

„BANJALUČKA PIVARA“ AD
BANJA LUKA
- Management Board -
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Report on Business Operations in 2014

Introduction

For the third year in succession, we managed to increase volume and sell more high value products, resulting in a 6.8% net revenue increase to 39.6 million KM. Sales volumes grew by 4.9% to 427 thousand hectolitres which, combined with excellent costs control and some efficiency gains, resulted in an increase of 27% in operating profitability or EBITDA to 11.7 million KM. This level of operating profitability, an EBITDA margin of 30%, is comparable with other high performing breweries in the region.

Net profit of 3.6 million KM is boosted by a one-off revenue item of 2.8 million KM due to a reversal of previous years' expenses related to provisions for preferential dividend. This move was done with the permission of the owner of the preferential shares to reverse the provisions for preferential dividend for those years in which the company operated with losses. Shareholders should note that future profits should be compared to the 3.6 million KM figure rather than the exceptional figure of 6.4 million KM.

The Beer Market in 2014

2014 has been without doubt the most difficult year in our industry for the last decade. As a result of the flooding in May, the market suffered severe disruption across the economy which was exacerbated by the subsequent terrible summer season, with very high levels of rainfall. Our business has showed great resilience in this period and despite all the problems has rebounded, recovering the losses from the summer, in the fourth quarter and returned to strong growth.

The competitive landscape on the BiH beer market continues to become more intensive. Our key competitors Molson Coors Serbia (Jelen) and Carlsberg Serbia (Lav) have both continuously increased their investment levels in the market particularly with contracts for bars and cafes where Nektar is a leading brand.

We believe the total market fell by around 4% in 2014, though it was encouraging to note a strong quarter 4 for all players in the market. Nektar is very close to overtaking Jelen to become the single largest volume beer brand on the BiH market.

In September 2014, a new excise law was passed raising excise rates from 0.20 KM per litre to 0.25 KM. Small breweries with average three year production below 400,000 hectolitres benefit from a lower rate by 20%. This law gave a small competitive advantage to „Banjalučka pivara“ in 2014 and will also apply in 2015.

Investments in Bottling capacity

Two important capital projects were successfully completed during 2014. The first was installation of a canning line in combination with our one-way glass line. This new capability will enable us to actively compete in this fast growing market segment, and boost our margins on products which were previously filled in Belgrade. As part of the project, we have installed a tunnel pasteuriser which gives us excellent capability for export and extended shelf life. Can volumes are likely to continue to grow as a percentage of overall sales and the Company is well placed to lead in this segment in the future.

The second project was to upgrade our PET line, with a new bottle blower and packer, which will also increase capacity and efficiency. It is particularly important that we are able to produce these products effectively, as this is the segment of the beer market which is most prone to price pressure. During 2014 the multinational competitors are regularly selling for a factory gate price close to 0.80 KM, before distribution costs, taxes and retail margins.

In addition, we have invested extensively in energy and water measurement devices. This will enable us to cut waste and optimise our production processes in the coming years.

Sales and Marketing

The launch of the canning line was somewhat disrupted by the flooding in May, leading to cancellation of the main promotional event. Nonetheless we continued with our first on-pack promotion for Nektar with excellent results in participation and sales.

Sales results in bars, clubs and cafes continue to be very positive with volume gains in draught beer and 33cl bottle sales, which indicates a high acceptance and positive image for the brand. Growth rates in retail sales for crates were also positive. Radler volumes fell due to a combination of a poor summer and less interest in the category in bars and cafes. This is expected as it is a fast moving category and consumers easily switch to new products.

In November a limited edition ale was launched under the name Nektar Special. This beer was targeted at beer drinkers looking for a more challenging beer flavour. The product was very well received by the market and more broadly consumed than was expected.

Prices and Margins

„Banjalučka pivara” increased prices by 2-3% in April 2014 in response to rising costs, and to take advantage of the general strengthening of brand equity. This increase was partly offset by an increase in discounts and incentives for customers. When combined with a positive change in sales mix, this move resulted in a 1.8% improvement in operating margin.

Human resources

The process of improving management processes has continued, with a focus upon clearer responsibilities throughout the business, with greater accountability. A number of changes were made to structure and a reduction of complexity in some of our processes was achieved, particularly in the logistics department. Our management aim is to build strength in depth throughout the Company. The Company is 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. In March 2011, „Banjalučka pivara” adopted its own Code of Conduct and Management, and the Company 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 achieved an excellent set of results in 2014 despite a relatively poor and disrupted summer. Our strategy of investing in efficient and high quality beer production has helped us to grow volume and raise prices while keeping costs under control. We consider that we can continue to deliver results with this strategy over the coming period. The investments that we have been able to make, as a result of the capital increase in 2013, are yielding results and will give us security into the future.

The management ambition is to continue the established trend of sustained double digit growth in volume and profit, to continue to reduce the Company's indebtedness and expand our market coverage, and to invest in marketing and distribution, building Nektar Pivo to be the leading beer brand in BiH.

CHAIRMAN of
MANAGEMENT BOARD
Ragnar Tryggvason

GENERAL MANAGER

Nicholas Penny