

ATLANTIC GRUPA d.d.

**AUDITOR'S REPORT AND
CONSOLIDATED FINANCIAL STATEMENTS
31 DECEMBER 2012**

ATLANTIC GRUPA d.d.

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2012

<i>(all amounts expressed in thousands of HRK)</i>	Note	2012	2011
Revenues	5	5,005,484	4,774,385
Cost of trade goods sold		(1,155,448)	(1,187,673)
Change in inventories of finished goods and work in progress		3,667	5,772
Material and energy costs		(1,814,941)	(1,641,174)
Staff costs	6	(651,498)	(635,047)
Marketing and promotion costs	7	(320,754)	(300,822)
Depreciation, amortisation and impairment	13, 13a, 14, 2.24	(180,065)	(165,827)
Other operating costs	8	(500,492)	(533,829)
Other gains - net	9	9,105	19,058
Operating profit		395,058	334,843
Finance income	10	49,085	24,447
Finance costs	10	(370,566)	(280,453)
Finance costs - net	10	(321,481)	(256,006)
Profit before tax		73,577	78,837
Income tax expense	11	(7,465)	(23,945)
Profit for the year		66,112	54,892
Attributable to:			
Owners of the parent		55,230	46,601
Non-controlling interests		10,882	8,291
		<u>66,112</u>	<u>54,892</u>
Earnings per share for profit attributable to the equity holders of the Company during the year (in HRK)	12		
- basic		16.57	13.98
- diluted		16.57	13.98

The consolidated financial statements set out on pages 2 to 62 were approved by the Management Board of Atlantic Grupa d.d. in Zagreb on 27 March 2013.

President of the Management Board

Emil Tedeschi



The accompanying notes on pages 7 to 62 are an integral part of these consolidated financial statements.

ATLANTIC GRUPA d.d.**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME****FOR THE YEAR ENDED 31 DECEMBER 2012**

<i>(all amounts expressed in thousands of HRK)</i>	Note	2012	2011
		<hr/>	<hr/>
Profit for the year		66,112	54,892
Other comprehensive income:			
Currency translation differences	22	(56,069)	47,667
Cash flow hedges	22	(10,226)	(44,202)
Other comprehensive (loss) / income for the year, net of tax		(66,295)	3,465
Total comprehensive (loss)/income for the year		(183)	58,357
		<hr/>	<hr/>
Attributable to:			
Owners of the parent		(5,620)	52,994
Non-controlling interests		5,437	5,363
Total comprehensive (loss)/ income for the year		(183)	58,357

The accompanying notes on pages 7 to 62 are an integral part of these consolidated financial statements.

ATLANTIC GRUPA d.d.

CONSOLIDATED BALANCE SHEET

AS AT 31 DECEMBER 2012

<i>(all amounts expressed in thousands of HRK)</i>	Note	31 December 2012	31 December 2011
ASSETS			
Non-current assets			
Property, plant and equipment	13	1,093,108	1,189,502
Investment property		1,707	1,934
Intangible assets	14	1,870,965	1,956,194
Deferred income tax assets	25	72,182	56,412
Available-for-sale financial assets	17	1,300	1,358
Derivative financial instruments	15	-	8,617
Trade and other receivables	18	9,584	21,514
		<u>3,048,846</u>	<u>3,235,531</u>
Current assets			
Inventories	19	543,317	533,680
Trade and other receivables	18	1,148,770	1,119,851
Prepaid income tax		23,703	24,877
Derivative financial instruments	15	-	18,249
Deposits	18	20,142	36,334
Cash and cash equivalents	20	250,865	247,596
		<u>1,986,797</u>	<u>1,980,587</u>
Non-current assets held for sale	13a	113,868	139,127
Total current assets		<u>2,100,665</u>	<u>2,119,714</u>
TOTAL ASSETS		<u>5,149,511</u>	<u>5,355,245</u>
EQUITY AND LIABILITIES			
Capital and reserves attributable to owners of the Company			
Share capital	21	133,372	133,372
Share premium	21	882,748	882,903
Treasury shares	21	-	(371)
Reserves	22	(57,091)	3,203
Retained earnings		455,201	425,297
		<u>1,414,230</u>	<u>1,444,404</u>
Non-controlling interests		47,136	67,920
Total equity		<u>1,461,366</u>	<u>1,512,324</u>
Non-current liabilities			
Borrowings	24	2,198,901	2,346,725
Deferred income tax liabilities	25	186,955	193,064
Derivative financial instruments	15	50,224	62,393
Other non-current liabilities	24a	191	36,357
Provisions	26	56,477	54,540
		<u>2,492,748</u>	<u>2,693,079</u>
Current liabilities			
Trade and other payables	23	793,596	719,606
Borrowings	24	354,101	375,035
Derivative financial instruments	15	20,911	20,673
Current income tax liabilities		3,575	12,553
Provisions	26	23,214	21,975
		<u>1,195,397</u>	<u>1,149,842</u>
Total liabilities		<u>3,688,145</u>	<u>3,842,921</u>
TOTAL EQUITY AND LIABILITIES		<u>5,149,511</u>	<u>5,355,245</u>

The accompanying notes on pages 7 to 62 are an integral part of these consolidated financial statements.

ATLANTIC GRUPA d.d.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2012

<i>(in thousands of HRK)</i>	Attributable to owners of the Company				Non-controlling interest	Total
	Share Capital	Reserves	Retained earnings	Total		
Balance at 1 January 2011	1,016,282	(3,190)	379,532	1,392,624	63,632	1,456,256
Comprehensive income:						
Net profit for the year	-	-	46,601	46,601	8,291	54,892
Other comprehensive income/(loss)	-	6,393	-	6,393	(2,928)	3,465
Total comprehensive income	-	6,393	46,601	52,994	5,363	58,357
Transaction with owners						
Acquisition of non-controlling interest	-	-	-	-	(26)	(26)
Share based payment (Note 21)	2,154	-	(836)	1,318	-	1,318
Purchase of treasury shares (Note 21)	(2,532)	-	-	(2,532)	-	(2,532)
Dividends relating to 2010	-	-	-	-	(1,049)	(1,049)
Balance at 31 December 2011	1,015,904	3,203	425,297	1,444,404	67,920	1,512,324
Comprehensive income:						
Net profit for the year	-	-	55,230	55,230	10,882	66,112
Other comprehensive loss	-	(60,850)	-	(60,850)	(5,445)	(66,295)
Total comprehensive (loss)/income	-	(60,850)	55,230	(5,620)	5,437	(183)
Transaction with owners						
Acquisition of non-controlling interest (Note 28)	-	-	(23,919)	(23,919)	(25,342)	(49,261)
Share based payment (Note 21)	5,609	-	247	5,856	-	5,856
Purchase of treasury shares (Note 21)	(5,393)	-	-	(5,393)	-	(5,393)
Transfer	-	556	(556)	-	-	-
Dividends relating to 2011	-	-	(1,098)	(1,098)	(879)	(1,977)
Balance at 31 December 2012	1,016,120	(57,091)	455,201	1,414,230	47,136	1,461,366

The accompanying notes on pages 7 to 62 are an integral part of these consolidated financial statements.

ATLANTIC GRUPA d.d.

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2012

<i>(all amounts expressed in thousands of HRK)</i>	Note	2012	2011
Cash flows from operating activities:			
Cash generated from operations	29	554,686	382,167
Interest paid		(219,779)	(188,372)
Income tax paid		(38,950)	(34,529)
		<u>295,957</u>	<u>159,266</u>
Cash flows used in investing activities			
Purchase of property, plant and equipment and intangible assets	13, 14, 24	(78,811)	(96,525)
Proceeds from sale of property, plant and equipment		20,071	13,591
Acquisition of available-for-sale financial assets		(21,000)	-
Proceeds from sale of available-for-sale financial assets	17	21,043	46,962
Acquisition of subsidiary net of cash acquired	28	-	(5,807)
Loans and deposits granted	18	(91,293)	(57,845)
Repayments of loan and deposits granted	18	112,291	32,350
Interest received		9,741	11,350
		<u>(27,958)</u>	<u>(55,924)</u>
Cash flows used in financing activities			
Purchase of treasury shares	21	(5,393)	(2,532)
Proceeds from borrowings, net of fees paid	24	1,919,805	1,121,484
Repayments of borrowings	24	(2,127,499)	(1,204,941)
Proceeds from issuance of bonds	24	-	62,221
Redemption of bonds	24	-	(66,082)
Acquisition of interest in a subsidiary from non-controlling interests	28	(40,536)	(26)
Dividends paid to non-controlling interests		(879)	(1,049)
Withholding tax paid on dividend distributed within the Group		(1,098)	-
		<u>(255,600)</u>	<u>(90,925)</u>
Net increase in cash and cash equivalents		<u>12,399</u>	<u>12,417</u>
Exchange (losses) / gains on cash and cash equivalents		(9,130)	3,201
Cash and cash equivalents at beginning of year		247,596	231,978
Cash and cash equivalents at end of year	20	<u>250,865</u>	<u>247,596</u>

The accompanying notes on pages 7 to 62 are an integral part of these consolidated financial statements.

NOTE 1 – GENERAL INFORMATION

Atlantic Grupa d.d. (the Company) is incorporated in the Republic of Croatia. Atlantic Grupa d.d. and its subsidiaries as disclosed in Note 31 (“the Group”) form one of the largest regional food industries with the well known brands such as Argeta, Barcaffe, Cedevita, Grand Kafa, Najlepše želje, Smoki, etc. The Group is prominent European producer of sports food with the well-known Multipower brand, the largest regional producer of food supplements with Dietpharm brand, a prominent producer of personal care products as well as the leading distributor of consumer goods in South-Eastern Europe. The distribution portfolio of Atlantic Grupa includes global premium brands of distinguished producers such as Wrigley, Ferrero, Johnson & Johnson and others. Atlantic Grupa is the owner of the leading private chain of pharmacies under the brand Farmacia. The Group has manufacturing plants in Croatia, Slovenia, Serbia, Bosnia and Herzegovina, Macedonia and Germany with firms and representative offices in 11 countries. The Group exports its products to more than 40 markets worldwide.

The Company is domiciled in Zagreb, Miramarska 23, Croatia.

The Company’s shares are listed on the official market of the Zagreb Stock Exchange. The shareholder structure is shown in Note 21.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all periods presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and derivative financial instruments.

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group’s accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4.

(a) New and amended standards adopted by the Group

There are no IFRSs or IFRIC interpretations that are effective for the first time for the financial year beginning on or after 1 January 2012 that had a material impact on the financial statements of the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(b) Standards and interpretations issued but not effective

A number of new standards and amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these financial statements.

- *Amendment to IAS 1 Financial Statement Presentation Regarding Other Comprehensive Income (effective for annual periods beginning on or after 1 July 2012).* The main change resulting from these amendments is a requirement for entities to group items presented in 'other comprehensive income' (OCI) on the basis of whether they are potentially reclassifiable to profit or loss subsequently (reclassification adjustments). The amendments do not address which items are presented in OCI. The amendment affects presentation only and therefore is not expected to have an impact on the Group's financial position or performance.
- *Amendment to IAS 19 Employee Benefits (effective for annual periods beginning on or after 1 January 2013).* These amendments eliminate the corridor approach and calculate finance costs on a net funding basis. The amendment is not expected to have an impact on the Group's financial position or performance.
- *IFRS 10 Consolidated Financial Statements (effective for annual periods beginning on or after 1 January 2013).* The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities (an entity that controls one or more other entities) to present consolidated financial statements. It defines the principle of control, and establishes controls as the basis for consolidation. It sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee. It sets out the accounting requirements for the preparation of consolidated financial statements. The Group is currently assessing the impact that IFRS10 will have on financial statements. The Group plans to adopt this new standard on its effective date.
- *IFRS 11 Joint Arrangements (effective for annual periods beginning on or after 1 January 2013).* IFRS 11 is a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement rather than its legal form. There are two types of joint arrangement: joint operations and joint ventures. Joint operations arise where a joint operator has rights to the assets and obligations relating to the arrangement and hence accounts for its interest in assets, liabilities, revenue and expenses. Joint ventures arise where the joint operator has rights to the net assets of the arrangement and hence equity accounts for its interest. Proportional consolidation of joint ventures is no longer allowed. This standard is not expected to have an impact on the financial statements. The Group plans to adopt this new standard on its effective date.
- *IFRS 12 Disclosures of Interests in Other Entities (effective for annual periods beginning on or after 1 January 2013).* IFRS 12 includes the disclosure requirements for all forms of interests in other entities, including joint arrangements, associates, special purpose vehicles and other off balance sheet vehicles. The Group is currently assessing the impact of IFRS12 on financial statements. The Group plans to adopt this new standard on its effective date.
- *IAS 27 (revised 2011) Separate Financial Statements (effective for annual periods beginning on or after 1 January 2013).* IAS 27 (revised 2011) includes the provisions on separate financial statements that are left after the control provisions of IAS 27 have been included in the new IFRS 10. The Group is currently assessing the impact of IAS 27 on financial statements. The Group plans to adopt this new standard on its effective date.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

- *IFRS 13 Fair Value Measurement (effective for annual periods beginning on or after 1 January 2013)*. IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across IFRSs. The requirements do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRSs or US GAAP. It is not expected to have a material impact on financial statements.
- *IAS 28 (revised 2011) Associates and Joint Ventures (effective for annual periods beginning on or after 1 January 2013)*. IAS 28 (revised 2011) includes the requirements for joint ventures, as well as associates, to be equity accounted following the issue of IFRS 11. This standard is not expected to have an impact on the financial statements. The Group plans to adopt this new standard on its effective date.
- *IFRIC 20, Stripping Costs in the Production Phase of a Surface Mine, (issued in October 2011 and effective for annual periods beginning on or after 1 January 2013)*. The interpretation clarifies that benefits from the stripping activity are accounted for in accordance with the principles of IAS 2, Inventories, to the extent that they are realised in the form of inventory produced. To the extent the benefits represent improved access to ore, the entity should recognise these costs as a 'stripping activity asset' within non-current assets, subject to certain criteria being met. This interpretation is not relevant to the Group's operations.
- *Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2014)*. The amendment added application guidance to IAS 32 to address inconsistencies identified in applying some of the offsetting criteria. This includes clarifying the meaning of 'currently has a legally enforceable right of set-off' and that some gross settlement systems may be considered equivalent to net settlement.
- *Disclosures - Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7 (issued in December 2011 and effective for annual periods beginning on or after 1 January 2013)*. The amendment requires disclosures that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements, including rights of set-off. The amendment will have an impact on disclosures but will have no effect on measurement and recognition of financial instruments. The Group is considering the implications of the amendment and the impact on the Group.
- *Amendment to IFRS 1 First time adoption on government loans (effective for annual periods beginning on or after 1 January 2013)*. This amendment addresses how a first-time adopter would account for a government loan with a below-market rate of interest when transitioning to IFRS. It also adds an exception to the retrospective application of IFRS, which provides the same relief to first-time adopters granted to existing preparers of IFRS financial statements when the requirement was incorporated into IAS 20 in 2008. This amendment is not relevant to the Group's operations.
- *Amendment to IFRSs 10, 11 and 12 on transition guidance (effective for annual periods beginning on or after 1 January 2013)*. These amendments provide additional transition relief to IFRSs 10, 11 and 12, limiting the requirement to provide adjusted comparative information to only the preceding comparative period. For disclosures related to unconsolidated structured entities, the amendments will remove the requirement to present comparative information for periods before IFRS 12 is first applied. The Group is considering the implications of the amendments and the impact on the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

- *IFRS 9 Financial Instruments (effective for annual periods beginning on or after 1 January 2015).* IFRS 9 is the first standard issued as part of a wider project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortised cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The guidance in IAS 39 on impairment of financial assets and hedge accounting continues to apply. The Group does not expect IFRS 9 to have an impact on the financial statements. The Group plans to adopt this new standard on its effective date.
- *Amendments to IFRS 10, IFRS 12 and IAS 27 - Investment entities (issued on 31 October 2012 and effective for annual periods beginning 1 January 2014).* The amendment introduced a definition of an investment entity as an entity that (i) obtains funds from investors for the purpose of providing them with investment management services, (ii) commits to its investors that its business purpose is to invest funds solely for capital appreciation or investment income and (iii) measures and evaluates its investments on a fair value basis. An investment entity will be required to account for its subsidiaries at fair value through profit or loss, and to consolidate only those subsidiaries that provide services that are related to the entity's investment activities. IFRS 12 was amended to introduce new disclosures, including any significant judgements made in determining whether an entity is an investment entity and information about financial or other support to an unconsolidated subsidiary, whether intended or already provided to the subsidiary. The Group is currently assessing the impact of the amendments on its financial statements.
- *Annual improvements 2011 (effective for annual periods beginning on or after 1 January 2013).* These annual improvements, address six issues in the 2009-2011 reporting cycle. It includes changes to:
 - IFRS 1, 'First time adoption'
 - IAS 1, 'Financial statement presentation'
 - IAS 16, 'Property plant and equipment'
 - IAS 32, 'Financial instruments; Presentation'
 - IAS 34, 'Interim financial reporting'

The Group is considering the implications of the improvements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Consolidation

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group and are de-consolidated from the date that control ceases.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of identifiable acquiree's net assets.

Goodwill is initially measured as excess of the aggregate of the consideration transferred and the fair value of non-controlling interest in the acquiree and acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired. If this is lower than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in profit or loss (Note 2.6).

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Mergers

The predecessor method of accounting is used to account for the merger of entities under common control. The carrying value of assets and liabilities of the predecessor entity are transferred as balances in the merged entity. On the date of the merger, inter-company transactions, balances and unrealised gains and losses on transactions between the two entities merging are eliminated. Any difference between the carrying value of net assets merged and net assets given up is recorded as equity.

(c) Transactions with non-controlling interests

The Group treats transactions with non-controlling interests that do not result in loss of control as transactions with equity owners of the Group. For purchase from non-controlling interests, the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Consolidation (continued)

When the Group ceases to have control or significant influence, any retained interest in the entity is re-measured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

2.3 Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, responsible for allocating resources and assessing performance of the operating segments, has been identified as the Strategic Management Council.

2.4 Foreign currencies

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment where the entity operates ('the functional currency'). The consolidated financial statements are presented in Croatian kuna (HRK), which is the Company's functional and the Group's 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 these transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Foreign exchange gains and losses related to borrowings are presented in the income statement within 'finance income or cost'. All other foreign exchange gains and losses are presented in the income statement within 'other gains/(losses) – net'.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Foreign currencies (continued)

(c) *Group companies*

The results and financial position of all Group entities with a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates; and
- (iii) all resulting exchange differences are recognised in other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations are taken into other comprehensive income. When a foreign operation is sold, exchange differences that were recorded in equity are reclassified from other comprehensive income to the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. Exchange differences arising are recognised in other comprehensive income.

2.5 Property, plant and equipment

Property, plant and equipment is included in the balance sheet at historical cost less accumulated depreciation and provision for impairment, if required. Historical cost includes expenditure directly attributable to the acquisition of items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they incurred.

Land and assets not yet in use are not depreciated. Depreciation of other items of property, plant and equipment is calculated using the straight-line method to allocate their cost to residual values over their estimated useful lives, as follows:

Buildings	10 to 50 years
Plant and equipment	2 to 20 years

The residual value of an asset is an estimated amount that the Group would currently obtain from disposal of the asset less estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Group expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (Note 2.7).

Gains and losses on disposals are determined by comparing the proceeds with carrying amount and are recognised within other gains/(losses)- net in the income statement.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.6 Intangible assets

(a) Goodwill

Goodwill represents the excess of the acquisition cost over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary at the acquisition date. Goodwill on acquisition of subsidiaries is included in intangible assets.

Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate a potential impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are recognised immediately as an expense and not subsequently reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units that are expected to benefit from synergies of the business combination in which the goodwill arose. Goodwill is monitored at the operating segment level.

(b) Distribution rights

Separately acquired distribution rights are shown at historical cost. Distribution rights acquired in a business combination are recognised at fair value at the acquisition date. Product distribution rights have a finite useful life and are carried at cost less accumulated amortization and impairment, if any. Amortization is calculated using the straight-line method to allocate the cost of rights over their estimated useful lives (from 1.5 to 5 years).

(c) Brands

Brands acquired in a business combination are carried at initially determined fair value (recognised at acquisition date) less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of brands over their estimated useful life (15 years).

Brands with indefinite useful lives are not amortized, but are tested annually for impairment at the cash generating unit level.

(d) Computer software

Acquired computer software licences are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized over their estimated useful lives (up to 5 years).

(e) Licences

Licences acquired in a business combination are recognized at fair value at the acquisition date. Licences have indefinite useful lives and are not amortised, but are tested annually for impairment at the cash generating unit level.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.7 Impairment of non-financial assets

Assets that have an indefinite useful life (such as land, brands, licences and goodwill) are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation and depreciation 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). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.8 Financial assets

The Group classifies its financial assets in the following categories: loans and receivables and available for sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and re-evaluates this designation at every reporting date.

(a) 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. The Group's loans and receivables comprise 'trade and other receivables', 'deposits' and 'cash and cash equivalents' in the balance sheet (Notes 2.11 and 2.12).

Loans and receivables are carried at amortised cost using the effective interest method.

(b) 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. They are included in non-current assets unless management intends to dispose the investment within 12 months of the balance sheet date. Available-for-sale financial assets are carried at fair value, except investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, consequently, these are carried at cost.

(c) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorised as held for trading unless they are categorised as hedges. Assets in this category are classified as current assets if expected to be settled within 12 months; otherwise, they are classified as non-current.

Regular way purchases and sales of financial assets are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.8 Financial assets (continued)

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the security and other changes in the carrying amount of the security. Interest income and the translation differences are recognised in the income statement, whereas other changes in carrying amount are recognised in other comprehensive income. Changes in the fair value of other monetary securities classified as available-for-sale and non-monetary securities classified as available-for-sale are recognised in other comprehensive income.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions and references to other instruments that are substantially the same, discounted cash flow analysis and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. A significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is reclassified from other comprehensive income to the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of receivables is described in Note 2.11.

2.9 Leases

The Group leases certain property, plant and equipment. 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 capitalized at the inception of the lease at the lower of fair value of the leased property or the present value of minimum lease payments. Each lease payment is allocated between the liability and finance charges in order to achieve a constant rate on the balance outstanding. The interest element of the finance costs is charged to the income statement over the lease period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset and the lease term.

Leases where the significant portion of risks and rewards of ownership are not transferred to the Group are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

2.10 Inventories

Inventories of raw materials and spare parts are stated at the lower of cost, determined using the weighted average method and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

The cost of work-in-progress and finished goods comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs.

Trade goods are carried at selling price less applicable taxes and margins.

Where necessary, a provision is made for damaged and expired inventories.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.11 Trade and other receivables

Trade and other 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 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. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the receivable is impaired. 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 original effective interest rate. The amount of the provision and subsequent recoveries of amounts previously written off are recognised in the income statement within 'other operating expenses'.

If collection of trade and other receivables is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

2.12 Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid instruments with original maturities of three months or less (excluding bills of exchange). Bank overdrafts are included within borrowings in current liabilities on the balance sheet.

2.13 Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Any excess of the fair value of the consideration received over the par value of the shares issued is presented in the notes as a share premium.

Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including all directly attributable incremental transaction costs, is deducted from equity until the shares are cancelled or reissued. Where such ordinary shares are subsequently reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

2.14 Borrowings

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

Fees paid on the establishment of the loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that is probable that some or all of the facility will be drawn down, the fee is capitalised as a prepayment for liquidity services and amortised over the period of the facility to which it relates.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.15 Current and deferred income tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively. The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation and consider establishing provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

2.16 Employee benefits

(a) Pension obligations and post-employment benefits

The Group makes payments to mandatory pension funds on behalf of its employees in the ordinary course of business through salary deductions, as required by law. All contributions made to the mandatory pension funds are recorded as salary expense when incurred. The Group has no other pension scheme and consequently, has no other obligations in respect of employee pensions. In addition, the Group is not obliged to provide any other post-employment benefits.

(b) Termination benefits

Termination benefits are payable when employment is terminated by the Group before the normal retirement date or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to their present value.

(c) Long-term employee benefits

The Group recognises a liability for long-term employee benefits (jubilee awards) evenly over the period the benefit is earned based on actual years of service. The long-term employee benefit liability is determined annually by an independent actuary, using assumptions regarding the likely number of staff to whom the benefit will be payable, estimated benefit cost and the discount rate. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged immediately or credited to the income statement.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.16 Employee benefits (continued)

(d) Share-based compensations

Key management of the Group receives remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ('equity-settled transactions').

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date on which they are granted. The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and service conditions are fulfilled, ending on the date on which relevant employees become fully entitled to the award ('the vesting date'). The cumulative expense recognised for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The income statement expense or credit for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

(e) Short-term employee benefits

The Group recognises a provision for bonuses and accumulating unused vacation entitlement days if contractually obliged or if there is a past practice that has created a constructive obligation.

2.17 Provisions

Provisions for termination and long term employee benefits, restructuring costs, warranty claims and legal claims are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated.

When there are number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.18 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is presented, net of value-added tax, returns, rebates and discounts, expenses of listing the products and marketing activities that are an integral part of contracts with customers. All other marketing activities related to marketing campaigns that are not integral part of customer contract are presented within Marketing and promotion costs.

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Group's activities as described below.

(a) *Sales of products and trade goods – wholesale*

The Group manufactures and sells its own products and goods of third parties in the wholesale market. Sales of goods are recognised when the Group has delivered the products to the wholesaler, the wholesaler has full discretion over the price to sell and there is no unfulfilled obligation that could affect the wholesaler's acceptance of the products. Delivery does not occur until the products have been shipped to the specified location, the risks of loss have been transferred to the wholesaler and either of the following has occurred: the wholesaler has accepted the products in accordance with the contract, the acceptance provisions have lapsed or the Group has objective evidence that all criteria for acceptance have been satisfied.

Products are sold with volume discounts and customers have a right to return faulty products in the wholesale market. Sales are recorded based on the price specific in the sales contracts, net of estimated volume discounts and returns at the time of sale. Accumulated experience is used to estimate and provide for the discounts and returns. The volume discounts are assessed based on anticipated annual purchases. No element of financing is deemed present as the sales are made with a credit term of up to 90 days, which is consistent with the market practice.

(b) *Sales of goods - retail*

The Group operates a pharmacy and specialised stores.

Sale of goods are recognised when a group entity sells a product to the customer. Retail sales are usually in cash or by credit card. At the end of 2009, the Group launched a customer loyalty programme, allowing customers to accumulate points when they purchase products. The points can then be redeemed as discount on subsequent purchase, subject to a minimum number of points being obtained. Consideration received is allocated between the products sold and the points issued. Part of fair value of the points issued is deferred as liability in the balance sheet and recognised as revenue when the points are redeemed.

(c) *Sales of services*

Sales of services are recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

If circumstances arise that may change the original estimates of revenues, costs or extent of progress toward completion, estimates are revised. These revisions may result in increases or decreases in estimated revenues or costs and are reflected in income in the period in which the circumstances that give rise to the revision become known to the management.

(d) *Interest income*

Interest income arising from fixed-term bank deposits, loans granted and interest from customers is recognised on a time-proportion basis using the effective interest method.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.19 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which dividends are approved by the Company's shareholders.

2.20 Value added tax

The Tax Authorities require the settlement of VAT on a net basis. VAT related to sales and purchases is recognised and disclosed in the balance sheet on a net basis. Where a provision has been made for impairment of receivables, the impairment loss is recorded for the gross amount of the debtor, including VAT.

2.21 Non-current assets held for sale

Non-current assets are classified as assets held for sale when their carrying value is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than continuing use.

2.22 Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

The Group designates derivatives as hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge).

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items as well as its risk management objectives and strategy for undertaking various hedging transactions. 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 offsetting changes in fair values or cash flows of hedged items.

The fair value of cash flow hedge derivatives is disclosed in Note 15 and changes in cash flow hedge reserves are disclosed in Note 22.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges, is recognised in other comprehensive income. The gain or loss related to the ineffective portion is recognised immediately in the income statement within 'other gains/(losses) – net'.

Amounts accumulated in equity are reclassified from other comprehensive income to profit or loss in the periods when the hedged item affects profit or loss. The gain or loss relating to the effective portion of interest rate swaps hedging variable rate borrowings is recognised in the income statement within 'finance costs - net'. The gain or loss relating to the ineffective portion is recognised in the income statement within 'other gains/(losses) – net'.

When a hedging instrument expires or is sold or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred from other comprehensive income to the income statement within 'other gains/(losses) – net'.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.23 Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the regular operating cycle of the business if longer). If not, they are presented as non-current liabilities. Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.24 Investment property

Investment property is carried at historical cost less accumulated depreciation and provision for impairment. Investment property is derecognized when it either has been disposed of or when it is permanently withdrawn from use and no future economic benefit is expected from its disposal. Transfers are made to or from investment property only when there is a change in use. The carrying amount approximates fair value. Investment property is held for long term rental yields and is not occupied by the Group. Depreciation expense related to investment property amounted HRK 231 thousand in 2012 (2011: HRK 61 thousand).

2.25 Comparatives

In 2012 the classification of Entertainment costs has changed from 'Marketing and promotion costs' to 'Other operating costs'.

The effect of these changes on comparative figures for 2011 is as follows:

<i>(in thousands of HRK)</i>	<u>2011</u>
Decrease in marketing and promotion costs	(12,396)
Increase in other operating costs	12,396

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 3 – FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and equity securities risk), credit risk and liquidity risk. Management closely monitors the risk profile of the Group's operations, including the establishment of authorisation and accountability levels.

(a) Market risk

(i) Foreign exchange risk

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the EURO, Serbian dinar (RSD), and to the lower extent the US dollar (USD) and Russian Rubles (RUB).

Movements in exchange rates between the above mentioned currencies and Croatian kuna (HRK) may have an impact on the results of future operations and future cash flow. The amounts in tables below represent the HRK amounts denominated in these currencies at the balance sheet date for major balance sheet monetary items.

31 December 2012	EUR	RSD	USD	RUB
Trade and other receivables	387,350	328,988	192	24,501
Cash and cash equivalents	113,105	52,249	224	2,452
Trade and other payables	(268,135)	(100,547)	(35,287)	(1,757)
Borrowings	(2,296,234)	-	(3,867)	-
Net balance sheet exposure	(2,063,914)	280,690	(38,738)	25,196

31 December 2011	EUR	RSD	USD	RUB
Trade and other receivables	354,892	361,785	-	16,949
Cash and cash equivalents	100,731	99,323	362	3,290
Trade and other payables	(249,046)	(105,656)	(31,841)	(666)
Borrowings	(2,498,577)	-	(3,938)	-
Net balance sheet exposure	(2,292,000)	355,452	(35,417)	19,573

Given that the Group also has subsidiaries outside of Croatia, its shareholders equity value is exposed to fluctuations in exchange rates. Equity changes caused by movements in foreign exchange rates are shown as translation differences in the Group's consolidated statement of comprehensive income.

In the event of a rise of 1% in the EUR against HRK and RSD, assuming no change in other items, the profit after tax would be HRK 9,826 thousand lower (2011: HRK 11,848 thousand lower), mainly due to the EUR denominated borrowings and other comprehensive income would be HRK 10,148 thousand higher (2011: HRK 10,866 thousand higher), due to the translation differences arising on consolidation of subsidiaries whose local currency is EUR.

In the event of a rise of 1% in the RSD against HRK, the profit after tax would be HRK 280 thousand higher (2011: HRK 777 thousand higher) and other comprehensive income would be HRK 3,094 thousand higher (2011: HRK 2,236 thousand higher), assuming no change in other items.

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

(ii) Equity securities risk

The Group is exposed to equity securities fair value and price risk amid investments held by the Group classified on the consolidated balance sheet as available for sale. Equity investments classified as available for sale are not listed. To manage its fair value and price risk arising from investments in equity securities, the Group monitors market transactions and performance of investment entities.

No reliable external information exists with respect to fair value. Management believes, based on internal information, that the fair value equals or exceeds carrying value. However, due to limited information available, management has not carried out a sensitivity analysis. At 31 December 2012, if the fair value of the available-for-sale investment would change, with all other variables held constant, other comprehensive income and revaluation reserves would also change by the same amount.

(iii) Cash flow and fair value interest rate risk

As the Group has no significant interest-bearing assets, the Group's income and operating cash flows are substantially independent of changes in market interest rates.

The Group's interest rate risk arises from long-term borrowings and bonds issued. Borrowings issued at variable rates expose the Group to cash flow interest rate risk which is partially offset by cash held at variable interest rates. Borrowings issued at fixed rates expose the Group to fair value interest rate risk although no borrowings are carried at fair value.

The Group analyses its interest rate changes on a regular basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions and alternative financing. Based on these scenarios, the Group calculates the impact on profit and loss of a defined interest rate shift. As at 31 December 2012, if the effective interest rate on borrowings increased/decreased by 100 basis points on an annual level (2011: 100 basis points), the profit after tax would have been lower/higher by HRK 10,992 thousand (2011: HRK 11,697 thousand) mainly as a result of increased/decreased interest expense.

The Group manages its cash flow interest rate risk by using floating-to-fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings with floating rates to fixed rates. The Group raised long-term borrowings at floating rates and swapped them into fixed rates that are lower than those available if the Group borrowed at fixed rates directly. Under the interest rate swaps, the Group agrees with other parties to exchange, at specified intervals (quarterly and semi-annually), the difference between fixed contract rates and floating-rate interest amounts calculated by reference to the agreed notional amounts.

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

(b) Credit risk

The Group's assets, potentially subjecting the Group to concentrations of credit risk, primarily include cash, deposits and trade and other receivables. The Group has policies in place to ensure that sales of products are made to customers with an appropriate credit history, within previously defined credit limits. The Group's credit risk is low, since receivables are dispersed among a large group of customers. Additionally, the Group's key customers are large retail chains, whereas dependence on these customers is reduced by developing alternative distribution channels. The Group reduces credit risk by implementing strict policies for receivables collection and goods delivery, as well as securing receivables with standard security instruments (bills of exchange and promissory notes). No credit limits were exceeded during the reporting period and management does not expect any losses from non-performance by these counterparties. A detailed analysis and maximum exposure to credit risk is shown in Notes 15, 16 and 18.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash, the availability of funding through an adequate amount of committed credit facilities and the ability to meet all obligations. The Group aims to maintain flexibility in funding by keeping committed credit lines available.

Cash flow forecasting is performed in the operating entities of the Group and aggregated by Group finance. Group finance monitors Group's liquidity requirements to ensure it has sufficient cash to meet operational needs while maintaining sufficient headroom on its undrawn committed borrowing facilities when needed. Such forecasting takes into consideration the Group's debt financing plans, covenant compliance and compliance with internal balance sheet ratio targets.

Surplus cash held over and above the balance required for working capital management is invested in interest bearing current accounts, time deposits and cash funds, i.e. instruments with appropriate maturities or sufficient liquidity.

At 31 December 2012, the Group held cash and cash equivalents in the amount of HRK 250,865 thousand (2011: HRK 247,596 thousand) and short-term deposits in the amount of HRK 20,142 thousand (2011: HRK 36,334 thousand). These are expected to readily generate cash inflows for managing liquidity risk.

Trade and other payables, as well as short-term borrowings, are due within 12 months after the balance sheet date, while the long-term borrowings' maturity is disclosed in Note 24.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

The next table analyses financial liabilities of the Group according to contracted maturities. The amounts stated below represent undiscounted cash flows.

<i>(in thousands of HRK)</i>	Less than 1 year	Between 1-5 years	Over 5 years	Total
31 December 2012				
Trade and other payables	735,312	-	-	735,312
Borrowings (excluding finance lease)	401,304	1,719,333	943,548	3,064,185
Finance lease liabilities	10,396	5,163	-	15,559
Derivative financial instruments	20,911	50,224	-	71,135

<i>(in thousands of HRK)</i>	Less than 1 year	Between 1-5 years	Over 5 years	Total
31 December 2011				
Trade and other payables	667,128	-	-	667,128
Borrowings (excluding finance lease)	499,591	2,309,318	655,328	3,464,237
Finance lease liabilities	15,270	15,039	-	30,309
Other non-current liabilities	1,570	37,671	-	39,241
Derivative financial instruments	20,673	62,393	-	83,066

3.2 Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Group monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings (including long-term and short-term borrowings, as shown in the consolidated balance sheet) less short-term deposits given and cash and cash equivalents. Total capital is calculated as equity, as shown in the consolidated balance sheet, plus net debt.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.2 Capital risk management (continued)

The gearing ratios were as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Total borrowings (Note 24)	2,553,002	2,721,760
Less: Short-term deposits given and Cash and cash equivalents (Note 18 and 20)	(271,007)	(283,930)
Net debt	2,281,995	2,437,830
Total equity	1,461,366	1,512,324
Total capital	3,743,361	3,950,154
Gearing ratio	61%	62%

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

3.3 Fair value estimation

Effective 1 January 2009, the Group adopted the amendment to IFRS 7 for financial instruments that are measured in the balance sheet at fair value, that requires disclosure of fair value measurements by level of the following fair value measurement hierarchy:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.3 Fair value estimation (continued)

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the balance sheet date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

The fair value of derivative financial instruments and of available-for-sale financial instruments is determined based on specific valuation techniques (level 3).

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES

The Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, rarely equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are outlined below.

(a) Deferred income tax asset recognition

The net deferred tax asset represents income taxes recoverable through future deductions from taxable profits and is recorded on the balance sheet. Deferred income tax assets are recorded to the extent that realisation of the related tax benefit is probable. In determining future taxable profits and the amount of tax benefits that are probable in the future, management makes judgements and applies estimation based on previous years taxable profits and expectations of future income that are believed to be reasonable under the existing circumstances (Note 25).

(b) Impairment test for goodwill and intangible assets with indefinite useful lives

Goodwill and intangible assets with indefinite useful lives are tested annually for impairment as stated in Note 2.7. Intangible assets with indefinite useful lives are tested for impairment on an individual asset basis whereas goodwill is tested based on the operating segment to which it is allocated.

Goodwill and intangible assets with indefinite lives have been allocated to cash generating units within operating segments as follows:

Operating segment <i>(in thousands of HRK)</i>	Goodwill	Licences	Brands
SBU Beverages	90,561	-	75,811
SBU Coffee	66,237	-	271,470
SBU (Sweet and Salted) Snacks	231,960	-	145,209
SBU Savoury Spreads	126,777	-	242,411
SBU Pharma and Personal Care	198,848	185,239	-
Russian market	21,895	-	28,575
SDU Croatia	38,455	-	-
SDU Slovenia, Serbia, Macedonia	89,727	-	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES (continued)*(b) Impairment test for goodwill and intangible assets with indefinite useful lives (continued)*

The recoverable amount of cash generating units is determined based on value-in-use calculations. These calculations use cash flow projections from financial budgets approved by the management, covering a seven-year period.

Value in use calculations for goodwill were determined based on the following assumptions:

Operating segment	Discount rate
SBU Beverages	10.7%
SBU Coffee	10.9%
SBU (Sweet and Salted) Snacks	11.6%
SBU Savoury Spreads	11.5%
SBU Pharma and Personal Care	9.1%
Russian market	11.4%
SDU Croatia	9.6%
SDU Slovenia, Serbia, Macedonia	9.6%

The Growth rate assumptions were based on historical data and management's expectations for market development. Terminal growth rate is 2% for all Operating segments and is based on management's expectations for market development.

Based on impairment tests performed, an impairment loss of HRK 4,002 thousand was recognised at the balance sheet date (2011: HRK 8,141 thousand) in respect of licence impairments.

The sensitivity analysis of key assumptions used in the impairment testing showed that a discount rate increase by 100 basis points would result on average in an 11.0% decrease of the recoverable amount of cash generating units. Despite the decrease, the net recoverable amount of cash generating units would still exceed the carrying value.

(c) Brand valuation

The fair value of acquired brands, relating to legally registered trademarks of Fidifarm/ Dietpharm, Montana and Multivita, was determined by independent valuers based on the income-comparative method. This method combined the use of comparative market transactions of licensing trademarks as well as cash flow projections of hypothetical royalty income based on historical sales information of related products and extrapolated estimated growth rates for subsequent periods.

Key assumptions used for cash flow projections were as follows:

	Growth rate	Hypothetical royalty rates	Discount rate
Fidifarm/ Dietpharm	10.00%	4.94%	11.87%
Montana	5.00%	3.55%	7.59%
Multivita	18.00%	4.94%	10.00%

The growth rate assumption was based on past performance and management's expectations for market development. The discount rate used was based on the weighted average cost of capital of entities using the trademarks.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES (continued)

(c) Brand valuation (continued)

The fair value of acquired brands relating to legally registered trademarks of Droga Kolinska was determined by independent valuers based on the Income approach, Relief-from-Royalty method. In using this method, arms'-length royalty or licence agreements are analyzed. The licensing transactions selected should reflect similar risk and characteristics that make them comparable to the subject asset. Finally estimated royalty rates were adjusted for brand's specifics including market position, geographic presence, future growth potential and additionally tested for reasonableness by applying licensee/licensor profit split method. The net revenue expected to be generated by the intangible assets during their expected remaining life are then multiplied by estimated royalty rates.

This valuation relied on the following assumptions:

	Estimated royalty rates	Discount rate
Barcaffè	4.0%	9.5%
Grand Kafa	4.0%	11.6%
Najlepše želje	8.0%	11.7%
Banatica	5.0%	11.5%
Smoki	8.0%	11.5%
Argeta	8.0%	11.5%
Donat	8.0%	10.3%
Cockta	5.0%	10.9%
Bebi	3.0%	11.4%

(d) Licences valuation

The fair value of acquired licences, relating to exclusive rights for the pharmacy business, was determined by independent valuers based on the income-comparative method. This method estimates net revenues from licences ownership (royalty) based on comparative market transactions of buying and selling of licences on the global market.

Key assumptions used for cash flow projections were as follows:

Growth rate	6.36%
Hypothetical royalty rate	4.80%
Discount rate	8.78%

The growth rate assumption was based on past performance and management's expectations for market development. The discount rate used was based on the weighted average cost of capital calculated as the risk free interest rate increased by the Republic of Croatia's risk premium.

NOTE 5 – SEGMENT INFORMATION

In January 2012, the Group adopted a new organization structure and replaced the earlier divisional structure with a model where the business has been organized through six strategic business units and four strategic distribution units, which have been joined by a separate market unit, Russia. The newly formed Strategic Management Council is responsible for strategic and operational issues.

For more efficient management of individual strategic business and strategic distribution units, the new organization unites similar business activities or products, shared markets or channels, together. Specifically, from now on, Atlantic Grupa's business has been organized in six strategic business units (SBU) and four strategic distribution units (SDU):

- SBU Beverages,
- SBU Coffee,
- SBU (Sweet and Salted) Snacks,
- SBU Savoury Spreads,
- SBU Sports and Functional Food,
- SBU Pharma and Personal Care
- SDU Croatia,
- SDU Slovenia, Serbia, Macedonia,
- SDU HoReCa,
- SDU International

and the Russian market.

Due to the fact that SDU HoReCa and MU Russia do not meet quantitative thresholds required by IFRS 8 for reportable segments, they are reported within Other segments. The Other segments category comprises also of non-allocable business activities (headquarters and support functions in Serbia, Slovenia and Macedonia) which are excluded from the reportable operating segments. For the time being, performance of SDU International will not be measured as a separate segment. Instead, sales and profitability of this unit will be reported within related SBUs.

Strategic Management Council monitors the operating results of the business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss. Group financing and income taxes are managed on a Group basis and are not allocated to operating segments.

Sales of individual SBUs represent market sales made to third parties (either directly through SBUs or through SDUs). SDU sales include sales of own products also reported as SBU sales. This double counting of own product sales is eliminated in the "Reconciliation" line. For the purpose of segmental profit calculation, sales between operating segments are carried out at arm's length.

The measure of assets and liabilities has not been disclosed for reportable segments as assets and liabilities are provided to the Strategic Management Council on a Group basis only.

Due to this significant change in organization structure, business model and segment reporting, it was not practical to restate prior year results and therefore comparative information for operating segment results are not disclosed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 5 – SEGMENT INFORMATION (continued)

Sales revenues <i>(in thousands of HRK)</i>	2012	2011
SBU Beverages	671,934	670,354
SBU Coffee	1,090,672	1,001,659
SBU (Sweet and Salted) Snacks	600,473	578,772
SBU Savoury Spreads	463,664	430,952
SBU Sports and Functional Food	679,971	648,140
SBU Pharma and Personal Care	481,328	446,302
SDU Croatia	876,829	888,080
SDU Slovenia, Serbia, Macedonia	1,930,387	1,875,454
Other segments	373,152	327,634
Reconciliation	(2,237,969)	(2,139,581)
Total	4,930,441	4,727,766

Operating results

For the year ending 31 December 2012

<i>(in thousands of HRK)</i>	EBITDA	Depreciation and Amortization	EBIT
SBU Beverages	150,980	44,926	106,054
SBU Coffee	159,009	17,853	141,156
SBU (Sweet and Salted) Snacks	117,891	21,611	96,280
SBU Savoury Spreads	126,480	16,525	109,955
SBU Sports and Functional Food	11,281	6,440	4,841
SBU Pharma and Personal Care	59,329	9,300	50,029
SDU Croatia	1,807	6,491	(4,684)
SDU Slovenia, Serbia, Macedonia	80,792	5,450	75,342
Other segments	(132,446)	51,469	(183,915)
Total	575,123	180,065	395,058

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 5 – SEGMENT INFORMATION (continued)

Geographical information

The total of non-current assets other than financial instruments, deferred income tax assets, derivative financial instruments and trade and other receivables is located as follows:

	2012	2011
	<i>(in thousands of HRK)</i>	
Serbia	1,029,562	1,204,354
Slovenia	978,566	941,833
Croatia	729,777	759,216
Other	227,875	242,227
Total geographically allocated non-current assets	2,965,780	3,147,630

Sales by markets	2012		2011	
	<i>(in thousands of HRK)</i>	%	<i>(in thousands of HRK)</i>	%
Croatia	1,313,338	26.6	1,332,229	28.2
Serbia	1,226,774	24.9	1,204,164	25.5
Slovenia	648,695	13.2	598,077	12.7
Bosnia and Herzegovina	376,980	7.7	359,183	7.6
Macedonia, Montenegro, Kosovo	316,936	6.4	294,658	6.2
Germany, Italy, United Kingdom	361,952	7.3	369,928	7.8
Russia and CIS countries	244,960	5.0	143,974	3.0
Other markets	440,806	8.9	425,553	9.0
Total sales by markets	4,930,441	100.0	4,727,766	100.0

Income by geographical segments is determined by geographical location of the customer.

Analysis of revenue by category	2012		2011	
	<i>(in thousands of HRK)</i>	%	<i>(in thousands of HRK)</i>	%
Sales by type of products				
Own brands	3,552,099	71.0	3,383,336	70.9
Principal brands	782,099	15.6	817,112	17.1
Pharmacy	300,230	6.0	274,558	5.7
Private label	296,013	5.9	252,760	5.3
Total sales by type of products	4,930,441	98.5	4,727,766	99.0
Other income /i/	75,043	1.5	46,619	1.0
Total revenues	5,005,484	100.0	4,774,385	100.0

/i/ Out of total other income in 2012, HRK 20,673 thousand relates to income from the cancellation of liability under the option for sale of property in Ljubljana.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 6 – STAFF COSTS

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Gross salaries /i/	578,532	568,985
Public transport	14,815	14,262
Termination benefits	7,128	8,147
Share options granted (Note 21)	6,083	3,818
Other staff costs /ii/	44,940	39,835
	<u>651,498</u>	<u>635,047</u>

At 31 December 2012, the number of staff employed by the Group was 4,247 (2011: 4,198).

/i/ Pension contributions that the Group calculated for payment to mandatory pension funds for the year ended 31 December 2012 amounted to HRK 60,883 thousand (2011: HRK 54,927 thousand).

/ii/ Other staff costs include bonuses, education expenses, accruals for unused vacation days and jubilee awards.

NOTE 7 – MARKETING AND PROMOTION COSTS

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Marketing and promotion costs - external	266,322	247,641
Marketing and promotion costs - related parties (Note 30)	17,045	15,969
Sponsorships and donations	37,387	37,212
	<u>320,754</u>	<u>300,822</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 8 – OTHER OPERATING COSTS

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Transportation costs	102,822	94,436
Maintenance	96,563	94,413
Rentals (Note 27)	75,860	74,178
Non-production material	29,844	31,559
Fuel	23,023	21,814
Provision for impairment of inventories (Note 19)	22,454	29,105
Intellectual services	20,420	28,503
Taxes and contributions not related to operating results	16,365	20,736
Travel expense and daily allowances	14,827	15,875
Non-production services	14,165	14,249
Telecommunication services	13,730	14,336
Entertainment	12,515	12,396
Bank charges	10,175	19,129
Provision for impairment of trade receivables (Note 18)	9,960	22,236
Production services	5,895	5,261
Supervisory Board fees	1,358	1,464
Royalties	1,441	1,220
Collection of receivables previously provided for (Note 18)	(5,148)	(9,499)
Other – related parties (Note 30)	2,743	59
Other	31,480	42,359
	<u>500,492</u>	<u>533,829</u>

NOTE 9 – OTHER GAINS – NET

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Gain / (loss) on sale of property, plant and equipment	9,248	(63)
Gain on sale of available-for-sale financial assets	43	11,962
Fair value (losses) / gains on financial assets	(1,168)	8,709
Foreign exchange gains / (losses) – net	1,470	(2,505)
Other (losses) / gains – net	(488)	955
	<u>9,105</u>	<u>19,058</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 10 – FINANCE COSTS – NET

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Finance income		
Foreign exchange gains on borrowings	(49,033)	(24,114)
Other finance income	(52)	(333)
	<u>(49,085)</u>	<u>(24,447)</u>
Finance costs		
Foreign exchange loss on borrowings	113,020	59,286
Interest expense on bank borrowings	195,348	172,240
Interest expense on bonds	8,419	8,528
Interest expense on borrowings – related parties (Note 30)	53,779	40,399
	<u>370,566</u>	<u>280,453</u>
Finance costs - net	<u>321,481</u>	<u>256,006</u>

NOTE 11 – INCOME TAX

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Current income tax	25,975	23,565
Deferred tax (Note 25)	(18,510)	380
	<u>7,465</u>	<u>23,945</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 11 – INCOME TAX (continued)

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated entities as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Profit before taxation	73,577	78,837
Income tax calculated at domestic tax rates applicable to profits in the respective countries	43,420	41,786
Tax effects of:		
Adjustments in respect of prior years	(404)	(4,393)
Income not subject to tax	(9,288)	(20,074)
Expenses not deductible for tax purposes	13,342	13,148
Utilisation of previously unrecognized tax losses	(21,095)	(6,902)
Effect of utilized tax losses	2,680	3,902
Effect of recognized tax losses	(22,866)	-
Effect of change in tax rate	(811)	-
Origination and reversal of temporary tax differences	2,487	(3,522)
Tax expense	7,465	23,945

The weighted average effective tax rate was 10.1% (2011: 30.4%). The decrease in effective tax rate is primarily caused by recognition of income tax losses that will be used in the following periods.

NOTE 12 – EARNINGS PER SHARE**Basic earnings per share**

Basic earnings per share are calculated by dividing the net profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the Company and held as treasury shares.

	<u>2012</u>	<u>2011</u>
Net profit attributable to shareholders of the Company <i>(in thousands of HRK)</i>	55,230	46,601
Weighted average number of ordinary shares in issue	3,334,014	3,333,889
Basic earnings per share <i>(in HRK)</i>	16.57	13.98

Diluted earnings per share

Diluted earnings per share are the same as basic earnings per share as there were no convertible potentially dilutive ordinary shares.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 13 – PROPERTY, PLANT AND EQUIPMENT

<i>(in thousands of HRK)</i>	<u>Land</u>	<u>Buildings</u>	<u>Plant and equipment</u>	<u>Assets not yet in use</u>	<u>Total</u>
At 31 December 2010					
Cost	95,870	741,726	1,586,171	67,182	2,490,949
Accumulated depreciation	-	(299,106)	(955,977)	-	(1,255,083)
Net book amount	95,870	442,620	630,194	67,182	1,235,866
At 1 January 2011					
Opening net book amount	95,870	442,620	630,194	67,182	1,235,866
Acquisition of subsidiary (Note 28)	532	5,756	1,414	-	7,702
Additions	781	5,067	26,209	74,236	106,293
Transfer	369	32,167	75,602	(108,138)	-
Disposals	-	(962)	(9,469)	-	(10,431)
Depreciation	-	(19,978)	(116,385)	-	(136,363)
Transfer to assets held for sale	(3,203)	(28,231)	(3,088)	-	(34,522)
Foreign exchange differences	1,611	7,668	11,032	646	20,957
Closing net book amount	95,960	444,107	615,509	33,926	1,189,502
At 31 December 2011					
Cost	95,960	752,800	1,640,606	33,926	2,523,292
Accumulated depreciation	-	(308,693)	(1,025,097)	-	(1,333,790)
Net book amount	95,960	444,107	615,509	33,926	1,189,502
At 1 January 2012					
Opening net book amount	95,960	444,107	615,509	33,926	1,189,502
Additions	-	472	9,406	60,817	70,695
Transfer	-	17,799	55,543	(73,342)	-
Disposals	-	(582)	(3,604)	-	(4,186)
Depreciation	-	(21,471)	(113,140)	-	(134,611)
Transfer to / from assets held for sale	(4,034)	(1,461)	21	-	(5,474)
Foreign exchange differences	(238)	(6,756)	(13,872)	(1,952)	(22,818)
Closing net book amount	91,688	432,108	549,863	19,449	1,093,108
At 31 December 2012					
Cost	91,688	772,920	1,633,867	19,449	2,517,924
Accumulated depreciation	-	(340,812)	(1,084,004)	-	(1,424,816)
Net book amount	91,688	432,108	549,863	19,449	1,093,108

Property, plant and equipment with a net book value of HRK 331,153 thousand as at 31 December 2012 (2011: HRK 460,410 thousand), have been pledged as collateral for borrowings (Note 24).

Property, plant and equipment include assets leased under finance lease with a net book value of HRK 35,791 thousand (2011: HRK 38,588 thousand).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 13a – NON-CURRENT ASSETS HELD FOR SALE

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Opening net book amount	139,127	111,310
Classified as held for sale during the year	5,495	37,957
Disposals	(5,551)	(7,324)
Impairment charge /i/	(25,107)	-
Transfer to own use assets	(21)	(3,435)
Foreign exchange differences	(75)	619
Closing net book amount	<u>113,868</u>	<u>139,127</u>

Non-current assets held for sale relate to the property of Droga Kolinska d.d. and Atlantic Trade Zagreb d.o.o. An active program to complete the sale plan has been initiated and management expects to finalize sales transactions in 2013.

/i/ An impairment charge of HRK 25,107 thousand was recognized to reduce the carrying amount of the assets to the fair value less costs to sell.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 14 – INTANGIBLE ASSETS

<i>(in thousands of HRK)</i>	Goodwill	Licences	Brands	Rights	Software	Total
At 31 December 2010						
Cost	886,942	193,737	822,210	40,055	104,239	2,047,183
Accumulated amortisation	-	-	(15,123)	(38,643)	(63,786)	(117,552)
Net book amount	886,942	193,737	807,087	1,412	40,453	1,929,631
At 1 January 2011						
Opening net book amount	886,942	193,737	807,087	1,412	40,453	1,929,631
Foreign exchange differences	16,121	-	17,167	-	548	33,836
Acquisition of subsidiary (Note 28)	8,864	9,500	-	-	103	18,467
Additions	-	-	-	-	4,037	4,037
Disposals	-	-	-	-	(374)	(374)
Amortisation	-	-	(4,359)	(1,412)	(15,491)	(21,262)
Impairment charge /i/	-	(8,141)	-	-	-	(8,141)
Closing net book amount	911,927	195,096	819,895	-	29,276	1,956,194
At 31 December 2011						
Cost	911,927	210,292	839,377	5,646	108,436	2,075,678
Accumulated amortisation and impairment	-	(15,196)	(19,482)	(5,646)	(79,160)	(119,484)
Net book amount	911,927	195,096	819,895	-	29,276	1,956,194
At 1 January 2012						
Opening net book amount	911,927	195,096	819,895	-	29,276	1,956,194
Foreign exchange differences	(43,551)	-	(18,803)	-	8	(62,346)
Additions	-	-	-	-	8,116	8,116
Disposals	(3,916)	(5,855)	-	-	(1,112)	(10,883)
Amortisation	-	-	(3,752)	-	(12,362)	(16,114)
Impairment charge /i/	-	(4,002)	-	-	-	(4,002)
Closing net book amount	864,460	185,239	797,340	-	23,926	1,870,965
At 31 December 2012						
Cost	864,460	204,437	820,574	-	114,711	2,004,182
Accumulated amortisation and impairment	-	(19,198)	(23,234)	-	(90,785)	(133,217)
Net book amount	864,460	185,239	797,340	-	23,926	1,870,965

The disclosure on goodwill and intangible assets with indefinite useful lives impairment test is given in Note 4 b).

/i/ The basis for impairment charge is explained in Note 4.

The 2012 disposal of goodwill and licences relate to the sale of one pharmacy, as part of the acquisition of non-controlling interests (Note 28).

Intangible assets with a net book value of HRK 711,703 thousand as at 31 December 2012 (2011: HRK 445,021) have been pledged as collateral for borrowings (Note 24).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 15 – FINANCIAL INSTRUMENTS BY CATEGORY

The accounting policies for financial instruments have been applied to the line items below:

<i>(in thousands of HRK)</i>	Loans and receivables	Available-for- sale financial assets	Total
31 December 2012			
Financial assets			
Available-for-sale	-	1,300	1,300
Trade and other receivables	1,105,359	-	1,105,359
Short-term deposits given	20,142	-	20,142
Cash and cash equivalents	250,865	-	250,865
Total	1,376,366	1,300	1,377,666

<i>(in thousands of HRK)</i>	Other financial liabilities	Finance leases	Derivatives used for hedging	Liabilities at fair value through profit or loss	Total
31 December 2012					
Financial liabilities					
Borrowings	2,538,342	-	-	-	2,538,342
Finance leases	-	14,660	-	-	14,660
Derivative financial instruments /i/	-	-	63,724	7,411	71,135
Trade and other payables	734,395	-	-	-	734,395
Total	3,272,737	14,660	63,724	7,411	3,358,532

<i>(in thousands of HRK)</i>	Loans and receivables	Available-for- sale financial assets	Assets at fair value through profit or loss	Total
31 December 2011				
Financial assets				
Available-for-sale	-	1,358	-	1,358
Trade and other receivables	1,084,925	-	-	1,084,925
Short-term deposits given	36,334	-	-	36,334
Derivative financial instruments	-	-	26,866	26,866
Cash and cash equivalents	247,596	-	-	247,596
Total	1,368,855	1,358	26,866	1,397,079

<i>(in thousands of HRK)</i>	Other financial liabilities	Finance leases	Derivatives used for hedging	Liabilities at fair value through profit or loss	Total
31 December 2011					
Financial liabilities					
Borrowings	2,694,054	-	-	-	2,694,054
Finance leases	-	27,706	-	-	27,706
Other non-current liabilities	36,357	-	-	-	36,357
Derivative financial instruments /i/	-	-	49,164	33,902	83,066
Trade and other payables	667,128	-	-	-	667,128
Total	3,397,539	27,706	49,164	33,902	3,508,311

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 15 – FINANCIAL INSTRUMENTS BY CATEGORY (continued)

/i/ Derivative financial instruments classified as held for trading as at 31 December 2012 relate to the fair value of interest-risk hedges. As at 31 December 2011, the receivables for derivatives comprised the fair value of interest-rate risk hedges in the subsidiary Droga Kolinska d.d. in the amount of HRK 18,045 thousand and the fair value of open futures contracts for hedging the foreign-exchange risk in the amount of HRK 8,821 thousand.

NOTE 16 – CREDIT QUALITY OF FINANCIAL ASSETS

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings (if available) or to historical information on counterparty default rates.

As at 31 December 2012, financial assets classified as trade and other receivables and short-term deposits given that are not past due amounted to HRK 919,572 thousand (2011: HRK 961,208 thousand). These receivables relate to existing customers with no defaults in the past.

External credit ratings about counterparty default rates for cash and cash equivalents are as follows:

<i>Credit rating</i>	2012	2011
	<i>(in thousands of HRK)</i>	
A-1/Negative (Standard & Poor's)	120,269	222,838
A-2/Negative (Standard & Poor's)	105,063	-
Non-Prime /Negative (Moody's)	3,891	5,692
Petty cash and other banks	21,642	19,066
	250,865	247,596

The credit quality of financial assets that are neither past due nor impaired can be assessed by reference to external credit ratings (if available) or to historical information about counterparty default rates:

	2012	2011
	<i>(in thousands of HRK)</i>	
Trade receivables		
Counterparties without external credit rating		
Group 1	25,839	32,510
Group 2	501,065	512,543
Group 3	320,389	321,612
Total unimpaired trade receivables	847,293	866,665

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 16 – CREDIT QUALITY OF FINANCIAL ASSETS (continued)

	2012	2011
	<i>(in thousands of HRK)</i>	
Other receivables		
A-	3	9
Counterparties without external credit rating		
Group 2	35,337	42,304
Total unimpaired other receivables	35,340	42,313

	2012	2011
	<i>(in thousands of HRK)</i>	
Loans and long-term deposits		
Counterparties without external credit rating		
Group 2	11,777	12,476
Group 3	5,020	3,420
	16,797	15,896

	2012	2011
	<i>(in thousands of HRK)</i>	
Short-term deposits		
A-1/Negative	20,142	36,334
	20,142	36,334

- Group 1 – new customers/related parties (less than 12 months)
- Group 2 – existing customers/related parties (more than 12 months) with no defaults in the past
- Group 3 – existing customers/related parties (more than 12 months) with some defaults in the past. All defaults were fully recovered.

None of the financial assets that are fully performing has been renegotiated in the last year.

NOTE 17 – AVAILABLE-FOR-SALE FINANCIAL ASSETS

Investments in available-for-sale financial assets relate to unlisted equity instruments and are carried at cost since they do not have quoted market price and fair value cannot be reliably measured. In 2011, the Group has disposed of a major part of its investment for the amount of HRK 46,962 thousand and realized a HRK 11,962 thousand gain from sale. During 2012 and 2011, there were no impairment provisions on available-for-sale financial assets.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 18 – TRADE AND OTHER RECEIVABLES

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Non-current receivables		
Loans receivable and deposits /i/	9,547	10,436
Other non-current receivables /iv/	37	11,078
	<u>9,584</u>	<u>21,514</u>
Current receivables		
Trade receivables /ii/	1,053,222	1,026,716
Loans receivable and deposits /i/	7,250	5,460
Current portion of other non-current receivables /iv/	9,595	5,000
Other receivables /iii/	78,703	82,675
	<u>1,148,770</u>	<u>1,119,851</u>
Short-term deposits /v/	20,142	36,334
	<u>1,178,496</u>	<u>1,177,699</u>

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Financial assets		
Category: Trade and other receivables		
Loans and deposits	16,797	15,896
Trade receivables	1,053,222	1,026,716
Other receivables	35,340	42,313
Short-term deposits	20,142	36,334
	<u>1,125,501</u>	<u>1,121,259</u>

/i/ Loans receivable and deposits are as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Non-current receivables		
Operating lease deposits	1,084	1,022
Loans	9,727	10,711
Current portion	(1,264)	(1,297)
	<u>9,547</u>	<u>10,436</u>
Current receivables		
Loans – related parties (Note 30)	4,248	3,420
Loans	1,738	743
Current portion of non-current receivables	1,264	1,297
	<u>7,250</u>	<u>5,460</u>
	<u>16,797</u>	<u>15,896</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 18 – TRADE AND OTHER RECEIVABLES (continued)

The fair value of loans and deposits approximates the carrying amounts.

/ii/ Trade receivables are as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Gross trade receivables	1,115,853	1,092,941
Trade receivables – related parties (Note 30)	76,099	89,931
Provision for trade receivables	<u>(138,730)</u>	<u>(156,156)</u>
	1,053,222	1,026,716

/iii/ Other receivables are as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Receivables from government institutions	35,164	40,773
Outstanding advances	2,206	4,114
Factoring	7,387	5,724
Prepaid expenses	5,068	5,590
Interest receivable	18	79
Other receivables – related parties (Note 30)	79	177
Other	<u>28,781</u>	<u>26,218</u>
	78,703	82,675

/iv/ Other non-current receivables primarily relate to receivables from continuous cession on Badel 1862 d.d.'s trade receivables in the amount of HRK 9,595 thousand (2011: HRK 15,802 thousand). The receivables will be collected over a 12-month period.

/v/ Accrued interest up to the balance sheet date is recorded within other income.

As of 31 December 2012, trade receivables in the amount of HRK 138,730 thousand (2011: HRK 156,156 thousand) were impaired and provided for. The individually impaired receivables relate to customers that are in unexpected difficult economic situations. The ageing of these receivables is as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Up to 3 months	850	1,008
3 to 6 months	945	2,206
Over 6 months	<u>136,935</u>	<u>152,942</u>
	138,730	156,156

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 18 – TRADE AND OTHER RECEIVABLES (continued)

As at 31 December 2012, trade receivables in the amount of HRK 205,929 thousand (2011: HRK 160,051 thousand) were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default.

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Up to 3 months	143,328	126,404
3 to 6 months	37,028	24,407
Over 6 months	25,573	9,240
	<u>205,929</u>	<u>160,051</u>

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

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
EUR	387,350	354,892
HRK	326,043	347,817
RSD	328,988	361,785
Other	83,120	56,765
	<u>1,125,501</u>	<u>1,121,259</u>

Movements on the provision for impairment of trade receivables are as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
As at 1 January	156,156	150,582
Provision for receivables impairment (Note 8)	9,960	22,236
Collected amounts reversed (Note 8)	(5,148)	(9,499)
Receivables written off	(21,016)	(8,108)
Exchange differences	(1,222)	945
As at 31 December	<u>138,730</u>	<u>156,156</u>

The other classes within trade and other receivables do not contain impaired assets.

The maximum exposure to credit risk at the reporting date is the carrying value of each class of receivable mentioned above.

The Group does not hold any collateral as security other than bills of exchange and promissory notes.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 19 – INVENTORIES

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Raw materials and supplies	199,332	183,110
Work in progress	16,968	12,022
Finished goods	195,494	170,305
Trade goods	131,523	168,243
	<u>543,317</u>	<u>533,680</u>

As of 31 December 2012, inventories of HRK 22,454 thousand (2011: HRK 29,105 thousand) were impaired and fully provided for, due to the adjustment to net realisable value (Note 8).

NOTE 20 – CASH AND CASH EQUIVALENTS

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Current account and cash on hand	71,490	26,898
Foreign currency account	93,977	60,172
Deposits up to three months /i/	85,398	160,526
	<u>250,865</u>	<u>247,596</u>

/i/ Accrued interest up to the balance sheet date is recorded within other income.

Cash and cash equivalents are denominated in the following currencies:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
EUR	113,105	100,731
HRK	71,583	27,493
RSD	52,249	99,323
Other	13,928	20,049
	<u>250,865</u>	<u>247,596</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 21 – SHARE CAPITAL

	Number of shares	Ordinary shares	Share premium	Treasury shares	Total
	<i>(in thousands of HRK)</i>				
1 January 2011	3,334,146	133,372	883,022	(112)	1,016,282
Purchase of treasury shares	(3,220)	-	-	(2,532)	(2,532)
Share based payments	2,901	-	(119)	2,273	2,154
31 December 2011	3,333,827	133,372	882,903	(371)	1,015,904
Purchase of treasury shares	(10,541)	-	-	(5,393)	(5,393)
Share based payments	11,014	-	(155)	5,764	5,609
31 December 2012	3,334,300	133,372	882,748	-	1,016,120

All shares issued are ordinary shares, including all relevant rights. All shares have the right to vote at the Company's General Assembly, as well as the right to dividend payment.

The ownership structure of the Company is as follows:

	31 December 2012		31 December 2011	
	Number of shares	%	Number of shares	%
Emil Tedeschi	1,673,819	50.20	1,673,819	50.20
Raiffeisen Obligatory pension fund	322,943	9.69	313,084	9.39
EBRD	284,301	8.53	284,301	8.53
DEG	283,209	8.49	283,209	8.49
Lada Tedeschi Fiorio	193,156	5.79	193,156	5.79
Management of the Company	37,481	1.12	41,490	1.25
Other shareholders	539,391	16.18	544,768	16.34
Treasury shares	-	-	473	0.01
Total	3,334,300	100.00	3,334,300	100.00

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 21 – SHARE CAPITAL (continued)

Share based payments

According to the Company's share option programme, shares are granted to Management Board members and to top management.

One part of the share grant is subject to the Group achieving its operating profit target growth and subject to individual performance achievements. The other part is conditional on the employee completing two or more years of service (the vesting period). Furthermore, part of the programme is designated for the extraordinary performance on special projects.

Under the programme, 6,538 new shares have been granted in 2012 (2011: 6,017 shares).

The fair value of equity-settled share based payment transactions amounted to HRK 6,491 thousand (2011: HRK 4,240 thousand). Of that amount, HRK 6,083 thousand (2011: HRK 3,818 thousand) has been reported, together with appropriated tax, as staff costs (Note 6), relating to shares for which vesting conditions were met in 2012 (6,127 shares; 2011: 5,418 shares) and HRK 408 thousand (2011: HRK 422 thousand) was deferred, relating to shares for which vesting conditions will be met in the next two years (411 shares; 2011: 599 shares).

The fair value of the shares granted is determined as of the grant date at the estimated market price of the share of HRK 700 (2011: HRK 500, with the exception of shares granted for special projects, where the market price at the grant date was HRK 800).

Dividend distribution

In 2012 and 2011, there were no payments of dividends to the Company's shareholders.

NOTE 22 – RESERVES

<i>(in thousands of HRK)</i>	Reserves /i/	Translation reserves /ii/	Cash flow hedge reserve /ii/	Total
At 1 January 2011	5,428	(5,459)	(3,159)	(3,190)
Foreign exchange differences	-	50,595	-	50,595
Cash flow hedge	-	-	(44,202)	(44,202)
At 31 December 2011	5,428	45,136	(47,361)	3,203
Foreign exchange differences	-	(50,737)	-	(50,737)
Transfer from retained earnings	556	-	-	556
Cash flow hedge	-	-	(10,113)	(10,113)
At 31 December 2012	5,984	(5,601)	(57,474)	(57,091)

/i/ Reserves mainly comprise statutory reserves recorded in accordance with the Company's Articles of Association. These reserves are distributable.

/ii/ Movements represent amounts attributable to the owner of the Company only.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 23 – TRADE AND OTHER PAYABLES

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Trade payables	626,685	574,722
Trade payables – related parties (Note 30)	1,816	2,003
Other payables	165,095	142,881
	<u>793,596</u>	<u>719,606</u>

Other payables recorded as at 31 December are as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Gross salaries payable	41,254	40,258
Liabilities to state institutions	17,648	11,787
Liabilities to Kapitalni Fond d.d. (Note 24a)	33,136	-
Accrued expenses	27,610	43,230
Vacation accrual	13,800	14,063
Severance payable	299	431
Deferred income	1,112	1,587
Dividend payable (Note 30)	22	22
Liabilities from share purchase agreement	-	20,709
Other	30,214	10,794
	<u>165,095</u>	<u>142,881</u>

Financial liabilities are denominated in the following currencies:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
EUR	268,135	249,046
HRK	314,433	264,156
RSD	100,547	105,656
Other	51,280	48,270
	<u>734,395</u>	<u>667,128</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 24 – BORROWINGS

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Long-term borrowings:		
Financial institutions /i/	415,045	1,830,596
Related parties /ii/ (Note 30)	1,665,948	389,134
Bonds /iii/	113,375	112,769
Finance lease	4,533	14,226
Long-term debt	2,198,901	2,346,725
Short-term borrowings:		
Financial institutions /i/	186,171	321,335
Related parties /ii/ (Note 30)	156,442	38,825
Bonds /iii/	1,361	1,395
Finance lease	10,127	13,480
	354,101	375,035
	2,553,002	2,721,760

/i/ In November 2012, Atlantic Grupa signed agreements to refinance its existing loans. The Agreements were signed with the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC) and other local commercial banks. The amount of the loan package granted was EUR 307 million and was structured such that the EBRD arranged a loan of EUR 232 million, the IFC participated in the package with a loan of EUR 50 million, while the remaining EUR 25 million were ensured by Raiffeisenbank Austria Zagreb and Zagrebačka banka. The funds from the contracted package were primarily used for restructuring of the Group's balance sheet, (EUR 272 million), an additional uncommitted energy efficiency line (EUR 10 million) and a working capital line (EUR 25 million). As at 31 December 2012, EUR 20.7 million of the committed line was unused.

/ii/ Borrowings from EBRD and DEG are disclosed separately since these financial institutions own shares of the Company (Note 21) and are therefore considered as related parties.

/iii/ In September 2011, Atlantic Grupa issued bonds in amount of HRK 115 million at the price of 99.375% with a coupon of 6.75% per annum and final redemption on 20 September 2016. The purpose of these bonds was to refinance bonds issued in December 2006 which matured on 6 December 2011.

Borrowings from financial institutions (including related parties) are secured by pledges over property, plant and equipment (Note 13), intangible assets (Note 14) and shares of subsidiaries (Atlantic Trade d.o.o., Droga Kolinska d.d., Grand Prom d.o.o. and Soko Nada Štark a.d.). Furthermore, issued bonds and part of borrowings from financial institutions are subject to covenant clauses, whereby the Group is required to meet certain key performance indicators such as total net debt cover, interest cover, cash flow cover and maximum capital expenditures. At the balance sheet date, all covenant clauses were met.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 24 – BORROWINGS (continued)

The exposure of the Group's borrowings to interest rate changes and the contractual re-pricing dates at the balance sheet date are as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Fixed interest rate	192,728	212,249
Up to 3 months	1,808,750	1,161,849
3 to 6 months	551,524	1,345,252
1-5 years	-	2,410
	<u>2,553,002</u>	<u>2,721,760</u>

The maturity of long-term borrowings is as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Between 1 and 2 years	233,084	246,075
Between 2 and 5 years	1,098,612	1,610,809
Over 5 years	867,205	489,841
	<u>2,198,901</u>	<u>2,346,725</u>

The average effective annual interest rate related to borrowings from financial institutions at the balance sheet date was 4.51% (2011: 6.55%). The effective annual interest rate related to bonds at the balance sheet date was 7.25% (2011: 6.99%).

The carrying amounts and fair value of long-term borrowings are as follows:

	Carrying amounts		Fair value	
	<u>2012</u>	<u>2011</u>	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>		<i>(in thousands of HRK)</i>	
Long-term borrowings				
Financial institutions	2,080,993	2,219,730	2,079,354	2,215,431
Bonds	113,375	112,769	119,669	109,193
Finance lease	4,533	14,226	4,533	14,226
	<u>2,198,901</u>	<u>2,346,725</u>	<u>2,203,556</u>	<u>2,338,850</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 24 – BORROWINGS (continued)

The fair values of borrowings from banks and financial institutions are based on cash flows discounted using a rate of 4.51% (2011: 6.55%).

The carrying amount of short-term borrowings approximates their fair value.

Gross finance lease liabilities – minimum lease payments:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
No later than 1 year	10,396	15,270
Later than 1 year and no later than 5 years	5,163	15,039
	<u>15,559</u>	<u>30,309</u>
Future finance charges on finance leases	(899)	(2,603)
Present value of finance lease liabilities	<u>14,660</u>	<u>27,706</u>

The carrying value of borrowings and bonds is translated from the following currencies:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
HRK	252,901	219,056
EUR	2,296,234	2,498,577
USD	3,867	3,938
CHF	-	189
	<u>2,553,002</u>	<u>2,721,760</u>

NOTE 24a – OTHER NON-CURRENT LIABILITIES

Out of total other non-current liabilities as at 31 December 2011, HRK 36,101 thousand related to liabilities towards closed investment fund - Kapitalni Fond d.d.. Since these liabilities mature in 2013, the remaining balance, including interest accrued as at 31 December 2012, is shown within Trade and other payables (Note 23).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 25 – DEFERRED INCOME TAX

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Deferred tax assets:		
- Deferred tax assets to be recovered after 12 months	60,914	46,962
- Deferred tax assets to be recovered within 12 months	11,268	9,450
	<u>72,182</u>	<u>56,412</u>
Deferred tax liabilities:		
- Deferred tax liabilities to be recovered after 12 months	(185,970)	(192,256)
- Deferred tax liabilities to be recovered within 12 months	(985)	(808)
	<u>(186,955)</u>	<u>(193,064)</u>
Deferred tax liabilities - net	<u>(114,773)</u>	<u>(136,652)</u>

Deferred tax assets are recognised for tax loss carry forwards and tax credits to the extent that realisation of the related tax benefit through future taxable profits of the related Group entities is probable.

The Group did not recognise deferred income tax assets of HRK 78,838 thousand (2011: HRK 86,877 thousand) in respect of losses that arose in its subsidiaries that can be carried forward against future taxable income. Deferred tax assets have not been recognised in respect of these losses as it is not certain that future taxable profit will be available for utilisation of the temporary differences. Losses amounting to HRK 388,118 thousand (2011: HRK 401,485 thousand) expire over the next ten years, while the losses in the amount of HRK 10,730 thousand (2011: HRK 73,048 thousand) do not expire.

Deferred tax assets*(in thousands of HRK)*

	<u>Tax losses</u>	<u>Provisions</u>	<u>Other</u>	<u>Total</u>
At 1 January 2011	20,174	8,795	24,745	53,714
(Charged)/credited to the income statement (Note 11)	(8,791)	(2,887)	9,512	(2,166)
(Charged)/credited to other comprehensive income	-	-	4,172	4,172
Other movements	160	(17)	(312)	(169)
Exchange differences	134	72	655	861
At 31 December 2011	11,677	5,963	38,772	56,412
(Charged)/credited to the income statement (Note 11)	18,678	1,800	(2,138)	18,340
(Charged)/credited to other comprehensive income	-	-	(818)	(818)
Exchange differences	(680)	(44)	(1,028)	(1,752)
At 31 December 2012	29,675	7,719	34,788	72,182

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 25 – DEFERRED INCOME TAX (continued)

Deferred tax liabilities

<i>(in thousands of HRK)</i>	Fair value gains	Fair value uplifts of assets acquired in business combinations	Other	Total
At 1 January 2011	103	182,532	7,237	189,872
Charged/ (Credited) to the income statement (Note 11)	(39)	(2,256)	509	(1,786)
Acquisition of subsidiary (Note 28)	-	1,900	-	1,900
Other movements	-	79	-	79
Exchange differences	2	2,811	186	2,999
At 31 December 2011	66	185,066	7,932	193,064
Charged/ (Credited) to the income statement (Note 11)	19	(1,057)	868	(170)
Other movements	-	(1,171)	(3,062)	(4,233)
Exchange differences	3	(1,323)	(386)	(1,706)
At 31 December 2012	88	181,515	5,352	186,955

NOTE 26 – PROVISIONS

<i>(in thousands of HRK)</i>	Employee benefits	Legal proceedings	Warranties	Other provisions	Total
At 31 December 2011	44,231	27,796	2,447	2,041	76,515
Analysis of total provisions:					
Non-current	26,099	26,718	-	1,723	54,540
Current	18,132	1,078	2,447	318	21,975
At 1 January 2012	44,231	27,796	2,447	2,041	76,515
Additions	36,118	603	2,441	3,115	42,277
Used during year	(15,119)	(471)	(2,443)	(300)	(18,333)
Unused amounts reversed	(18,013)	(1,003)	-	(16)	(19,032)
Exchange differences	(1,253)	(379)	5	(109)	(1,736)
At 31 December 2012	45,964	26,546	2,450	4,731	79,691
Analysis of total provisions:					
Non-current	29,762	25,146	-	1,569	56,477
Current	16,202	1,400	2,450	3,162	23,214

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 26 – PROVISIONS (continued)**Legal proceedings**

In the ordinary course of business, the Group is defendant and plaintiff in pending legal proceedings. In Managements opinion, the outcome of these legal proceedings will not give rise to any significant loss beyond the amounts provided at 31 December 2012.

Employee benefits

This provision comprises estimated long-term employee benefits relating to termination benefits and jubilee awards, as defined by the collective bargaining agreement and bonuses to employees. The non-current portion of the provision relates to estimated acquired rights to termination benefits and jubilee awards that will be paid after 31 December 2013. The current amount of employee benefits includes annual bonuses to employees and part of jubilee awards and termination benefits in the amount of HRK 1,568 thousand that will be paid out within the following year from the balance sheet date.

Other provisions

Other provisions mainly relate to provisions for severance payments for employees due to restructuring.

NOTE 27 – COMMITMENTS

There were no capital expenditures contracted for at the balance sheet date but not yet incurred relating to property, plant and equipment and intangible assets.

The Group leases various outlets, offices and warehouses under non-cancellable operating lease agreements. The lease terms are between three and ten years and the majority of lease agreements are renewable at the end of the lease period at market rate.

The Group also leases various property, plant and equipment under cancellable operating lease agreements. The Group is required to give three to six months notice for the termination of these agreements.

The lease rentals charged to the income statement during the year is disclosed in Note 8.

The future aggregate minimum lease payments under non-cancellable operating leases for equipment, vehicles and business premises are as follows:

	<u>2012</u>	<u>2011</u>
	<i>(in thousands of HRK)</i>	
Not later than 1 year	35,317	37,582
Later than 1 year and not later than 5 years	65,066	87,261
Over 5 years	6,495	8,309
	<u>106,878</u>	<u>133,152</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 28 – BUSINESS COMBINATIONS

(i) Acquisitions in 2012

During the year ended 31 December 2012, the Group acquired non-controlling interests and became the sole owner of subsidiaries ZU Ljekarne Bamapharm and Atlantic Farmacia d.o.o.. Acquisition of these non-controlling interests was partially settled in cash (HRK 20,343 thousand) and partially in kind by selling one pharmacy from subsidiary ZU Farmacia (Note 14). Subsidiary Atlantic Farmacia d.o.o. was subsequently merged into Fidifarm d.o.o..

In October 2012, the Group became the sole owner of Soko Nada Štark a.d., Belgrade, by acquiring the remaining 5.86% of the share capital from non-controlling interest shareholders through the majority shareholder Grand Kafa d.o.o., Belgrade for purchase consideration of EUR 2.3 million (HRK 19,601 thousand).

Finally, in December 2012, the Group became the sole owner of Palanački Kiseljak a.d., Smederevska Palanka, after acquiring the remaining 7.1% of the share capital for cash consideration of HRK 592 thousand.

The Group derecognised non-controlling interests of HRK 25,342 thousand and recorded a decrease in equity attributable to owners of the parent of HRK 23,919 thousand.

The effect of changes in ownership interest in the above mentioned subsidiaries on the equity attributable to owners of the company during the year is summarised as follows:

(in thousands of HRK)

Carrying amount of non-controlling interests acquired	25,342
Cash consideration paid to non-controlling interests	(40,536)
Consideration in kind, net of tax	<u>(8,725)</u>
Excess of consideration paid recognized in parent's equity	<u>(23,919)</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 28 – BUSINESS COMBINATIONS (continued)

(ii) Acquisitions in 2011

In May 2011, the Group acquired 100% interest and obtained control over the subsidiary ZU Ljekarne Dvoržak 2, Zagreb, Croatia. Additionally, in February 2011 the Group acquired a pharmacy which operates within ZU Ljekarne Farmacia, Zagreb.

Details of the value of assets and liabilities acquired are as follows:

<i>(in thousands of HRK)</i>	Carrying value	Fair value of identifiable assets acquired and liabilities assumed
	<hr/>	<hr/>
Property, plant and equipment (Note 13)	7,702	7,702
Licences (Note 14)	-	9,500
Software (Note 14)	103	103
Trade and other payables	(3,478)	(3,478)
Borrowings	(3,121)	(3,127)
Deferred tax liability (Note 25)	-	(1,900)
Total identifiable net assets	1,206	8,800
Purchase consideration paid in cash in 2009		11,857
Purchase consideration paid in cash in 2011		5,807
Fair value of identifiable net assets acquired		(8,800)
Goodwill (Note 14)		<hr/> 8,864

The businesses acquired in 2011 contributed to the consolidated result for the year ended 31 December 2011 with revenue of HRK 18,830 thousand and net loss of HRK 76 thousand. Had the businesses been consolidated from 1 January 2011, the consolidated revenue for the year ended 31 December 2011 would have been HRK 9,194 thousand higher, while profit before taxation would not change significantly than currently reported.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 29 – CASH GENERATED FROM OPERATIONS

	<u>Note</u>	<u>2012</u>	<u>2011</u>
Net profit		66,112	54,892
Income tax	11	7,465	23,945
Depreciation, amortisation and impairment	13, 13a, 14, 2.24	180,065	165,827
(Gain) / loss on sale of property, plant and equipment	9	(9,248)	63
Gain on sale of available-for-sale financial assets	9	(43)	(11,962)
Provision for current assets		32,414	51,341
Foreign exchange differences - net		49,460	43,148
Increase / (decrease) in provision for risks and charges - net	26	3,176	(9,129)
Fair value losses/(gains) on financial assets	9	1,168	(8,709)
Share based payment		5,855	1,318
Interest income		(9,741)	(11,350)
Interest expense	10	257,546	221,167
Other non-cash items, net		918	(5,757)
Changes in working capital:			
Increase in inventories		(32,090)	(59,771)
Increase in current receivables		(31,576)	(57,316)
Increase / (decrease) in current payables		33,205	(15,540)
Cash generated from operations		554,686	382,167

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 30 – RELATED PARTY TRANSACTIONS

The Group enters into transactions with the following related parties: shareholders and other entities owned or controlled by shareholders ('other entities').

Related party transactions that relate to balances as at 31 December 2012 and as at 31 December 2011 and transactions recognised for years then ended, are as follows:

<i>(all amounts expressed in thousands of HRK)</i>	Note	2012	2011
RECEIVABLES			
Current receivables			
Other entities	18	80,426	93,528
LIABILITIES			
Borrowings			
Shareholders	24	1,822,390	427,959
Trade payables			
Shareholders	23	22	22
Other entities	23	1,816	2,003
		<u>1,838</u>	<u>2,025</u>
REVENUES			
Sales revenues			
Other entities		459,324	388,914
Other revenues			
Other entities		-	93
EXPENSES			
Marketing and promotion expenses			
Other entities	7	17,045	15,969
Other operating expenses			
Other entities	8	2,743	59
Finance cost - net			
Shareholder	10	53,779	40,399
Key management compensation			
Gross salaries and bonuses /i/		9,868	18,620
Share based payment	6	6,083	3,818

/i/ Key management compensation relates to gross wages and bonuses for 4 employees (2011: 9 employees).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 31 – SUBSIDIARIES

The Group is comprised of the Company and the following subsidiaries in which the Company has an ownership interest above 50% and exercises control:

	2012	2011
Cedevita d.o.o., Croatia	81%	81%
- Multivita d.o.o., Serbia	100%	100%
Neva d.o.o., Croatia	100%	100%
Atlantic Trade d.o.o., Croatia	100%	100%
- Atlantic Naložbe d.o.o., Slovenia (liquidated in 2012)	-	100%
- Droga Kolinska d.d., Slovenia	100%	100%
- Soko Nada Štark a.d., Serbia	100%	94%
- Grand Kafa d.o.o., Serbia (merged to Soko Nada Štark a.d. in 2012)	-	100%
- Palanački kiseljak a.d., Serbia	100%	93%
- Tobess d.o.o., Serbia (merged to Soko Nada Štark a.d. in 2012)	-	100%
- Droga d.o.o., Bosnia and Herzegovina (merged to Argeta d.o.o. in 2012)	-	100%
- Argeta d.o.o., Bosnia and Herzegovina	100%	100%
- Droga d.o.o.e.l., Macedonia (liquidation proceedings)	100%	100%
- o.o.o. Droga Kolinska, Russia	100%	100%
- Grand Prom d.o.o., Serbia	100%	100%
- Unikomerc d.o.o., Serbia	100%	100%
- Kofikom Produkt d.o.o., Bosnia and Herzegovina	100%	100%
- DK Trade d.o.o., Bosnia and Herzegovina (merged to Kofikom produkt d.o.o. in 2012)	-	100%
- Kofikom d.o.o., Bosnia and Herzegovina (merged to DK Trade d.o.o.)	-	100%
- Droga Kolinska d.o.o.e.l., Macedonia	100%	100%
- Slovin Jugokokta d.o.o.e.l., Macedonia (merged to Droga Kolinska d.o.o.e.l. in 2012)	-	100%
- DK Mont d.o.o., Montenegro (liquidated in 2012)	-	100%
- Atlantic Brands d.o.o., Serbia	100%	100%
- Atlantic Trade d.o.o., Slovenia	100%	100%
- Atlantic Trade d.o.o., Macedonia	75%	75%
- Lasago d.o.o., Croatia (bankruptcy proceedings)	100%	100%
- Bionatura bidon vode d.o.o., Croatia	100%	100%
Atlantic Trade Sofia e.o.o.d., Bulgaria (liquidation proceedings)	100%	100%
Atlantic Ulaganja d.o.o., Croatia (merged to Atlantic Grupa d.d. in 2012)	-	100%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 31 – SUBSIDIARIES (continued)

	<u>2012</u>	<u>2011</u>
Fidifarm d.o.o., Croatia	100%	100%
- Atlantic Pharmacentar d.o.o., Croatia	100%	100%
- Atlantic Farmacia d.o.o., Croatia (merged to Fidifarm d.o.o. in 2012)	-	95%
- ZU Ljekarne Farmacia, Croatia	100%	100%
- ZU Ljekarna Farmacia, Bosnia and Herzegovina (liquidated in 2012)	-	100%
- ZU Ljekarne Bamapharm, Croatia	100%	75%
- Farmacia Plus d.o.o., Croatia (merged to Atlantic Farmacia d.o.o. in 2012)	-	100%
Farmacia - specijalizirana prodavaonica d.o.o., Croatia	100%	100%
ZU Ljekarne Dvoržak 2. Croatia (acquired in 2011, Note 28)	100%	100%
ZU Ljekarne Marijam, Croatia	100%	100%
Alpha Medical 2,d.o.o., Croatia (merged to Farmacia - specijalizirana prodavaonica d.o.o.)	-	100%
Montana Plus d.o.o., Croatia	100%	100%
Atlantic s.r.l., Italy (liquidation proceedings)	100%	100%
Hopen Investments, BV, Netherlands	100%	100%
- Atlantic Multipower GmbH & CO OHG, Germany	100%	100%
- Atlantic Multipower UK Ltd, Great Britain	65%	65%
- Sport Direct Ltd, Great Britain	100%	100%
- Atlantic Multipower Srl, Italy	100%	100%
- Atlantic Multipower Iberica, Spain	100%	100%
- AKTIVKOST Handelsgesellschaft mbH, Germany	100%	100%
- Atlantic Management GmbH, Germany	100%	100%

NOTE 32 – AUDITORS' FEES

PricewaterhouseCoopers d.o.o., the auditor of the Group's financial statements has rendered services in the amount of HRK 3,062 thousand (2011: HRK 3,847 thousand). These services relate to the audits and reviews of the financial statements and agreed upon procedures in relation to financial covenants calculation.