

„BANJALUČKA PIVARA“ AD  
BANJA LUKA  
- Management Board -  
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## **Report on Business Operations in 2017**

### **Introduction**

In 2017, the company continued to follow through on a number of important initiatives from previous years, these included a steady upgrade in brewery capability and expanding our market area for sales of Nektar pivo into neighbouring markets. The good weather throughout the summer led to a small increase in the total beer market and the brewery grew with the market.

Despite a great deal of threatening talk and political posturing, the threatened excise tax increases on beer did not materialise and eventually towards the end of the year, the fuel tax excise increase was passed in parliament without mention of other products. It is our hope that the various lobbying efforts and strong and valid arguments that have been put forth by the industry have been listened to. 2018 is an election year and consequently it is unlikely that any increases will be proposed, however after the elections and formation of the government, we expect this to return.

Sales volume increased by 2% to 483 thousand hectolitres in 2017. This was mostly due to a growth in non-returnable products for export markets. Whilst any sales increase can be counted as a positive, the achieved margins on exports and non-returnable product are generally not as good as returnable products. This can be seen in a slight drop in margin on sales and, when taken with the increased costs of maintenance and marketing, the result operating profit of EBITDA has fallen by 2%. The final result before tax, benefited from a fall in depreciation and interest costs resulting in an increase of 5% to reach 7.4 million KM for the full year. This is an after tax result of 6.3 million KM.

### **The Beer Market in 2017**

The total beer market in BiH appears to have slightly grown in 2017 due to the very good and extended summer season. However, it is noticeable, particularly in rural areas where beer consumption is high, that the trend of working age men leaving the country to find work elsewhere is becoming more and more visible. This is seen in the continued closure of shops and bars where simply there is no longer business where there once was. Despite a good year this year, we anticipate that the beer market will resume a longer term trend of single digit decline in the near future.

The competitive landscape on the BiH beer market continues to become more intensive. Our main competitors Molson Coors (Jelen) continued to focus a large portion of its investment on Banja Luka in 2017. In particular, they attempted to drive Nektar out of distribution in leading bars and restaurants in the region by offering inflated sales incentives and capital investments. To a very large degree, thanks to the

loyalty of Nektar consumers, they have not been successful in this endeavour. Nonetheless, we were again obliged to increase our level of spend in HoReCa and leading retailers to maintain our presence.

Heineken is now an important player in the BiH beer market, now that they have consolidated their regional breweries under one distributor. With brands such as Karlovačko, Zaječarsko and Laško, along with their international brands, Heineken and Amstel, the company now has an estimated 17% of the total BiH beer market. Their approach in the RS is to offer Zaječarsko at extremely low prices in order to lure away consumers from Nektar, Jelen and Lav (Carlsberg). We expect that the level of competitive activity will only grow in the coming years.

Carlsberg continue to compete strongly with their international brands Tuborg and Carlsberg, as well as Lav and Pan pivo. In the Eastern RS, Lav pivo has lost share despite continued heavy discounting, whereas Tuborg has grown volumes by repositioning to a lower price point.

Among the local breweries, Tuzla brewery has shown significant development in recent years, selling approximately 210 thousand hectolitres in 2016, overtaking Sarajevo brewery in sales volume. A controlling stake in this company has recently been purchased by Bingo, the leading supermarket group in BiH. This will not doubt give a boost to Tuzlanska sales in their supermarkets, but it is hard to see the further commercial logic of this take over.

### **Investments in Production**

An increasing burden for the Company is the need to continuously keep up with the evolution of hardware and software used in manufacturing technology. This year we undertook a major upgrade of our main filling line, to bring all the electronics up-to-date. This project was successfully implemented in May, with a major planned stoppage during the season. This would not have been possible without the many improvements that have been achieved in stock management and planning in recent years. The next round of investment in this area in 2018 will be in our cellaring and fermentation systems which are also becoming out of date.

At the end of 2017, we purchased two labelling machines for one-way bottles and for PET bottles. These machines will be commissioned in early 2018. We also replaced the folio packing machine on our non-returnable line. This new machine will pack all of our non-returnable glass as well as cans. This is of particular importance and urgency, as the existing machine suffered regular breakdowns, leading to unreliable supply and wasted production time. The process of gradually upgrading our filling lines will involve some important further investments in the next few years.

### **Sales and Marketing**

In the spring the Company launched a completely new advertising concept. This concept focuses on the unusual name of our brand Nektar, which is known in classical mythology as the drink of the gods. The new concepts based on three famous actors is designed to be funny and amusing and through the claim 'Nektar Pivo, it's not only for the Gods', emphasises the quality of the beer.

The Company followed through on our long term commitments to three important music festivals, Demofest, OK Fest and Fresh wave, which are the centre piece of our wide ranging event and activation program. Other than these three leading events, during the year we participated in over 400 individual events from music festivals, to sports, culture, the Banja Luka half marathon and many other manifestations.

### **Prices and Margins**

A limited price increase of 2% was achieved on returnable crates in spring 2017. This was necessary to cover rising costs and has enabled us to maintain a stable position for this core SKU. However, prices of non-returnable, convenient products, especially PET and cans, continue to fall due to almost constant promotion by all players. In our view some of the prices, particularly for Pet are below long term viable levels.

### **Human resources**

One of the benefits of the recent few years of growing volumes and financial stability has been that we have managed to rebalance our workforce. We have now achieved a good balance of male and female employees throughout the business and, in 2017, through expansion of headcount we have brought in more than 30 new younger employees. These are both replacements for retiring older workers and through the creation of new jobs in the Brewery. As a result, we are starting to see a better balance of youth and experience in the Company.

The Company continues to be committed to its employees, and in particular the long term stability of the workforce, recruiting and maintaining good skills and experienced employees. The Company also seeks and supports young, dedicated and ambitious talents in all areas of its operations, and is fully supportive of continuous development of its employees' skills.

### **Corporate Governance - Application of Standards**

Commitment of the Brewery management to transparency of its operations and application of recognised Standards of corporate governance (adopted by the Republic of Srpska Securities Commission) is unchanged. The Standards Governing Joint Stock Companies (applying to companies enlisted on the official stock exchange) are applied in daily practices of the Company. „Banjalučka pivara” has its own Code of Conduct and Management, and „Banjalučka pivara” continues to further develop its corporate website, to include all relevant, timely available investor information - company financials, the most important information on business operations, its governing bodies and members of the management team, etc.

In addition to this, „Banjalučka pivara” is fully implementing various imperative norms, regulated and sanctioned by various laws (Law on Enterprises, Law on Securities Market, Law on Accounting and Audit, etc.) and acts of the Commission for Securities and Stock Exchange Rules, incorporated in the Brewery's Articles of Association, Rulebook on Procedures of the Assembly and other acts of the Company.

## **Conclusion**

The Company remains in good financial health, able to compete with the major multinationals who are importing large quantities of sometimes too cheap beer into BiH. Our business will continue to compete vigorously and more and more, into the future we will export our brands into neighbouring markets.

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Ragnar Tryggvason

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Nicholas Penny