk, foreign exchange risk, inflation risk, liquidity risk, etc. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge certain risk exposures.

The Group's risk management is carried out by the separate body named Council of the Mercator Group for Risk Management. The Council provides estimates of risk exposure and written principles for overall risk management, as well as policies covering specific areas. Among others, the Group has through the process of risk management implemented a thorough financial risk management policy covering different types of financial risks. The policy consists of analysis of the Group's risk exposure, determination of the Group's risk profile and of mitigation measures. A brief summary of the financial risk management policy is set out below.

Credit risk

The Group limits its credit exposure towards wholesale buyers and customers of production companies by a number of activities, including: limiting its exposure towards individual business partners, constant monitoring of wholesale buyers, sale of goods conditional upon receipt of adequate credit risk insurance instruments and continuing debt collection. Management consider the level of credit risk to be low.

Interest rate risk

The Group's interest-rate risk arises from long-term borrowings. These borrowings expose the Group to cash flow interest-rate risk. At the year end, 75,3% of borrowings were at variable rates.

The Group continuously monitors its level of interest rate risk exposure, focusing on interest rate variability and potential growth of variable debt. Also, a portion of foreign currency loans which are held at a variable rate of interest is being hedged by the usage of interest rate swaps. Under these interest rate swaps, the Group agreed with other parties to exchange, at specified intervals (quarterly or semi-annually), the difference between floating contract interest and fixed rate interest calculated by reference to the agreed notional principal amounts. The hedges have been entered into in a period of low level of market interest rates, enabling the Group to fix its Euro financing costs at an advantageous level.

Given the currently stable macroeconomic environment and Group's constant monitoring of interest rate risk exposure, the Group perceives this risk as moderate. Also, by performing the afore-mentioned hedges Mercator estimates interest rate exposure to have been further reduced due to the fixation of a part of total euro financing costs, thus narrowing the variability and improve predictability of future financing charges. Moreover, corporate bonds issued at a fixed rate of interest contribute to the favourable ratio between fixed and floating rate debt.

Foreign exchange risk

The Group operates internationally and is therefore to some extent exposed to foreign exchange risk arising from local currency exposures towards euro. However, by the entrance of Slovenia into ERM2 and the planned adoption of euro in the beginning of 2007 the exposure of Slovenian tolar against the euro has been almost completely eliminated.

Nevertheless, he Groups carefully monitors the exposure and will, if needed, adopt appropriate measures with a view to mitigate the negative impacts of exchange rate variability. Based on this the Group identifies a somewhat higher exposure in case of Croatian kuna or Serbian dinar. However, the size of foreign currency transactions of the Serbian and Croatian subsidiaries is still very low compared to that of the Group. Unless the level of risk rises above the level determined in the Group's hedging policy, no forward exchange rate contracts are entered into.

Inflation risk

The Group is in a position to transfer changes in purchase prices into selling prices of its goods, thereby almost completely eliminating its inflation risk exposure. Also, current trends regarding inflation in all markets with Mercator's presence indicate a future lowering of exposure towards this risk.

Liquidity risk associated with marketable securities

The Group's marketable securities are readily tradable and therefore its liquidity risk is assessed as being low. Also, the portion of such securities is negligible whereas derivative financial instruments entered into are used only for hedging and not for trading purposes.

Liquidity risk

The Group actively manages liquidity risk by:

— operating a computerised cash management system;
— statistically supported forecasting of cash flows;
— daily contact with its largest wholesale customers, thereby increasing the predictability of its cash flows;
— operating a centralised cash pooling system.

Low exposure towards liquidity risk does not require additional activities to be carried out. The Group's liquidity reserves are represented by revolving borrowings and overdraft facilities with Slovenian banks, which can be drawn down in case additional liquidity is required. Additionally, the Group can increase its liquidity by discontinuing the practice of early payment of suppliers. Early payments can be stopped immediately without the consent of suppliers, and thus represents a possible source of emergency liquidity. Additional reserves can also be provided by the Group's Euro commercial paper programme, which enables prompt reaction to liquidity requirements.

Accounting for derivative financial instruments and hedging activities

Adopted derivative instruments in respect of interest rate risk (interest rate swaps) are held strictly for hedging purposes and also meet all hedge accounting criteria. The adopted instruments are designated as cash flow hedges and are highly effective in achieving offsetting changes in cash flows of underlying loans.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives designated as hedges to specific underlying loans.

The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offseting changes in cash flow of the underlying loans.

Since hedge accounting is applied, the instruments are initially recognised in equity and subsequently remeasured at their fair value. The method of recognising the resulting gain or loss is independent of the nature of the item being hedged.

The fair value of interest rate swaps is disclosed in Note 4 (Derivative financial instruments). Movements on the hedging reserve in shareholder's equity are shown in the Consolidated statement of changes in shareholders' equity on page 5.

Fair value estimation

The fair value of interest rate swaps has been calculated as the present value of the estimated future cash flows and deferred in a "hedging reserve" in equity. Calculation of the fair value changes of each instrument is assessed on a semi-annual basis and recognised in the income statement when the hedged transaction affects the income statement.

On 31 December 2005 euro swap rates stood at higher levels compared to 31 December 2004. Also, the outstanding notional amount of the loans being hedged was lower. Due to this, a fair value change on the interest rate swaps resulted. Please see Note 5 for a more detailed disclosure.

On 31 December 2005 all interest rate swaps had a positive fair value.

Audited Consolidated Financial Statements of the Mercator Group in Accordance with International Financial Reporting Standards

Consolidated Balance Sheet

(all amounts in millions of Slovenian tolars)	Note	As at 31 December 2005	(Restated) 2004
ASSETS			
Non-current assets			
Property, plant and equipment	2	275,552	211,343
Intangible assets	3	2,425	1,260
Deferred income tax assets	13	684	-
Derivative financial instruments	4	28	36
Trade and other receivables	5	2,512	3,003
		281,200	**215,642**
Current assets			
Inventories	6	43,110	39,120
Trade and other receivables	5	38,390	31,354
Other financial assets at fair value through profit and loss	7	718	1,048
Cash and cash equivalents	8	3,961	2,664
		86,179	**74,186**
Total assets		**367,379**	**289,828**
EQUITY			
Capital and reserves attributable to equity holders of the Company			
Share capital	9	41,153	32,704
Other reserves	10	14,209	2,781
Retained earnings		75,260	73,093
		130,622	108,578
Minority interest		1,426	2,421
Total equity		**132,048**	**110,999**
LIABILITIES			
Non-current liabilities			
Borrowings	12	106,240	71,102
Deferred income tax liabilities	13	386	-
Retirement benefit obligations	14	4,229	4,162
		110,855	**75,264**
Current liabilities			
Trade and other payables	11	60,694	52,436
Borrowings	12	60,383	47,512
Provisions for other liabilities and charges	15	3,399	3,617
		124,476	**103,565**
Total liabilities		**235,331**	**178,829**
Total equity and liabilities		**367,379**	**289,828**

Consolidated Income Statement

(all amounts in millions of Slovenian tolars)	Note	Year ended 31 December 2005	2004
Sales	1	419,067	376,969
Cost of goods sold		(301,473)	(271,240)
Gross profit		**117,594**	**105,729**
Other gains - net	16	3,161	6,062
Selling and marketing costs	17	(95,459)	(78,135)
Administrative expenses	17	(18,012)	(21,325)
Operating profit		**7,283**	**12,331**
Finance costs	19	(2,351)	(6,405)
Profit before income tax		4,932	5,926
Income tax expense	20	(1,667)	(914)
Profit for the year		**3,265**	**5,012**
Attributable to:			
Equity holders of the Company		3,187	4,912
Minority interest		78	100
		3,265	**5,012**
Basic earnings per share for profit attributable to the equity holders of the Company during the year in tolars (undiluted)	22	985	1,531

Consolidated Statement of Changes in Equity

(all amounts in millions of Slovenian tolars)	Note	Attributable to equity holders of the Company Share capital	Other reserves	Retained earnings	Minority interest	Total equity
Balance at 1 January 2004		**32,707**	**3,245**	**73,287**	**2,328**	**111,567**
Profit for the year		-	-	4,912	100	5,012
Sale of treasury shares		(3)	-	-	-	(3)
Dividend relating to 2003		-	-	(1,604)	-	(1,604)
Cash flow hedge net of tax	4	-	(106)	-	-	(106)
Currency translation differences		-	(358)	-	-	(358)
Increase in share capital of existing subsidiaries		-	-	-	(7)	(7)
Balance at 31 December 2004		**32,704**	**2,781**	**76,595**	**2,421**	**114,501**
Restatement:						
Employee benefit obligations				(3,502)		(3,502)
Balance at 31 December 2004 (Restated)		**32,704**	**2,781**	**73,093**	**2,421**	**110,999**
Balance at 1 January 2005		**32,704**	**2,781**	**73,093**	**2,421**	**110,999**
Profit for the year		-	-	3,187	78	3,265
Issue of share capital		9,700	-	-	-	9,700
Purchase of treasury shares		(1,347)	-	-	-	(1,347)
Sale of treasury shares		96	-	-	-	96
Dividend relating to 2004		-	-	(1,020)	-	(1,020)
Cash flow hedge net of tax	4	-	(8)	-	-	(8)
Currency translation differences		-	(608)	-	-	(608)
Increase in share capital of existing subsidiaries		-	-	-	(1,073)	(1,073)
Revaluation of PP&E to fair value		-	12,320	-	-	12,320
Deffered tax			(276)			(276)
Balance at 31 December 2005		**41,153**	**14,209**	**75,260**	**1,426**	**132,048**

Consolidated Cash Flow Statement

(all amounts in millions of Slovenian tolars)	Note	Year ended 31 December 2005	2004
Cash flows from operating activities			
Cash generated from operations	24	23,668	18,781
Interest paid	19	(4,973)	(5,532)
Income tax paid	20	(2,218)	(914)
Net cash generated from operating activities		16,477	12,335
Cash flows from investing activities			
Acquisition of subsidiaries, net of cash acquired	27	(6,386)	(2,685)
Purchases of property, plant and equipment (PPE)	2	(46,353)	(24,601)
Proceeds from sale of PPE	2	2,436	3,407
Purchases of intangible assets	3	(789)	(665)
Proceeds from sale of intangible assets	3	28	2
Movement of non current investments		(2,541)	(81)
Purchase of current investments		-	(307)
Loans made		(211)	(1,134)
Loan repayments received		409	1,990
Proceeds from sale of current investments		20	1,666
Interest received		704	795
Net cash used in investing activities		(52,683)	(21,614)
Cash flows from financing activities			
Proceeds from issuance of shares		9,700	-
Purchase of treasury shares		(1,251)	-
Proceeds from borrowings		93,580	68,608
Repayments of borrowings		(63,516)	(57,314)
Dividends paid to Company's shareholders	23	(996)	(1,604)
Net cash used in financing activities		37,517	9,690
Net increase in cash		**1,311**	**411**
Cash at beginning of the year		2,664	2,271
Exchange losses on cash		(14)	(18)
Cash at end of the year	**8**	**3,961**	**2,664**

Notes to the Consolidated Financial Statements

(In the notes all amounts are shown in millions of Slovenian tolars unless otherwise stated)

1 Segment information

The Group is organised into two main business segments:

- Trade, which consist of retail and wholesale of fast moving consumer goods, apparel goods and technical goods. Fast moving consumer goods trade represents the core business of the Mercator Group.

- Non-trade, which consists of food processing, hospitality and other services.

Primary reporting format - business segments

Year ended 31 December 2004	Trade	Domestic Trade	Trade in Foreign Markets	Non-trade	Elimina -tions	Group
Total gross segment sales	370,807	321,105	49,702	16,310	-	387,117
Inter-segment sales	(1,017)	(1,012)	(5)	(9,131)	(10,148)	(10,148)
Sales	**369,790**	**320,093**	**49,697**	**7,179**	**-**	**376,969**
Segment result	12,277	10,895	1,382	571	(517)	12,331
Finance cost (net)						(6,405)
Profit before tax						**5,926**
Tax						(914)
Profit for the year						**5,012**
Segment assets	371,123	305,544	65,579	17,767	(99,062)	289,828
Segment liabilities	192,969	160,886	32,083	6,524	(24,166)	175,327
Capital expenditure	23,057	12,361	10,696	2,201	-	25,258
Depreciation and amortisation	12,260	9,544	2,716	978	-	13,238
Negative goodwill removal	2,055	2,055	-	-	-	2,055

1 Segment information (continued)

Primary reporting format - business segments (continued)

Year ended 31 December 2005	Trade	Domestic Trade	Trade in Foreign Markets	Non-trade	Elimina -tions	Group
Total gross segment sales	412,593	344,984	67,609	17,153	-	429,746
Revenue from other segments	(1,054)	(1,023)	(30)	(9,625)	(10,679)	(10,679)
Segment sales	**411,539**	**343,961**	**67,579**	**7,528**	**-**	**419,067**
Segment result	11,301	14,627	(3,326)	(1,359)	(2,659)	7,283
Finance cost (net)						(2,351)
Profit before tax						**4,932**
Tax						(1,667)
Profit for the year						**3,265**
Segment assets	425,081	307,471	117,610	16,336	(74,039)	367,378
Segment liabilities	242,005	182,898	59,107	7,079	(13,754)	235,330
Capital expenditure	55,735	24,332	31,403	1,327	-	57,062
Depreciation and amortisation	13,550	9,749	3,801	1,120	-	14,670
Impairment of goodwill	-	-	2,629	-	-	2,629

1 Segment information (continued)

Secondary reporting format - geographical segments

Although the Group's business segments are managed centrally, they operate in two main geographical areas:

- Slovenia is the home country of the parent company, which is also the main operating company. The areas of operation in Slovenia are: trade (retail and wholesale), food processing, hospitality and services.

- Former Yugoslav countries, which include Croatia, Bosnia and Herzegovina, Serbia and Montenegro, and Macedonia. The area of operations in these countries is trade (retail).

	Sales		Total assets		Capital expenditure	
Country	2005	2004	2005	2004	2005	2004
Slovenia	354,665	329,901	323,426	322,980	25,659	14,562
Former Yugoslav countries	67,737	50,400	117,992	65,910	31,403	10,696
Inter-segment	(3,335)	(3,332)	(74,039)	(99,062)	-	-
Total	**419,067**	**376,969**	**367,379**	**289,828**	**57,062**	**25,258**

Analysis of sales by category

	2005	2004
Sales of goods	384,724	349,050
Revenue from services	27,993	20,906
Sales of products	6,350	7,013
	419,067	**376,969**

2 Property, plant and equipment

	Land and buildings	Plant and machinery	Office and other equipment	Construction in progress	Total
At 1 January 2004					
Cost or valuation	203,774	21,883	32,378	6,662	264,851
Accumulated depreciation	(41,721)	(7,082)	(20,876)	-	(69,833)
Net book amount	**162,053**	**14,801**	**11,502**	**6,662**	**195,018**
Year ended 31 December 2004					
Opening net book amount	162,053	14,801	11,502	6,662	195,018
Exchange differences	87	-	(2)	18	104
Acquisition of subsidiaries	5,227	-	599	923	6,749
Additions	(34)	-	(4)	-	(38)
Disposal of subsidiaries	19,203	1,526	3,869	-	24,598
Disposals / transfers	(701)	(74)	(963)	(452)	(2,190)
Depreciation charge	(6,527)	(2,742)	(3,628)	-	(12,897)
Closing net book amount	**179,308**	**13,511**	**11,373**	**7,151**	**211,343**
At 31 December 2004					
Cost or valuation	227,557	23,336	35,875	7,151	294,073
Accumulated depreciation	(48,249)	(9,825)	(24,502)	-	(82,730)
Net book amount	**179,308**	**13,511**	**11,373**	**7,151**	**211,343**
Year ended 31 December 2005					
Opening net book amount	179,308	13,511	11,373	7,151	211,343
Exchange differences	222	17	17	22	278
Revaluation surplus	12,772	-	-	-	12,772
Acquisition of subsidiaries	14,748	504	580	8	15,840
Additions	28,806	3,887	1,511	22,174	56,378
Disposals / transfers	(15,843)	(5,801)	828	13,923	(6,893)
Depreciation charge	(7,667)	(2,906)	(3,593)	-	(14,166)
Closing net book amount	**212,346**	**9,212**	**10,716**	**43,278**	**275,552**
At 31 December 2005					
Cost or valuation	305,965	34,708	35,609	43,278	419,560
Accumulated depreciation	(93,619)	(25,496)	(24,893)	-	(144,008)
Net book amount	**212,346**	**9,212**	**10,716**	**43,278**	**275,552**

2 Property, plant and equipment (continued)

Bank borrowings are secured by land and buildings with a carrying value of 594 million tolars at 31 December 2005 (2,786 million tolars at 31 December 2004).

Mercator Group appraised its property, plant and equipment to their fair value. A valuation was made on 31 December 2005 on the basis of fair market value undertaken by an independent registered valuer and compared with carrying values.

If land and buildings were stated on the historical cost basis, the amounts would be as follows:

	2005	2004
Cost	249,926	214,205
Accumulated depreciation	62,407	57,506
Net book amount	**187,519**	**156,699**

Net carrying amount of assets held under financial leases comprise 21,280 million tolars (2004: 8,183 million tolars) and refer to land and buildings.

3 Intangible assets

	Goodwill	Trademarks, Rights & licenses	Total
At 1 January 2004			
Cost	1,001	1,168	2,169
Accumulated amortisation and impairment	(668)	(622)	(1,290)
Net book amount	**333**	**546**	**879**
Year ended 31 December 2004			
Opening net book amount	333	546	879
Acquisition of subsidiaries	-	52	52
Additions	-	660	660
Disposal / transfer	(333)	343	10
Amortisation charge	-	(341)	(341)
Closing net book amount	**-**	**1,260**	**1,260**
At 31 December 2004			
Cost	-	2,223	3,224
Accumulated amortisation and impairment	-	(963)	(1,964)
Net book amount	**-**	**1,260**	**1,260**
Year ended 31 December 2005			
Opening net book amount	-	1,260	1,260
Exchange differences	-	(58)	(58)
Acquisition of subsidiaries	3,006	150	3,156
Impairment charge	(2,629)	-	(2,629)
Additions	-	1,201	1,201
Disposal / transfer	-	(1)	(1)
Amortisation charge	-	(504)	(504)
Closing net book amount	**377**	**2,048**	**2,425**
At 31 December 2005			
Cost	3,006	4,615	7,621
Accumulated amortisation and impairment	(2,629)	(2,567)	(5,196)
Net book amount	**377**	**2,048**	**2,425**

Intangible assets represent expenditure on rights, patents and trademarks.

3 Intangible assets (continued)

Impairment tests for goodwill

Goodwill is allocated to the Group's cash-generating units (CGUs), identified according to sales format.

A summary of the goodwill allocation is presented below:

	30 September 2005	Impairment of goodwill	31 December 2005
Hypermarkets	1,991	(1,731)	260
Supermarkets	722	(638)	84
Markets	269	(240)	29
Other stores	24	(20)	4
	3,006	**(2,629)**	**377**

The recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by management for the next year, and on extrapolated growth rates for all subsequent periods.

Key assumptions used for value-in-use calculations:

Gross margin	13%
Sales growth rate	1%
Discount rate	8.58%

Management determined budgeted gross margin based on past performance and its expectations for market development. The discount rate used is based on market rates, which are adjusted to reflect specific risks relating to relevant business units.

4 Derivative financial instruments

		2005		2004
	Assets	Liabilities	Assets	Liabilities
Interest rate swaps - cash flow hedges	28	28	36	36
Total	**28**	**28**	**36**	**36**

4 Derivative financial instruments (continued)

The net fair values of derivative financial instruments at the balance sheet date and designated for cash flow hedges were:

	2005	2004
Contracts with positive fair values:		
Interest rate swaps	28	36
Contracts with negative fair values:	-	-

The notional principal amounts of the outstanding interest rate swap contracts at 31 December 2005 were in total of SIT 7,416 bn (EUR 30.9 mn) whereas on the same date the fixed interest rates varied from 2.2775 % to 2.39 % and the applicable floating rates, i.e. 3m and 6m Euribor, were at 2.488 % and 2.637 % respectively.

Other than interest rate swaps Mercator did not hold any other derivative financial instruments as at 31 December 2005.

5 Trade and other receivables

	2005	2004
Trade receivables	41,413	35,206
Less: provision for the impairment of receivables	(5,352)	(3,953)
Trade receivables - net	36,061	31,253
Prepaid expenses	1,464	230
Other receivables	3,377	2,874
	40,902	34,357
Less non-current portion	(2,512)	(3,003)
Current portion	**38,390**	**31,354**

Prepaid expenses of 1,464 million tolars (2004: 230 million tolars) comprise mainly accrued supplier rebates and prepaid items. Other receivables of 3,377 million tolars (2004: 2,874 million tolars) comprise mainly loans to third parties, the majority of which are secured by bills of exchange.

The carrying values of all trade and other receivables approximate fair values.

6 Inventories

	2005	2004
Raw materials	969	974
Work in progress	1,130	2,216
Finished goods	91	273
Merchandise	42,720	36,732
Advances paid for inventories	30	139
Less: Provision for the impairment of inventories	(1,830)	(1,214)
	43,110	**39,120**

When write downs of inventories have been done, no reversal is permitted unless the inventory is actually sold. Write downs are based on fair value.

7 Other financial assets at fair value through profit and loss

	2005	2004
Equity securities	700	1,013
Loans, originated by the enterprise	18	35
	718	**1,048**

Other financial assets at fair value are carried at fair value, which represents the market value of each financial asset at year-end.

8 Cash and cash equivalents

	2005	2004
Cash at bank and in hand	3,961	2,664
	3,961	**2,664**

9 Share capital

	Number of shares (thousands)	Ordinary shares	Share premium	Treasury shares	Total
At 1 January 2004	**3,209**	**32,085**	**619**	**3**	**32,707**
Sale of treasury shares	-	-	-	(3)	(3)
At 31 December 2004	**3,209**	**32,085**	**619**	**-**	**32,704**
Issue of share capital	255	2,546	7,154	-	9,700
Purchase of treasury shares	(71)	-	-	(1,347)	(1,347)
Sale of treasury shares	3			96	96
At 31 December 2005	**3,396**	**34,631**	**7,773**	**(1,251)**	**41,153**

The Company acquired in 2005 70,864 of its own shares, 68,000 of them from the insurance company Zavarovalnica Triglav, d.d. At the end of 2005 the Company has 68,076 treasury shares in the amount of 1,251 million tolars, which has been deducted from shareholders' equity.

10 Other reserves

	Regulatory reserves	Land and buildings revaluation	Hedging reserve	Currency translation adjustments	Deferred tax	Total
Balance at 1 January 2004	**3,209**	**-**	**142**	**(106)**	**-**	**3,245**
Cash flow hedge net of tax	-	-	(106)	(358)	-	(464)
Currency translation differences	-	-	-	-	-	-
Balance at 31 December 2004	**3,209**	**-**	**36**	**(464)**	**-**	**2,781**
Revaluation of PP&E to fair value	-	12,320	-	-	-	12,320
Cash flow hedge net of tax	-	-	(8)	-	-	(8)
Currency translation differences	-	-	-	(608)	-	(608)
Deferred tax	-	-	-	-	(276)	(276)
Balance at 31 December 2005	**3,209**	**12,320**	**28**	**(1,072)**	**(276)**	**14,209**

11 Trade and other payables

	2005	2004
Trade payables	51,300	44,159
Social security and other taxes	3,875	3,077
Other payables	3,345	3,480
Accruals	2,174	1,720
	60,694	**52,436**

Accruals of 2,174 million tolars (2004: 1,720 million tolars) comprise mainly accrued discounts payable in respect of bonus points to the holders of Mercator-Pika loyalty cards.

12 Borrowings

	2005	2004
Non-current		
Bank borrowings	74,238	54,018
Debentures and other loans	32,002	17,084
	106,240	**71,102**
Current		
Bank borrowings	58,216	45,827
Debentures and other loans	2,167	1,685
	60,383	**47,512**
Total borrowings	**166,623**	**118,614**

The interest rate exposure of the borrowings of the Group was as follows:

	2005	2004
Total borrowings:		
- At fixed rates	41,146	35,254
- At floating rates	125,477	83,360
	166,623	**118,614**

12 Borrowings (continued)

Floating rates mainly refer to interest rates linked to EURIBOR. Fixed rates mainly refer to loans from domestic banks with fixed nominal interest rate.

Total borrowings include secured liabilities of 135,002 million tolars.

The exposure of the Group's borrowings to interest-rate changes and the contractual repricing dates are as follows:

	6 months or less	6-12 months	1-5 years	Over 5 years	Total
At 31 December 2004					
Total borrowings	21,836	25,676	51,938	19,164	118,614
Effect of interest-rate swaps	(2,577)	(2,577)	(7,421)	-	(12,575)
	19,259	**23,099**	**44,517**	**19,164**	**106,039**
At 31 December 2005					
Total borrowings	25,699	34,684	66,791	39,449	166,623
Effect of interest-rate swaps	(2,577)	(2,577)	(2,265)	0	(7,419)
	23,122	**32,107**	**64,526**	**39,449**	**159,204**

Maturity of non - current borrowings:

	2005	2004
Between 1 and 2 years	20,643	11,598
Between 2 and 5 years	46,148	40,340
Over 5 years	39,449	19,164
	106,240	**71,102**

The effective interest rates at the balance sheet date were as follows:

		2005		2004
	SIT	Other	SIT	Other
Bank borrowings	4.3%	3.4%	5.4%	3.1%
Debentures and other loans	-	4.6%	4.5%	4.8%

12 Borrowings (continued)

The carrying amounts of the Group's borrowings are denominated in the following currencies:

	2005	2004
- In Tolars	20,038	21,822
- In EUR	144,454	95,945
- In Croatian Kuna (HRK)	1,886	-
- In Swiss Francs (CHF)	-	218
- Other	245	629
	166,623	**118,614**

The Group has the following undrawn borrowing facilities:

	2005	2004
Floating rate		
- Expiring within one year	2,936	4,334
Fixed rate		
- Expiring within one year	3,121	3,939
	6,057	**8,273**

Finance lease liabilities - minimum lease payments

	2005	2004
Not later than 1 year	1,609	611
Later than 1 year and not later than 5 years	6,436	2,329
Later than 5 years	20,887	7,867
	28,932	10,807
Future finance charges on finance leases	7,652	2,624
Present value of finance lease liabilities	**21,280**	**8,183**

12 Borrowings (continued)

The present value of finance lease liabilities is as follows:

	2005	2004
Not later than 1 year	800	311
Later than 1 year and not later than 5 years	3,528	1,299
Later than 5 years	16,952	6,573
	21,280	**8,183**

The carrying values of all borrowings approximate fair values. The percentage of non-current borrowings within total borrowings was 64 % at 31 December 2005 (60% at 31 December 2004).

13 Deferred income tax

Deferred income taxes are calculated on all temporary differences under the liability method using a principal tax rate of 25 %.

The movement in the deferred income tax account is as follows:

	2005	2004
At beginning of year - net deferred tax asset	**-**	**-**
Credited to the income statement	(574)	-
Tax credited to equity	276	
At end of year - net deferred tax asset	**(298)**	**-**

The deferred tax assets and liabilities are attributable to the following items:

	Depreciation of PP&E
Deferred income tax liabilities	
At 31 December 2004	**-**
Charged/(credited) to the income statement	110
Charged/ (credited) to equity	276
At 31 December 2005	**386**

13 Deferred income tax (continued)

	Impairment not recognised for tax purposes	Provisions	Total
Deferred income tax assets			
At 31 December 2004	-	-	-
Charged/(credited) to the income statement	(534)	(150)	(684)
Charged/ (credited) to equity	-	-	-
At 31 December 2005	**(534)**	**(150)**	**(684)**

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

14 Retirement benefit obligations

	2005	(Restated) 2004
Balance sheet obligations for:		
Provision for jubilee and retirement payments	4,229	4,162
Income statement charge for:		
Provision for jubilee and retirement payments	67	101

Provisions are made for the estimated liability of statutory retirement payments and jubilee (long service) bonuses as a result of service rendered by employees up to the balance sheet date, discounted to present value. The above provision has been made for expected payments.

Retirement benefit obligations were calculated by an actuary in 2005. Due to the change in the method of calculation comparative data for 2004 have been restated. Additional obligations in the amount of 3,502 million tolars were created in 2004 by a charge to retained earnings relating to provisions for employees hired in previous periods (see also Consolidated statement of changes in equity).

In 2005 additional provision of 67 million tolars was made, which was recognised in the income statement.

Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates in force during the year, based on gross salary payments. The cost of social security payments is expensed in the same period as the related salary cost. The Group is paying contributions for its employees to a voluntary additional collective pension insurance plan according to the Law on pension insurance from 1 January 2001, from which the Group has no future obligations.

15 Provisions for liabilities and charges

	Restitution claims	Environmental & other liabilities	Legal claims	Total
At 31 December 2004	**982**	**548**	**2,087**	**3,617**
Acquisition of subsidiary	377	-	195	572
Utilised during year	(542)	(225)	(23)	(790)
Reclassification	12	(12)	-	-
At 31 December 2005	**829**	**311**	**2,259**	**3,399**

Restitution claims

Restitution claims refer to potential liabilities of the Group arising from the Law on Denationalisation. Management is at present unable to estimate the timing of cash outflows relating to denationalisation claims. The increase of restitution claims in the amount of 377 million tolars refers to restitution claims of the acquired company Era Tornado, d.o.o. Restitution claim for a building Modna hiša, Nazorjeva 4/Cigaletova 10 in Ljubljana has been utilised in the amount of 461 million tolars as a result of a court resolution.

Legal claims

The increase in legal claims in the amount of 195 million tolars refers to legal claims of the acquired company RM Trgohit, d.o.o. A legal claim connected to a legal action against the subsidiary company Mercator-SVS, d.d., relating to a violation of contract liabilities with its acquired company Klas, d.d., Maribor, has been utilised according to a court resolution in the amount of 23 million tolars.

16 Other (losses)/gains - net

	2005	2004
Net gain on disposal of property, plant and equipment	769	1,613
Negative goodwill from acquisition recognised directly in P/L (Note 25)	287	2,055
Other operating income	2,105	2,394
	3,161	**6,062**

17 Expenses by nature

	2005	2004
Depreciation	14,166	12,897
Amortisation	504	341
Impairment charges	5,801	-
Employee benefit expense	54,817	52,046
Raw materials and consumables used	15,151	13,755
Costs of services	28,908	25,212
Other expenses	6,332	4,561
Cost of goods sold	289,265	261,888
Total cost of goods sold, marketing & distribution costs and administrative expenses	**414,944**	**370,700**
Number of employees at 31 December	16,372	15,564

18 Employee benefit expense

	2005	2004
Wages and salaries, including restructuring costs and termination benefits	36,470	34,039
Social security costs	7,371	6,998
Other payroll costs	10,976	11,009
	54,817	**52,046**

The average number of persons employed by the Group during the year (calculated based on hours worked) was 15,086 (2004: 14,395).

19 Finance costs (net)

	2005	2004
Interest income	704	795
Revenue from investments	1,572	488
Other financial revenues	**1,378**	**159**
Finance income	**3,654**	**1,442**
Net foreign exchange transaction losses (Note 21)	**(874)**	**(2,088)**
Interest expense	**(4,973)**	**(5,532)**
Realised and unrealised losses on financial investments	**(158)**	**(227)**
Finance costs	**(5,131)**	**(5,759)**
Net finance costs	**(2,351)**	**(6,405)**

Revenue from investments of 1,572 million tolars mainly refer to profit from sale of equity securities of the company Sava, d.d., Kranj in the amount of 1,487 million tolars.

Realised and unrealised losses on financial investments of 158 million tolars (2004: 227 million tolars) refer to other realised losses on financial investments in subsidiary companies.

20 Income tax expense

	2005	2004
Current tax	2,241	914
Deferred tax (Note 13)	(574)	-
	1,667	**914**

20 Income tax expense (continued)

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Group as follows:

	2005	2004
Profit before tax	4,932	5,897
Expected tax calculated at tax rate of 25%	1,233	1,474
Expenses not deductible for tax purposes	4,050	1,293
Utilisation of tax reliefs	(3,042)	(1,853)
Tax charge	**2,241**	**914**

Tax reliefs that have been utilised are according to national tax legislation and refer mostly to investment reliefs.

21 Net foreign exchange gains/losses

The exchange differences (charged)/credited to the income statement are included as follows:

	2005	2004
Finance costs - net (Note 19)	(874)	(2,088)
	(874)	**(2,088)**

22 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the year, excluding the average number of ordinary shares purchased by the Company and held as treasury shares. There are no dilutive ordinary shares.

	2005	2004
Net profit attributable to shareholders (millions of tolars)	3,187	4,912
Number of ordinary shares in issue	3,236,201	3,208,504
Basic earnings per share (tolars)	**985**	**1,531**

23 Dividends per share

The dividends paid in 2005 and 2004 were 1,020 million tolars (SIT 318 per share) and 1,604 million tolars (SIT 500 per share) respectively. A dividend in respect of 2005 of SIT 600 per share, amounting to a total dividend of 2,142 million tolars, is to be proposed at the Annual General Meeting.

24 Cash generated from operations

	2005	2004
Profit for the period	3,265	5,012
Adjustments for:		
Tax (Note 20)	1,667	914
Depreciation (Note 2)	14,166	12,897
Amortisation (Note 3)	504	341
Goodwill impairment charge (Note 3)	2,629	333
Impairment of property, plant and equipment (Note 2)	3,183	-
(Profit)/loss on sale of property, plant and equipment (see below)	(769)	(1,613)
Net movements in provisions for liabilities and charges (Note 15)	(516)	1,958
Fair value gains (including profit on disposal) on other financial assets at fair value	(1,487)	(259)
Interest income (Note 17)	(704)	(795)
Negative goodwill from acquisition recognised directly in P/L	(287)	(2,055)
Interest expense (Note 17)	4,973	5,532
	26,624	22,265
Changes in working capital (excluding the effects of acquisition and disposal of subsidiaries):		
- Trade and other receivables	(4,343)	(4,189)
- Inventories	(1,789)	(2,046)
- Trade and other payables	3,176	2,751
Cash generated from operations	**23,668**	**18,781**

24 Cash generated from operations (continued)

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	2005	2004
Net book amount	1,667	1,793
Profit/(loss) on sale of property, plant and equipment	769	1,613
Proceeds from sale of property, plant and equipment	**2,436**	**3,407**

25 Contingencies

At 31 December 2005 the Group had no contingent liabilities in respect of bank and other guarantees or other matters arising in the ordinary course of business from which it is anticipated that material unprovided liabilities will arise.

26 Commitments

The amount of capital expenditure contracted for at the balance sheet date but not recognised in the financial statements was as follows:

	2005	2004
Property, plant and equipment	17,477	18,194

26 Commitments (continued)

Certain of these commitments are denominated in EUR. Management considers, that due to the close correlation of the movement in the domestic currencies/EUR exchange rates with domestic inflation rates, there are no significant financial impacts of these commitments that need to be accounted for at 31 December 2005. The euro is commonly used currency in Slovenia.

The Group does not have any non-cancellable or cancellable operating lease agreements at 31 December 2005.

27 Business Combinations

On 19 September 2005 the Group acquired 100% of the share capital of Era Tornado, d.o.o., a trade company operating in Croatia. The acquired business contributed revenues of 6,452 million tolars and net profit/(loss) of (1,597) million tolars to the Group for the period from 19 September 2005 to 31 December 2005.

On 19 September 2005 the Group acquired 100% of the share capital of Trgohit, d.o.o., also a trade company operating in Croatia. The acquired business contributed revenues of 200 million tolars and net profit/(loss) of (182) million tolars to the Group for the period from 19 September 2005 to 31 December 2005.

Details of net assets acquired and goodwill are as follows:

Purchase consideration:	
- Cash paid	5,268
Fair value of net assets acquired	(2,262)
Goodwill (Note 3)	**3,006**

27 Business Combinations (continued)

The assets and liabilities arising from the aquisitions are as follows (as at the date of aquisition):

	Fair value	Acquiree's carrying amount
Cash and cash equivalents	240	298
Property, plant and equipment (Note 6)	8,354	6,348
Intangible assets	188	188
Other financial assets at fair value	33	33
Inventories	2,302	2,373
Receivables	2,452	2,600
Payables	(6,769)	(6,769)
Borrowings	(4,376)	(4,376)
Provisions for other liabilities and charges	(162)	(162)
Net assets	**2,262**	**533**
Minority interests	-	
Net assets acquired	**2,262**	
Purchase considerstion settled in cash	5,268	
Cash and cash equivalents in subsidiary acquired	(240)	
Cash outflow on acquisition	5,028	

Goodwill was tested for impairment at the end of the year. As the actual results of acquired companies were lower than previously expected, goodwill was impaired. Loss from the impairment of goodwill is shown within administrative expenses.

In the year ended 31 December 2004 the Group acquired companies Alpkomerc, d.d., and Emona Maximarket, d.d. In 2005 the Group acquired an additional ownership share in the company Alpkomerc, d.d. Negative goodwill from this purchase in the amount of 287 million tolars was recognised directly in P/L.

28 Related party transactions

The Group does not have any related parties other than key management personnel. Key management personnel are members of management boards, supervisory boards and senior management of companies in the Mercator Group.

Key management compensation:

	2005	2004
Management board members of companies in Mercator Group	864	1,067
Supervisory board members of companies in Mercator Group	112	124
Senior management	1,184	1,258
	2,160	**2,450**

29 Restatement of the Audited 2004 figures

The consolidated financial statements for the prior year have been restated for the effects arising from calculation of Retirement benefit obligations by an actuary. The restatement is a result of a change in the method of calculation.

	Restated 2004	2004
Retirement benefit obligations (Note 14)	4,162	660
Retained earnings	73,093	76,595

30 Events after the balance sheet date

— On 1 January 2006, the new Management Board of the company Poslovni sistem Mercator, d.d., which includes the President Mr. Žiga Debeljak and three Board members, Mrs. Vera Aljančič Falež, Mrs. Mateja Jesenek and Mr. Peter Zavrl, assumed its five-year term;

— In January 2006, Era retail and wholesale network in Slovenia was effectively integrated within the Mercator Group;

30 Events after the balance sheet date (continued)

— On 31 January, the company KD Group, d.d., paid its capital increase sum of 4,115 million tolars for 106,950 new shares; the company KLM, d.o.o., paid a part of its entitled capital increase sum, in the amount of 800 million tolars for 20,790 new shares. On 31 January 2006, the payment deadline for new shares was reached. All invited companies, except for KLM, d.o.o., paid for the entire sum of offered shares. In line with the Supervisory Board resolution, the company Poslovni sistem Mercator, d.d., offered the remaining shares (259,360 shares) to other investors, in relevant proportionate shares, which means 86,453 shares per investor. Since the investors waived their preemptive right to acquire the shares, these remain unsold or will be offered to a new investor, subject to the Supervisory Board approval;

Company	Number of shares authorized	Number of shares paid up until 31 January 2006	Percent of shares paid up at 31 January 2006	Sum paid up
Kapitalska družba, d.d.	106,950	106,950	100.00%	4,064
Slovenska odškodninska družba, d.d.	106,950	106,950	100.00%	4,089
KD Group, d.d.	106,950	106,950	100.00%	4,115
KLM, d.o.o.	320,850	61,490	19.16%	2,347
Total	**641,700**	**382,340**	**59.58%**	**14,615**

The company Poslovni sistem Mercator, d.d., has already started the proceedings for entering new shares into the court register, whereby it is estimated after consideration of required approvals and administrative procedures, that the shares will be issued with Central Securities Clearing Corporation or will be listed on the Ljubljana Stock Exchange organized market in April 2006;

— On 14 February 2006, the Constitutional Court withheld the part of the Trade Act that regulates the opening hours of grocery stores to a maximum of ten Sundays per year. This means that until the final court decision on the constitutionality of this Article, the opening hours for stores with a grocery program are unrestricted.

31 Subsidiary undertakings

The principal subsidiary undertakings are set out below. The country of incorporation is Slovenia unless otherwise stated.

Company	2005 Ownership	2004 Ownership
Trade		
Mercator SVS, d.d.	100.0%	100.0%
Mercator Goriška, d.d. (merged into Poslovni sistem Mercator, d.d.)	-	99.6%
Mercator Dolenjska, d.d. (merged into Poslovni sistem Mercator, d.d.)	-	100.0%
Mercator Modna hiša, d.d.	100.0%	100.0%
Živila Kranj, d.d. (merged into Poslovni sistem Mercator, d.d.)	-	98.4%
Emona Maximarket, d.d.	98.9%	98.7%
Alpkomerc, d.d.	97.4%	77.1%
Savski otok, d.o.o.	100.0%	49.0%
Mercator - H, d.o.o. (Croatia)	99.8%	99.8%
Era Tornado, d.o.o. (Croatia)	100.0%	-
RM - Trgohit, d.o.o. (Croatia)	100.0%	-
Mercator - BH, d.o.o (Bosnia and Herzegovina)	100.0%	100.0%
Mercator - S, d.o.o. (Serbia and Monte Negro)	100.0%	100.0%
Mercator Makedonija, d.o.o. (Macedonia)	90.0%	-
Food-processing		
Mercator Emba, d.d.	76.8%	71.5%
Eta, d.d.	97.3%	97.3%
Pekarna Grosuplje, d.d.	75.1%	75.1%
Belpana, d.o.o. (Croatia)	100.0%	100.0%
Hospitality & other services		
Mercator - Optima, d.o.o.	100.0%	100.0%
M Hotel, d.o.o.	100.0%	100.0%

The following changes in the structure of the Group occurred in the year 2005:

— In September 2005 Mercator-H, d.o.o., acquired a 100% ownership share in the companies Era Tornado, d.o.o., and RM - Trgohit, d.o.o.

— Mercator Goriška, d.d., Mercator Dolenjska, d.d., and Živila Kranj, d.d., were merged into Poslovni sistem Mercator, d.d., on 1 December 2005.

— At the end of the year Poslovni sistem Mercator, d.d., acquired 100% ownership share in the company Savski otok, d.o.o.

Management Responsibility Statement

The consolidated financial statements set out on pages 3 to 30 are the responsibility of the Company's management. The consolidated financial statements present a true and fair view of the financial position of the Group at 31 December 2005, and of the results of its operations and changes in financial position for the year then ended.

Management confirms that appropriate accounting policies are applied on a consistent basis and that the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures are based on the principle of prudence. Management is responsible for ensuring an appropriate accounting and internal control structure to protect the assets of the Group and comply with relevant laws and regulations.

Management also confirms that the consolidated financial statements with disclosures are prepared under the going concern assumption and in accordance with International Financial Reporting Standards as adopted by the European Union, which include the standards and interpretations issued by the IASB and SIC.

Tax authorities can check the operations of the Company, which may result in incurring of additional liabilities of tax payment, interest on arrears and penalty relating to Corporate Income Tax or other taxes and tributes at any time, within five years after the year in which the tax should have been assessed. The management of the Company has not been informed of circumstances that may incur any material liabilities arising from this issue.

Žiga Debeljak
President of the Board of Directors

Ljubljana, 28 March 2006

Report of the Auditors

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers d.o.o.
Parmova 53, 1000 Ljubljana
Telephone: (01) 4750 100
Facsimile: (01) 4750 109
Matična št.: 5717159
Davčna št.: 35498161

To the Shareholders of Poslovni sistem Mercator, d.d.

We have audited the accompanying consolidated balance sheet of Poslovni sistem Mercator, d.d. (the Company) and its subsidiaries (the Group) as at 31 December 2005 and the related consolidated statements of income, cash flows and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2005, and of the results of its operations and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Ljubljana, 28 March 2006

Vida Lebar
Certified Auditor

PricewaterhouseCoopers d.o.o.
PRICEWATERHOUSECOOPERS d.o.o.
1
Francois Mattelaer
Partner

Audited Financial Statements of the Company Poslovni sistem Mercator, d. d., in Accordance with International Financial Reporting Standards

Balance Sheet

(all amounts in millions of Slovenian tolars)	2005	As at 31 December 2004 (Restated)
ASSETS		
Non-current assets		
Property, plant and equipment	142,301	94,322
Intangible assets	951	328
Deferred income tax assets	551	-
Derivative financial instruments	28	36
Trade and other receivables	93,813	82,056
	237,643	176,741
Current assets		
Inventories	25,472	20,224
Trade and other receivables	33,922	26,237
Other financial assets at fair value through profit and loss	1,459	4,187
Cash and cash equivalents	1,819	872
	62,672	51,520
Total assets	**300,316**	**228,261**
EQUITY		
Share capital	41,187	32,085
Other reserves	29,605	3,897
Retained earnings	53,206	59,895
	123,998	95,877
Total equity	**123,998**	**95,877**
LIABILITIES		
Non current liabilities		
Borrowings	74,764	55,344
Deferred income tax liabilities	2,154	1,548
Retirement benefit obligations	2,981	2,981
	79,898	**59,873**
Current liabilities		
Trade and other payables	51,090	41,337
Borrowings	42,804	27,943
Provisions for other liabilities and charges	2,526	3,232
	96,419	**72,512**
Total liabilities	**176,317**	**132,384**
Total equity and liabilities	**300,316**	**228,261**

Income Statement

(all amounts in millions of Slovenian tolars)	2005	Year ended 31 December 2004
Sales	289,459	225,444
Cost of goods sold	(209,994)	(161,017)
Gross profit	**79,464**	**64,427**
Other gains - net	5,442	2,082
Selling and marketing costs	(55,601)	(43,073)
Administrative expenses	(13,746)	(14,295)
Operating profit	**15,560**	**9,141**
Finance income	3,463	1,137
Finance costs	(10,546)	(5,328)
Profit before income tax	**8,477**	**4,950**
Income tax	(1,482)	(435)
Deferred tax	463	-
Profit for the year	**7,457**	**4,515**

Cash Flow Statement

(all amounts in millions of Slovenian tolars)	2005	Year ended 31 December 2004
Cash flows from operating activities		
Cash generated from operations	27,344	16,991
Interest received	779	536
Interest paid	(3,602)	(3,635)
Income tax paid	(1,019)	(435)
Net cash generated from operating activities	**23,501**	**13,458**
Cash flows from investing activities		
Acquisition of subsidiaries, net of cash acquired	(29,912)	(9,007)
Purchases of property, plant and equipment (PPE)	(31,078)	(20,264)
Purchases of intangible assets	(491)	(113)
Movement of non-current investments	(127)	(120)
Purchase of current investments	-	(221)
Proceeds from property, plant and equipment (PPE)	1,622	2,573
Proceeds from sale of current investments	142	-
Dividends received	-	18
Loan repayments received and sale of non-current investment	1,477	-
Net cash used in investing activities	**(58,367)**	**(27,134)**
Cash flows from financing activities		
Proceeds from issuance of shares	9,700	-
Repayments/proceeds from borrowings	28,360	15,538
Purchase of treasury shares	(1,251)	-
Dividends paid to Company's shareholders	(996)	(1,626)
Net cash used in financing activities	35,813	13,913
Net increase in cash	947	236
Movement in cash and cash equivalents		
Cash at beginning of the year	872	636
Net increase in cash	947	236
Exchange losses on cash		
Cash at the end of the year	**1,819**	**872**

Contact Persons

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Management Board Member for Retail, Wholesale and Logistics	Peter Zavrl	01 560-32-74	peter.zavrl@mercator.si
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The Mercator Group

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