

Translation from Bulgarian

INTERIM REPORT

**ON THE ACTIVITY OF BULGARTABAC GROUP
AS OF 31 DECEMBER 2011**

**(prepared in accordance with Art. 100o, para. 4, i.2 of Public Offering of
Securities Act (POSA))**

1. Important events, which have occurred during the fourth quarter of 2011, with accumulation from the beginning of the year, and their impact on the results reported in the financial statements of the Group

Completion of the procedure for privatisation of Bulgartabac-Holding AD

An important event, which has occurred in the fourth quarter of 2011, is the change in the persons exercising control over Bulgartabac-Holding AD as a result of the completed procedure for privatisation of the State participation in the company's capital.

As a result of the publicly announced tender, in pursuance of a decision № 3219-II dated 18 April 2011 (promulgated in the State Gazette, issue 34 of 10 May 2011) of the Agency of Privatisation and Post Privatisation Control (APPC), a privatisation contract between APPC and BT Invest GmbH, Austria, was signed on 12 September 2011 for the privatisation of 79.83% of the capital of Bulgartabac-Holding AD, Sofia.

On 14 October 2011, APPC, in its capacity of a seller, transferred to BT Invest GmbH, Austria, 5,881,380 shares, or 79.83% of the capital of Bulgartabac-Holding AD.

The transaction was registered with Central Depository on 14 October 2011.

Holding extraordinary General Meetings of Shareholders of Bulgartabac-Holding AD and of its subsidiaries Sofia-BT AD, Blagoevgrad-BT AD, Pleven-BT AD, and Bulgartabac-Trading EAD

During the fourth quarter of 2011, extraordinary General Meetings of Shareholders of Bulgartabac-Holding AD (01 November 2011) and of the following its subsidiaries were held: Sofia-BT AD (21 November 2011), Blagoevgrad-BT AD (23 November 2011), Pleven-Bulgartabac AD (22 November 2011), and Bulgartabac-Trading EAD (01 December 2011). The key agenda items of the above extraordinary GMS included the replacement of the members of the Boards of Directors of these companies. The new members of the Boards of Directors were duly registered with the Trade Register at the Registry Agency.

- At the extraordinary GMS of **Bulgartabac-Holding AD**, held on 01 November 2011, Alexander Manolev, Georgi Kostov, and Ivan Bilarev were discharged as members of the Board of Directors of the company. As new members of the Board of Directors of the company were elected Alexander Romanov, Yavor Draganov, Angel Dimitrov, Ventsislav Cholakov, and Miglena Hristova, with a 3-year mandate. The company is managed and represented jointly by the two Executive Directors, Angel Dimitrov and Ventsislav Cholakov. Alexander Romanov was elected as Chairman and Yavor Draganov as Vice Chairman of the Board of Directors. On 18 November 2011, Ivan Bilarev was registered with the Trade Register at the Registry Agency as Procurator who is able to represent the company jointly with either one of the Executive Directors.
- At the extraordinary GMS of **Sofia-BT AD**, held on 21 November 2011, Irena Valeva, Rumen Porozhanov and Krasimir Petrov were discharged as members of the Board of Directors. As new members of the Board of Directors of the company were elected Angel Dimitrov, Ventsislav Cholakov, and Lilyana Dinkova, with a 3-year mandate. The company is managed and represented by the Executive Director Lilyana Dinkova. Angel Dimitrov was elected as Chairman and Ventsislav Cholakov as Vice Chairman of the Board of Directors.
- At the extraordinary GMS of **Pleven-Bulgartabac AD**, held on 22 November 2011, Angel Blazhev, Diana Nikolova and Vladimir Tsvetanov were discharged as members of the Board of Directors. As new members of the Board of Directors of the company were elected Angel Dimitrov, Ventsislav Cholakov, and Ivo Koychev, with a 3-year mandate. The company is managed and represented by the Executive Director Ivo Koychev. Ventsislav Cholakov was elected as Chairman and Angel Dimitrov as Vice Chairman of the Board of Directors.
- At the extraordinary GMS of **Blagoevgrad-BT AD**, held on 23 November 2011, Emil Sandev, Yasen Popvasilev, and Petar Papucharov were discharged as members of the Board of Directors.

As new members of the Board of Directors of the company were elected Ventsislav Cholakov, Angel Dimitrov, and Georgi Kostov, with a 3-year mandate. The company is managed and represented by the Executive Director Georgi Kostov. Ventsislav Cholakov was elected as Chairman and Angel Dimitrov as Vice Chairman of the Board of Directors.

- On 01 December 2011, without attendance and with the consent of all members of the Board of Directors of Bulgartabac-Holding AD, in its capacity of a sole owner of the capital of Bulgartabac-Trading EAD, resolutions were passed regarding **Bulgartabac-Trading EAD**: changes in the Articles of Incorporation, it has been decided that the Board of Directors shall comprise 5 members; Ekaterina Hristova, Mariana Kancheva, and Meglena Madjarova were discharged as members of the Board of Directors; as new members of the Board of Directors of the company were elected Ivan Bilarev, Ventsislav Cholakov, Angel Dimitrov, Boris Zahariev, and Miglena Hristova, with a 3-year mandate. The company is managed and represented jointly by the two Executive Directors Ivan Bilarev and Boris Zahariev. Ventsislav Cholakov was elected as Chairman and Angel Dimitrov as Vice Chairman of the Board of Directors.

Making the cigarette production compliant with Directive 2001/95/EC of the European Union

In connection with Directive No 2001/95/EC for safety of goods of the European Union and the introduction of Standard EN 16156:2010, as of 17 November 2011 all cigarettes to be sold in the domestic market and in the markets of the EU Member States must be produced using a LIP cigarette paper.

Announcement of Asenovgrad-Tabac AD, a subsidiary of Bulgartabac-Holding AD, in liquidation

By a decision of the extraordinary General Meeting of Asenovgrad-Tabac AD, held on 1 September 2011, the following decisions were passed: winding up and announcing the company's liquidation, discontinuing the powers of the Board of Directors, setting a term to complete the liquidation – one year as of the date of announcing the invitation to the creditors to request their receivables, and appointing a liquidator. The decision was registered with the Trade Register at the Registry Agency on 5 October 2011.

Dividends

- At the regular General Meetings of Shareholders of the subsidiaries of Bulgartabac Group held in June 2011 decisions for distribution of dividends for 2010 were taken by the following subsidiaries:

Blagoevgrad-BT AD	BGN 31 159 thousand
Sofia-BT AD	BGN 7 002 thousand
Total	BGN 38 161 thousand

Dividends distributed by Blagoevgrad-BT AD originated from the 2010 profit amounting to BGN 7 105 thousand and from prior years' retained earnings amounting to BGN 24 054 thousand.

Dividends distributed by Sofia-BT AD originated from the 2010 profit.

Out of dividends approved, the amount of BGN 32,035 thousand will be paid to the parent company Bulgartabac-Holding AD, and the amount of BGN 6,126 thousand will be paid to minority shareholders.

- At the regular GMS of Bulgartabac-Holding, held on 23 June 2011, a resolution was passed to distribute dividends to the shareholders in the amount of 80 per cent of the 2010 profit, less the 10% deductions to the Reserve Fund. Also, decisions were taken to distribute dividends to the shareholders in proportion to their shares against accumulated profits and additional reserves of the company.

The exact amount of dividends to be paid by Bulgartabac-Holding AD to its shareholders is as follows:

- The total amount of dividends under items 5, 6 and 16 of the agenda is BGN 52,983 thousand, incl. for the State, represented by the Ministry Economy, Energy and Tourism – BGN 42,298 thousand.
- Gross amount of dividends per share – BGN 7.19;
- Net amount of dividends per share /less tax on dividends of 5% for the persons under Art.194, para.1 of Corporate Income Taxation Act and the persons under Art.38, para.1 of the Personal Income Taxation Act /PITA/ - BGN 6.83.

Termination of the insolvency procedure and obliteration of Harmanli-Tabac AD, town of Harmanli, a subsidiary of Bulgartabac-Holding AD

By a decision of the Haskovo District Court dated 28 December 2010 issued in relation to a civil case No 138/2007 the insolvency procedure of Harmanli-Tabac AD /in insolvency/, with registered address and address of management: town of Harmanli, 13 Bulgaria Boulevard, UIC 126065718, was terminated due to exhausting the insolvency mass. The powers of the trustee in bankruptcy were ceased and also the effectiveness of the general interdiction and pledge on the debtor's property. The obliteration of the company was enacted due to exhausting the insolvency mass. The court decision was entered into the Trade Register on 5 January 2011 and entered into force on 12 January 2011.

2. Development of the activity in 2011

Tobacco buy-up and processing

During Quarter IV of 2011, Pleven-BT AD purchased primarily tobacco of variety group Virginia, the quantity bought being 2 345 tons. Tobacco was paid with funds of Pleven-BT AD and advance financing against finished products (strips) from both cigarette factories. In the end of October, the processing of Virginia tobacco, crop 2011, commenced and at 31 December 2011 the finished products manufactured amounted to 2 456 tons, incl.:

- Strips 1 902 tons;
- Stems (large and small) 492 tons;
- Fines 62 tons.

In view of the tobacco needs of the cigarette factories of Bulgartabac Group, 1,000 tons of Virginia tobacco in leaves were imported, which are of the filler type tobacco as the Bulgarian Virginia and have competitive prices. The imported raw tobacco, after stripping – processing in Pleven-BT AD – will be used in the cigarette production of Sofia-BTR AD and Blagoevgrad-BT AD. The quantity of Virginia tobacco in leaves imported during the quarter was 808 tons.

During Quarter IV of 2011, the Board of Directors of Bulgartabac-Holding AD took a decision to replace Pleven-BT AD as a party to the contracts for manufacturing and purchasing with tobacco growers of groups Basma, Kaba Koulak and Burley varieties, crop 2011. The purchasing of Burley and Basma varieties commenced in the end of 2011 and by the end of the year 364 tons of raw materials were bought up.

The tobacco buy up was done by Pleven-BT AD in accordance with the purchase contracts concluded

Considering the market situation in the sector of raw tobacco, the Board of Directors of Bulgartabac-Holding AD approved the purchase prices by classes for the variety groups Basma, Kaba Koulak and Burley, crop 2011, and that of Pleven-BT SAD for the variety group Virginia:

During the calendar year, the company in Pleven produced the following more significant quantities of finished products:

- Tobacco own production 2 556 tons;

- Expanded tobacco stems own production 1 597 tons;
- Toll processing of group companies 3 544 tons;

During Quarter IV of 2011, Bulgartabac-Holding AD concluded service contracts with Pleven-BT AD for the sale of variety groups Burley and Kaba Koulak and for the purchase of variety group Basma, as well as of for the processing of Burley and variety groups Basma and Kaba Koulak .

Trade in tobacco

The operating results from the sales of tobacco (exports, Intra Community Supplies and domestic sales to non-related parties) by Bulgartabac-Holding AD at 31 December 2011, accumulated as of the beginning of the year 2011, were as follows:

Sales of tobacco for Export and Intra Community Supplies - total for BULGARTABAC Group	
31.12.2011	31.12.2010
1 071,5 tons	1 896,4 tons

Sales of tobacco in the domestic market to third parties outside BULGARTABAC Group	
31.12.2011	31.12.2010
1 011,5 tons	758,6 tons

Total sales of tobacco /Export, Intra Community Supplies and domestic market/ for BULGARTABAC Group	
31.12.2011	31.12.2010
2 083 tons	2 655 tons

The operating results from the sales of tobacco (exports, Intra Community Supplies and domestic sales to non-related parties) by Bulgartabac Group companies in 2011 were as follows:

	2011		2010	
	tons	BGN'000	tons	BGN'000
Sales of tobacco to third parties outside Bulgartabac Group	2 083	10 121,7	2 655	13 319,2
Blagoevgrad-BT AD	240,8	1 695,9	205,3	570,2
Sofia-BT AD	212,1	2 133,7	33,3	310,7
Bulgartabac-Holding AD	882,7	4 199,3	1 194,2	7 827,6
Pleven-BT AD	747,4	2 092,8	1 222,2	4 610,7

- Tobacco Export, Intra Community Supplies and domestic market

Tobacco supply in 2011 was directed mainly to leading tobacco dealers in the sector, thus on the one hand allowing the maintenance and activation of export possibilities, and on the other hand reducing significantly existing trade risks. Risks related to payment of tobaccos sold are cut down to the minimum,

and no tobacco deliveries are made under deferred payment conditions to markets and firms at risk.

In 2011, tobaccos were sold under contracts concluded in 2009, 2010, and 2011. The export structure for this period includes also batches from crops 2008, 2009, and 2010, as also some small quantities of crop 2006. Compared with 2010, during 2011 there was a decrease in the total volume of tobacco sold to non-related parties in terms of quantity and amount, and respectively, a decrease in the trade representation fees payable upon tobacco export. In 2011, the total quantity of tobacco sold for export, Intra Community Supplies and domestic sales to non-related parties of Bulgartabac Group was 2,083 tons of tobacco amounting to BGN 10,121.7 thousand.

- Tobacco Import and Intra Community Supplies

For the needs of cigarette production the Bulgartabac group companies import Virginia and Burley tobaccos, tobacco stems and reconstituted tobacco. The main sources for purchasing high quality large leaf Virginia and Burley tobaccos are the countries with the most developed production and international trade – Brazil, Zimbabwe, USA, Argentina, Kenya, and Malawi. Tobacco stems are imported mainly from China and Argentina, and reconstituted tobacco from France due to the sufficiently good quality characteristics and good trade terms and conditions. In 2011, 12,256.6 tons of raw tobacco were imported for the amount of USD 62,427 thousand and EUR 2,492 thousand. The increase in the total volume in terms of quantity and amount has led respectively to higher income from trade representation fees upon import of tobacco.

Trade in tobacco products

➤ *Domestic market of tobacco products*

The policy pursued by Bulgartabac-Holding AD during 2011 with regard to the domestic market is entirely consistent with the market conditions and is subject to the aim of stabilizing and maintaining the positions on the domestic market achieved in the end of 2010.

In 2011, the company maintained the volume of sales compared with that achieved in 2010, despite of the declining volumes in the banderol market.

The usual fluctuations in the separate months are observed during the reporting period; in general, however, we report a trend of regaining the company's market share.

Since the beginning of the year Bulgartabac-Holding AD has been manufacturing and marketing to the domestic market a new format of consumer pack containing 10 cigarettes by the piece of the well-known brands Melnik, MM and GD, the brand GD being one of the top in the segment of 10-cigarette packs.

In Quarter III of 2011 Bulgartabac-Holding AD commenced the production of Reduced Ignition Propensity cigarettes, or the so called "RIP cigarettes", which comply with Standard EN 16156:2010 for fire safety in accordance with the new regulation adopted within the European Union and the introduction, as of 17 November 2011, of a new standard for tobacco products manufacturing by using special cigarette paper.

The market of tobacco products during the reporting period was characterized by extraordinary dynamics and experienced a number of objective factors which had a direct impact on the sales of cigarettes on the domestic market:

- ***Pricing policy and competition***

During the current calendar year, for the first time in the last five years, the excise duty rate of tobacco products was not changed and the 2010 levels were kept. Nevertheless, the declining trend in consumption reported in 2010 continued to exist throughout 2011 as well, although in slower paces.

For most of the Bulgarian smokers, their preferences for a given trademark are strongly influenced by its price.

During the past year, the efforts of Bulgartabac-Holding with regard to its pricing policy for the domestic market are directed towards stabilising and maintaining the market share of the Holding's leading brands within the separate price groups. In response to the reduced purchasing power of the population, a new format of cigarette pack was launched - cigarettes in packs of 10 pieces – a format which market share has increased constantly over the year and reached 7% of total sales of tobacco products in the territory of the country.

The competition is strong, with the cigarette factories in the country facing a constantly shrinking market. Moreover, the product we offer and sale is under a regime that imposes gradually various normative restrictions and other restrictive legal measures to limit smoking. Some of the companies started a price war by reducing the prices of its brands by 10 to 50 stotinki per pack.

- *Unregulated trade*

During 2011, the levels of offering and unregulated trade in tobacco products remained high. The levels of contraband offering of cigarettes and ROY tobacco of an unclear origin and quality remained the same. The sale of cigarettes with foreign excise stamps or without excise stamps is nation-wide and covers the entire territory of the country including the tiniest settlements.

According to data of an independent marketing agency, the excise market of tobacco products for 2011 has shrunk by almost 15% compared to the same period of 2010.

- *The financial and economic crisis*

The trend of decrease in sales of tobacco products with Bulgarian excise stamps applies to ours as well as to some of the competitor's cigarette brands. The significant fall of consumption of FMCG is due to the decreased purchasing power of the population, shrinking of households' expenses, the trend among smokers to reduce their smoking or even quit smoking completely.

Retailers experience some difficulties in ensuring the required working capital due on the one hand to the expensive credit resources and on the other hand to the significant decline in turnovers. This reflects on the range of tobacco products offered in the points of sale. Only the best selling brands are supplied in limited quantities to the shops with lower levels of turnover.

- *Distribution*

The marketing studies of the reporting period show that the distribution of Bulgartabac-Holding AD covers 96% of the points of sale of tobacco products in the country.

During the reporting period, the company updated the packing of the most sellable brand in Bulgaria - "Victory". Since March the family has been offered to the trade network in a new format and design. The new vision of the family "Victory" was supported by a large-scope marketing activity.

The brands of the Bulgartabac Group have a sustained nation-wide presence and in almost all points of sale, regardless of their size and importance.

- *Export of tobacco products*

The trade policy of Bulgartabac-Holding AD for 2011 was directed towards the implementation of the main targets, set by the 2011 export program, namely:

- Increase of exported cigarette volumes;
- Expansion of markets where cigarette brands owned by Bulgartabac-Holding AD are being sold;
- Diversification and expansion of product portfolio for export;
- Increase of sales revenue per unit of produce;
- Selection of a strategic partner having a well-developed distribution network in each region;
- Development of blends in conformity with consumers' preferences in the respective regions;
- Finding the optimal forms for brands' establishment (promotional prices, marketing activities, etc);
- Collecting information on the main competitors in the region;
- Setting up of a product portfolio of brands enjoying legal protection within the respective region.

During the period 01 January – 31 December 2011, the export policy of the Holding covered the targeted markets in the following regions: Middle East, Africa, Balkan countries, CIS, Far East, EU, and Duty Free Zones.

During the past year of 2011, the export of Bulgartabac-Holding AD reached 15 648.85 million pieces, while for the same period of 2010 it was 13 035.20 million pieces. There is a growth of 20.05% in the

natural volumes. Respectively, in 2011 Blagoevgrad-BT AD manufactured and exported 7 462.795 million pieces vs. 6 661.28 million pieces in 2010, or a growth of almost 12.03%, while Sofia-BT AD manufactured and exported 8 186.056 million pieces in 2011 vs. 6 373.92 million pieces in 2010, or a 28.43% growth in volumes sold.

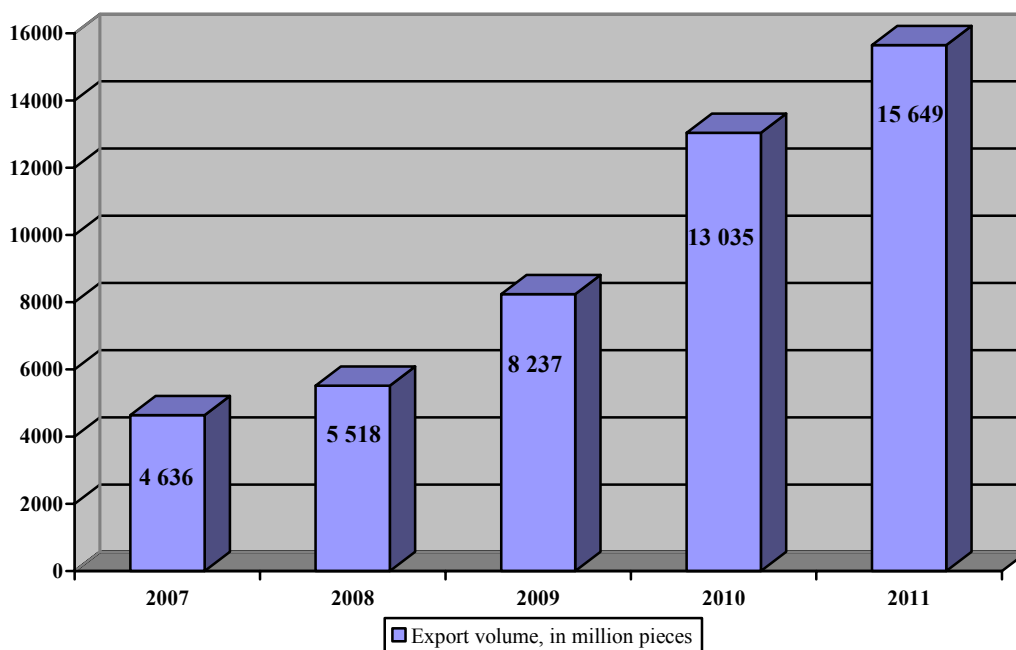
Sales in 2011 – 15 648.85 million pieces

Sales in 2010 – 13 035.20 million pieces

Volume growth (2011/2010) – 20.05%

(million pieces)

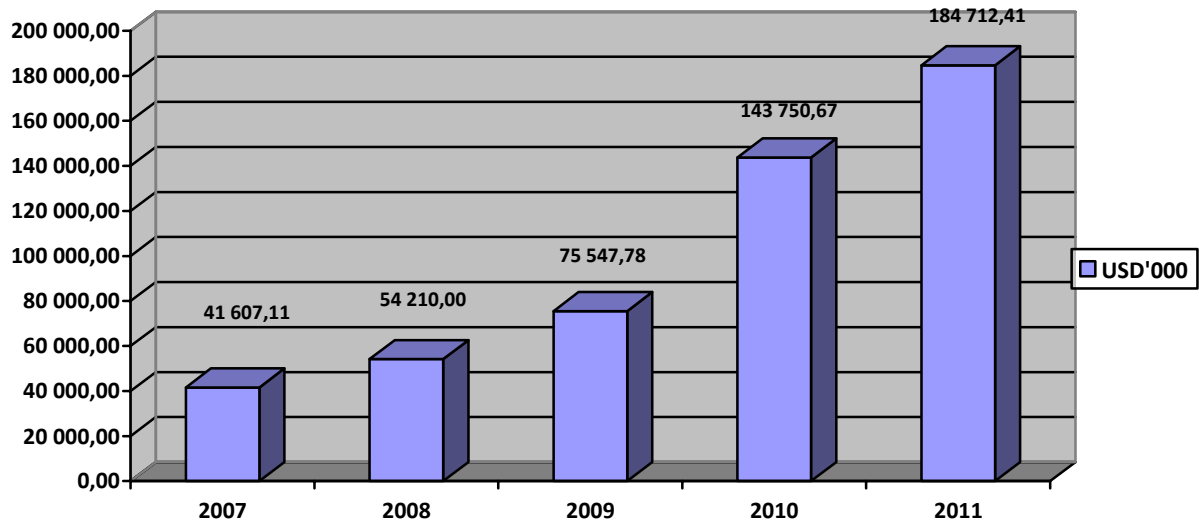
2007	4 636
2008	5 518
2009	8 237
2010	13 035
2011	15 649



Sales revenue for 2011 amounted to USD 184 712 407.44 and EUR 12 134 832.34 vs. USD 143 750 671.16 and EUR 12 532 126.44 for 2010. Revenue in the period under review in USD, by factories, is as follows: Blagoevgrad-BT AD – USD 97 482 800 in 2011 vs. USD 83 010 178 in 2010, or a 17.43% growth; Sofia-BT AD – USD 87 229 607.44 in 2011 vs. USD 60 740 493.16 in 2010, or a 43.61% growth. Revenue in EUR, by factories, is as follows: Blagoevgrad-BT AD – EUR 1 679 554.00 in 2011 vs. EUR 1 349 204.00 in 2010, or a 24.48% growth; Sofia-BT AD – EUR 10 455 278.34 in 2011 vs. EUR 11 182 922.44 in 2010, or a 6.5% decline.

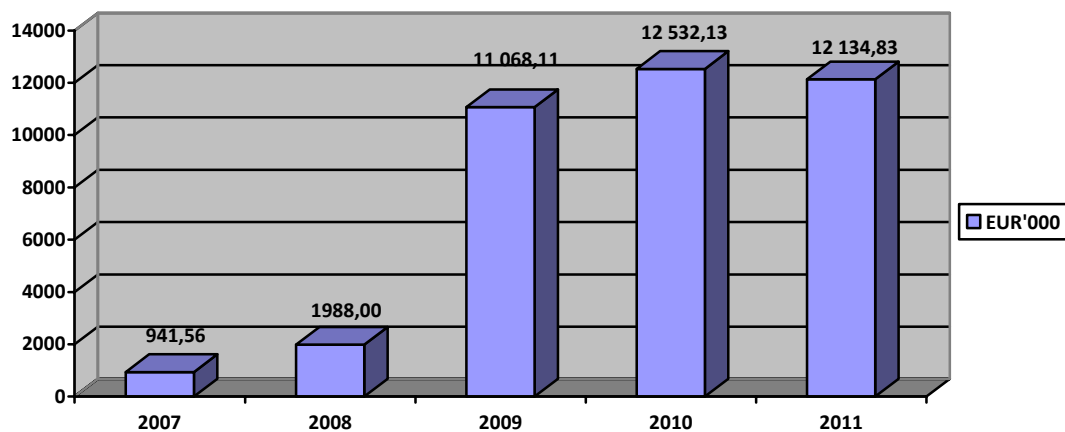
(USD'000)

2007	41 607.11
2008	54 210.00
2009	75 547.78
2010	143 750.67
2011	184 712.41



(EUR'000)

2007	941.56
2008	1 988.00
2009	11 068.11
2010	12 532.13
2011	12 134.83



Considering the above data, it may be concluded that **during 2011, despite of the gradual increase in export prices, the volumes sold are increasing.** Moreover, following the significant drop in sales for the Africa region in 2010 due to the termination of the production of brands owned by the client, the volumes of sales of brands owned by Bulgartabac-Holding AD has started to grow.

Based on the concluded trade representation contracts, Bulgartabac-Holding AD mediates in the overall process of negotiating, ordering and exporting the respective quantities of cigarette varieties by the subsidiaries. In relation to the above:

- Contracts were concluded and discussions were held with strategic partners operating well-developed distribution networks in each of the above-mentioned regions;
- The domestic competition of our brands offered in one and same region was successfully neutralised;
- During the last quarter of 2011, the negotiations were finalised and cigarettes were exported for the first time to Russia;
- The development of slims cigarettes 83mm for export continued;

The results achieved so far are based on Bulgartabac-Holding AD's well-developed export portfolio for 2011.

- Well balanced – covering all possible formats and lengths in cigarette manufacturing – HLP (84 mm., 94 mm, 100 mm.), RC 84 mm., Slims 97 mm. (flap-flip top & octagonal), soft pack (84 mm.& 100 mm.);
- Optimal ratio “quality – price”;
- State-of-the-art design;

In the area of auxiliary materials and spare parts

The main target in 2011 was to provide the subsidiaries with auxiliary materials and spare parts in order to ensure the implementation of their production programs.

During the period under review, aiming at achieving the goals for maintaining the best possible prices and terms of delivery of auxiliary materials, the practice to enlarge the scope of companies-suppliers and to carry out production testing at subsidiaries for approval of the qualities of at least three suppliers for each material as to avoid monopolization of supplies by one supplier was continued.

Events directly related to this activity and having an impact on the financial results were in the following fields:

- In view of the drastic raise of PP resin prices – the main raw material for PP foil production and the increase of PP foil world prices, the foil prices are by approx. 3% higher than that in 2010.
- Considering the increased consumption in 2011 of stiff cardboard for recess filters production, a 5% discount was agreed upon when reaching certain annual quantities. The levels of supply prices of stiff cardboard in Q'4 of 2011 were 9% lower as compared to the same period of 2010.
- Despite the raise in cellulose prices, upon negotiations, we managed to agree on prices for the supply of cigarette paper for slim cigarettes, wrapping paper and tipping paper that are by about 3% lower on the average than the prices at the beginning of 2011.
- The price of inner frame cardboards has decreased by 2.6% to 4.5% compared to the average 2010 prices.
- In 2011 the trend of limited supply of acetate tow in the global market continued due to the higher demand and shortage of raw materials. Production capacities of all manufacturers are filled up and in view of the increased prices of cellulose in the international markets, the prices for tow delivery in 2011 have increased by approximately 4 - 5% compared with that in 2010.

However, a reduction by 1% in the price of quantities supplied during 2011 was achieved with one of the suppliers of acetate tow.

- Recess filters – despite of the increased prices of acetate tow, the main raw material for the production of filters, after negotiations held a decrease of 1.5% in the prices for Q’4 was agreed compared with the levels at the beginning of the year.
- The analysis of the period under review revealed an increase in price of Tryacetin by 8% to 10% and maintaining their 2010 levels for the other chemical products - propilenglikol and glycerine.
- The prices of printing products for Quarter IV had decreased from 7.5% to 10.3%. For Quarter IV the prices of most of glues and aluminium foil supplied were decreased by 3-4%.
- A significant decrease was achieved in the price of one of the main aroma products - 20-23% for Quarter IV. With a main supplier, supplying about 80% of the required quantities of aroma products, a 5% discount was agreed of the price of the total quantity supplied in 2011 to both subsidiaries – Sofia-BT AD and Blagoevgrad-BT AD.
- The subsidiaries commenced the production of cigarettes with LIP cigarette paper in the end of September. This trend will continue in the future as well.
- The activity on securing the manufacturing process with spare parts is performed through placing orders to a designated supplier of the company – manufacturer of the respective plant and equipment.

➤ **In the area of technological policy, recipes and blends**

During Quarter IV of 2011 activities aimed at securing cigarette manufacturing with tobaccos and reconstituted tobacco, technological developments for adapting cigarette blends to the technology of drying and expansion of cut tobacco, commencement of the production of self extinguishing cigarettes with the aim of their introduction to the market, implementation of technological projects for the development of super slims cigarettes and design of cigarettes for export were carried out.

Provision of tobaccos and reconstituted tobacco for the production.

- Visual assessments and selection of samples of Virginia tobacco, origin USA, Malawi, Zimbabwe, and Italy; and of Burley tobacco, origin USA, Italy, and Argentina, as also Maryland tobacco, MPA class, USA, were carried out. Taste evaluations and chemical analyses of all selected samples were carried out as well. Approved for reservation were quality groups of Virginia tobacco, origin USA and Italy, crops 2010 and 2011, and of Burley tobacco, origin USA and Argentina. A specification of the approved samples and their allocation together with a schedule for supply of tobaccos by classes and suppliers were drawn up with the aim to cover the needs of cigarettes manufacturing for 2012.
- In order to secure the cigarette production with Bulgarian Virginia tobacco, crop 2011, an analysis and evaluation of the quality of tobacco bought-up by Pleven-BT AD were carried out. Based on the visual and taste evaluation and chemical indicators, specialists of Bulgartabac-Holding AD, Blagoevgrad-BT AD and Sofia-BT AD prepared and coordinated with Pleven-BT AD terms of reference for the processing of Virginia tobacco, crop 2011.
- Tobacco processing commenced at Pleven-BT AD and batches were prepared of the two approved Virginia tobacco classes, based on which technological control was exercised over the production, as also a taste evaluation and chemical analysis of control samples were carried out.
- Taste evaluations and chemical analyses of regular samples of reconstituted tobacco, quality AZ6N of “LTR”, France, were made. A statement of the required quantities of reconstituted tobacco, quality AZ6N France was drawn up with the aim to secure the cigarette production in 2012.

Technological developments

- Implementation of a technology for drying and expansion of cigarette blends cut tobacco at Sofia-BT AD. The recipes of cigarette brands produced at 50% and 100% cut tobacco expansion were updated and customised. Production monitoring was provided upon drying and expanding cut tobacco and the effectiveness of the processing of tobacco blends of different qualities was measured. Chemical analyses and taste evaluations of currently manufactured cigarettes were carried out. The physical indicators of cigarette blends manufactured by Sofia-BT AD were optimized in accordance with the achieved effect of blend expansion.
- Dossiers of new varieties of cigarette brands produced by Sofia-BT AD for clients of the Holding and for export were developed and approved.
- In Sofia-BT AD and Blagoevgrad-BT AD commenced the production of self extinguishing cigarettes – brands intended for sale in the domestic market and for export to the markets of the EU Member States. Production tests were carried out with new qualities of cigarette paper with lower ignition propensity (LIP). A comparative evaluation of the quality was carried out – chemical indicators and taste evaluation of cigarettes manufactured using LIP cigarette papers supplied by various suppliers. Tests of cigarettes under the ASTM method were carried out with the purpose to assess their compliance with the requirement for extinguishment. The reported results were in line with the normative requirements of the European Standard EN 16156:2010.
- In order to improve smoking and taste qualities of American blend cigarettes, an evaluation and production testing of a new casing for toasting Burley tobaccos were carried out at Blagoevgrad-BT AD.

Development of cigarettes “super slims”, 83 mm

- Two tobacco blends were developed and production tests were carried out of cigarettes “super slims” 83 mm, in the direction of Virginia and American blend. New qualities of additions were used – casing and aroma compositions; a taste evaluation and chemical indicators of sample cigarettes were carried out. The developed cigarette “super slims” blends, 83mm, are of smoking and taste characteristics approved for specific markets; they have been produced in varieties with different levels of smoke indicators.

Liquidation and insolvency procedures of group companies

Haskovo Tabac AD (in liquidation)

The decision of the General Meeting for winding-up of the company and starting a liquidation procedure was entered with a decision of Haskovo District Court dated 31 March 2006. On 11 July 2006 the creditors were invited by a published invitation by liquidators to request their receivables within a three-month period as from that date. Encashment of company's property was forthcoming for their settlement. With a decision of the General Meeting of Shareholders, dated 9 May 2007, the initial financial statements and the balance sheet at the liquidation date were approved. Initially the deadline to effect the liquidation was 12 January 2008.

By a decision of the extraordinary General Meeting of Shareholders of the company held on 21 December 2007, the term for completing the company's liquidation was extended by 18 (eighteen) months as of the date of expiry of the term set by a decision of the extraordinary General Meeting of Shareholders of the company held on 15 March 2006.

By a decision of the regular General Meeting of Shareholders held on 26 June 2009, it was agreed that the company's liquidation deadline should be extended by 12 (twelve) months as of 11 July 2009 - the date of expiry of the term set by a decision of the extraordinary General Meeting of Shareholders held on 21 December 2007.

By a decision of the regular General Meeting of Shareholders held on 23 June 2010, it was agreed that the company's liquidation deadline should be extended by 12 (twelve) months as of 11 July 2010 - the date of expiry of the term set by a decision of the regular General Meeting of Shareholders held on 26 June 2009.

By a decision of the regular General Meeting of Shareholders of the company held on 21 June 2011, it was decided that the term for completion of the liquidation of Haskovo Tabac AD, in liquidation, to be extended by 6 /six/ months as of 11 July 2011 – the date of expiry of the term decided upon by a decision of the regular General Meeting of Shareholders held on 23 June 2010.

By a decision of the extraordinary General Meeting of Shareholders of the company held on 04 January 2012, it was decided that the term, for completion of the liquidation of Haskovo Tabac AD, in liquidation, to be extended by 12 /twelve/ months as of 11 January 2012.

Asenovgrad-Tabac AD /in liquidation/

By a decision of the extraordinary General Meeting of Asenovgrad-Tabac AD, held on 1 September 2011, the following decisions were passed: winding up and announcing the company's liquidation, discontinuing the powers of the Board of Directors, setting a term to complete the liquidation – one year as of the date of announcing the invitation to the creditors to request their receivables, and appointing a liquidator. The decision was registered with the Trade Register at the Registry Agency on 5 October 2011.

Dulovo Tabac AD /in insolvency/

By a decision No 32 dated 22 January 2010 of the Silistra District Court, on the grounds of Art. 632, para. 1 with reference to Art. 710 of the Commercial Act, the insolvency of „Dulovo Tabac” AD was announced, effective 17 November 2008; an insolvency proceeding was opened as regards the company; collateral is allowed in the form of pledge and interdiction imposed on the entire property of the company; the activity of the entity „Dulovo Tabac” AD was terminated. By a decision dated 28 April 2010 of the Varna Appellate Court, the decision of the Silistra District Court dated 22 January 2010 was repealed in its part determining the initial date of insolvency of „Dulovo Tabac” AD on the grounds of Art. 630, para. 1, i. 1 of the Commercial Act, and instead, a new date of insolvency of „Dulovo Tabac” AD was set, namely 26 April 2002. In January 2011, two appeals were filed for the re-initiation of proceedings – by the National Revenue Agency and CD TAB EOOD, as well as an appeal by CD TAB EOOD for cessation of the proceedings.

3. Analysis of the financial status and financial result of Bulgartabac Holding AD as of 31 December 2011

I. CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	1.01- 31.12.2011	1.01- 31.12.2010	Change	
	BGN'000	BGN'000	BGN'000	%
Sales revenue	366,929	312,665	54,264	17.36
Cost of products and services sold	(277,041)	(232,874)	44,167	18.97
	89,888	79,791	10,097	12.65
Write down of inventories	(4,826)	(1,085)	3,741	344.79
Cost of production below the normal capacity	(5,128)	(2,264)	2,864	126.50
Gross profit (margin)	79,934	76,442	3,492	4.57

Other operating income / (losses), net	1,662	2,047	(385)	(18.81)
Distribution and realisation expenses	(22,660)	(12,111)	10,549	87.10
Administrative expenses	(30,581)	(27,783)	2,798	10.07
Other operating expenses	(18,034)	(17,776)	258	1.45
Operating profit	10,321	20,819	(10,498)	(50.43)
Finance income	5,710	8,125	(2,415)	(29.72)
Finance costs	(7,662)	(3,480)	4,182	120.17
Operating profit after finance items	8,369	25,464	(17,095)	(67.13)
(Accrued) / reversed impairment of property, plant and equipment, and intangible assets, net	(5,191)	(3,172)	2,019	63.65
Expenses on stopped production activities in subsidiaries	(216)	(229)	(13)	(5.68)
Profit before income tax	2,962	22,063	(19,101)	(86.57)
Income tax expense	(270)	(3,072)	(2,802)	(91.21)
Net profit for the period	2,692	18,991	(16,299)	(85.82)
Attributable to:				
Equity owners of the parent company	1,976	16,100	(14,124)	(87.73)
Non-controlling interest	716	2,891	(2,175)	(75.23)
Other comprehensive income				
Revaluation of property, plant and equipment against revaluation reserve	141	1,181	(1,040)	(88.06)
Impairment of property, plant and equipment against revaluation reserve	(503)	(45)	458	1017.78
Taxes on other comprehensive income	36	(113)	149	131.86
Total other comprehensive income	(326)	1,023	(1,349)	(131.87)
Total comprehensive income	2,366	20,014	(17,648)	(88.18)
Attributable to:				
Equity owners of the parent company	1,681	16,915	(15,234)	(90.06)
Non-controlling interest	685	3,099	(2,414)	(77.90)

For Quarter IV (01 January – 31 December) of 2011, the financial result of Bulgartabac Group is a profit amounting to BGN 2,692 thousand, including – attributable to the equity owners of the parent company – BGN 1,976 thousand and to non-controlling interest – BGN 716 thousand.

If compared with 2010, the financial result has decreased by BGN 16,299 thousand (85.82%), including a decrease for both the equity owners of the parent company by BGN 14,124 thousand (87.83%) and the non-controlling interest by BGN 2,175 thousand (75.23%).

The gross profit of Bulgartabac Group for Quarter IV (01 January – 31 December) of 2011 amounted to BGN 79,934 thousand; if compared with 2010, the increase is by BGN 3,492 thousand (4.57%). The increase in gross profit for the current period, compensated, is due mainly to:

- **the increase in net sales revenue** by BGN 54,264 thousand (17.36%) – mostly affected by the compensated influence of:
 - **domestic market:** the increase in sales of tobacco products (cigarettes) by BGN 11,922 thousand (19.79%); the increase in sales of tobacco by BGN 2,105 thousand (159.23%); the decrease in revenue from ROY tobacco by BGN 576 thousand (92.46%), and the decrease in revenue from sales of expanded stems by BGN 168 thousand (17.13%);
 - **foreign market:** the increase in sales of tobacco products (cigarettes) by BGN 46,248 thousand (19.48%), the increase in sales of expanded stems by BGN 204 thousand (80.95%), the decrease in sales of tobacco by BGN 5,219 thousand (48.49%), and the decrease in sales of filter rods by BGN 134 thousand (74.86%).
- **the increase in cost of goods and services sold** during the period under review is by BGN 44,167 thousand (18.97%). The higher pace of increase (18.97%) compared with the pace of increase in net revenue (17.36%) leads to lower gross financial result for the current period.

The following have also affected the change in gross profit for Quarter IV (01 January to 31 December) of 2011 vs. 2010:

- **the increase in costs of impairment of inventories** by BGN 3,741 thousand (344.79%) is affected mainly by the accrued higher costs of tobacco impairment – BGN 2,927 thousand and the higher costs of impairment of spare parts by BGN 914 thousand, compensated by the lower costs of impairment of auxiliary materials by BGN 75 thousand;
- **the increase in costs of production below normal capacity during the current period compared with the previous one** is by BGN 2,864 thousand (126.50%).

The operating profit of Bulgartabac Group for Quarter IV (1 January to 31 December) of 2011 amounts to BGN 10,321 thousand. The decrease in the operating financial result for the current period compared with the previous one is by BGN 10,498 thousand (50.43%), which is due, compensated, to:

- **the increase in gross profit;**
- **the decrease in the amount of other operating profits / (losses), net,** by BGN 385 thousand (18.81%) is mainly due to:
 - the net change (decrease) by BGN 540 thousand in foreign exchange differences (due to changes in the exchange rates) of cash, trade receivables and payables, incl. the decrease in foreign exchange gains related to trade receivables and payables by BGN 792 thousand and the decrease in foreign exchange losses by BGN 252 thousand related to trade receivables and payables;
 - the decrease in income from interest and liquidated damages under contracts by BGN 200 thousand;
 - the revenue of BGN 357 thousand from reversed provisions for liabilities.
- **the increase in distribution and selling expenses** by BGN 10,549 thousand (87.10%) is mainly due to:
 - the expenses on trade representation fees by BGN 9,116 thousand,

- the increase in costs of impairment of trade receivables by BGN 607 thousand,
 - the increase in costs of salaries and wages by BGN 433 thousand,
 - the increase in costs of commissions by BGN 226 thousand, and
 - the increase in expenses on security by BGN 118 thousand.
- the increase in **administrative expenses** by BGN 2,798 thousand (10.07%) is mainly due to:
- the increase in costs of salaries and wages by BGN 971 thousand;
 - the expenses on tobacco buy-up by BGN 817 thousand;
 - the increase in business trip expenses by BGN 540 thousand;
 - the increase in costs of training and qualification by 374 thousand;
 - the increase in costs of trade marks maintenance and registration by BGN 287 thousand;
- the increase in **other operating expenses** by BGN 258 thousand (1.45%), is mainly due to:
- the increase in costs of scrap and shortages of assets by BGN 350 thousand;
 - the decrease in expenses on principal under deeds issued by NSSI by BGN 132 thousand;

The operating profit after financial items of Bulgartabac Group for Quarter IV (01 January to 31 December) of 2011 amounts to BGN 8,369 thousand. If compared with 2010, the decrease in the financial result is by BGN 17,095 thousand (67.13%), which is due to the compensated effect of:

- **the decrease in the operating financial result for Quarter IV (01 January to 31 December) of 2011, and**
- the decrease in finance income by BGN 2,415 thousand compared with the previous period (29.72%) is mainly due to:
- the decrease in interest income on term deposits by BGN 1,916 thousand, and
 - the decrease in foreign currency gains by BGN 504 thousand;
- the increase in finance costs compared with the previous period by BGN 4,182 thousand (120.17%) is mainly due to:
- the increase in foreign currency losses by BGN 4,739 thousand;
 - the decrease in interest costs on bank loans received by BGN 276 thousand;
 - the decrease in expenses on bank charges on loans and guarantees by BGN 246 thousand, and
 - the decrease in impairment of interest and liquidated damages on loans granted by BGN 34 thousand.

The profit before income taxes of Bulgartabac Group for Quarter IV (01 January to 31 December) of 2011 amounts to BGN 2,962 thousand. The decrease in financial result vs. that for 2010 is by BGN 19,101 thousand (86.57%) and is mainly due to:

- **the decrease in earned operating profit after financial items for Quarter IV (01 January to 31 December) of 2011, and**
- the change in the (accrued) / reversed impairment of property, plant and equipment and of intangible assets – BGN 2,019 thousand (63.65 %), results from:
- the increase in **impairment of property, plant and equipment and of intangible assets** by BGN 1,988 thousand (62.07%) is due to the compensated effect of: the increase in the accrued impairment of plant and equipment by BGN 1,482 thousand, the increase in the accrued impairment of buildings by BGN 297 thousand, the increase in the impairment of FTA in progress by BGN 164 thousand, and the increase in the accrued impairment of motor vehicles by BGN 45 thousand.
- the decrease in costs of discontinued production activities by BGN 13 thousand (5.68%).

The net profit for Quarter IV (01 January to 31 December) of 2011 amounts to BGN 2,962 thousand, the decrease in net profit vs. that for 2010 is by BGN 16,299 thousand (85.82%).

For Quarter IV (01 January to 31 December) of 2011, the total comprehensive income of Bulgartabac Group is a positive figure and amounts to BGN 2,366 thousand, including attributable to the equity owners of the parent company, a profit of BGN 1,681 thousand, and to the minority interest, a profit of BGN 685 thousand.

Compared to 2010, the total comprehensive income is a decrease by BGN 17,648 thousand (88.18%), including a decrease for the equity owners of the parent company by BGN 15,234 thousand (90.06%) and for the non-controlling interest by BGN 2,414 thousand (77.90 %).

The other comprehensive income of Bulgartabac Group for Quarter IV (01 January to 31 December) of 2011 is a negative figure and amounts to BGN 326 thousand; if compared with 2010, the decrease is by BGN 1,349 thousand. The decrease in other comprehensive income is due to:

- the lower amount of revaluation of property, plant and equipment in increase of the revaluation reserve amounting to BGN 1,040 thousand;
- the higher amount of impairment of property, plant and equipment against the revaluation reserve amounting to BGN 458 thousand.

II. CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	31.12.2011	31.12.2010	Change	
	BGN '000	BGN '000	BGN '000	%
ASSETS				
Non-current assets				
Property, plant and equipment, incl.	220,461	212,350	8,111	3.82
1. Land	13,690	13,690	-	0.00
2. Buildings	62,262	65,669	(3,407)	(5.19)
3. Plant	100,026	100,313	(287)	(0.29)
4. Equipment	4,525	4,984	(459)	(9.21)
5. Motor vehicles	1,273	1,280	(7)	(0.55)
6. Fixtures & Fittings	1,522	1,372	150	10.93
7. FTA in progress	35,894	23,825	12,069	50.66
8. Other assets	1,269	1,217	52	4.27
Intangible assets	230	163	67	41.10
Investments available for sale	320	320	-	0.00
Deferred tax assets	631	460	171	37.17
Other non-current assets	4,636	1,218	3,418	280.62
	226,278	214,511	11,767	5.49

Current assets

Inventories	160,246	132,351	27,895	21.08
Receivables from clients and suppliers, incl.	32,318	25,523	6,795	26.62
1. Receivables from clients	29,087	22,913	6,174	26.95
2. Advances to suppliers	3,231	2,610	621	23.79
Other current assets, incl.	8,272	4,003	4,269	106.65
1. Taxes refundable	6,985	3,073	3,912	127.30
2. Court and awarded receivables	455	194	261	134.54
3. Other receivables	365	308	57	18.51
4. Prepayments	467	428	39	9.11
Cash and cash equivalents	123,593	183,595	(60,002)	(32.68)
	324,429	345,472	(21,043)	(6.09)
TOTAL ASSETS	550,707	559,983	(9,276)	(1.66)

EQUITY AND LIABILITIES**Capital attributable to the equity owners of the parent company**

Share capital	7,367	7,367	-	0.00
Reserves	108,254	106,815	1,439	1.35
Retained earnings	161,001	213,759	(52,758)	(24.68)
	276,622	327,941	(51,319)	(15.65)
Non-controlling interest	39,859	45,301	(5,442)	(12.01)
Total equity	316,481	373,242	(56,761)	(15.21)

LIABILITIES**Non-current liabilities**

Long-term bank loans	13,149	6,782	6,367	93.88
Deferred tax liabilities	2,904	3,531	(627)	(17.76)
Retirement benefit obligations	20,005	16,838	3,167	18.81
	36,058	27,151	8,907	32.81

Current liabilities

Payables to suppliers and clients	81,781	38,277	43,504	113.66
Short-term bank loans	6,494	6,486	8	0.12
Short-term portion of long-term bank loans	7,126	4,054	3,072	75.78
Tax liabilities	90,802	98,402	(7,600)	(7.72)
Payables to personnel	6,453	8,128	(1,675)	(20.61)
Payables to social security	1,889	1,907	(18)	(0.94)
Other current liabilities	3,623	2,336	1,287	55.09
	198,168	159,590	38,578	24.17
TOTAL LIABILITIES	234,226	186,741	47,485	25.43
TOTAL EQUITY AND LIABILITIES	550,707	559,983	(9,276)	(1.66)

At 31 December 2011, the balance sheet figure of Bulgartabac Group is BGN 550,707 thousand and if compared with the figure as of 31 December 2010 it has decreased by BGN 9,276 thousand (1.66%).

The change in the amounts of Group's assets is due to the increase in non-current assets by BGN 11,767 thousand (5.49%), as also to the decrease in current assets by BGN 21,043 thousand (6.09%).

The increase in non-current assets is mainly due to the increase of carrying amounts of items of **property, plant and equipment** by BGN 8,111 thousand (3.82%). This increase is affected by the compensated effect of the following factors:

- the increase due to newly acquired assets and FTA in progress – BGN 29,204 thousand;
- the decrease due to depreciation accrued for the period from 1 January 2011 to 31 December 2011 – BGN 14,953 thousand, the impairment of BGN 5,694 thousand, and the assets derecognised – BGN 587 thousand.

The increase in **intangible assets** by BGN 67 thousand (41.10%) is due to the compensated effect of:

- the increase due to newly acquired intangible assets – BGN 132 thousand
- the decrease due to depreciation accrued for the period from 01 January to 31 December 2011 of BGN 65 thousand.

Deferred tax assets have increased by BGN 171 thousand.

Other non-current assets have increased by BGN 3,418 thousand (280.62%) (the increase is due primarily to the pledge imposed on receivables of Bulgartabac-Holding AD for the positive balance of BGN 3,500 thousand on the deposit account in accordance with the Contract for privatization sale of shares in the capital of Bulgartabac-Holding AD; the increase by BGN 14 thousand in the BGN equivalent of the funds deposited in the escrow account; the decrease by BGN 65 thousand of rents paid in advance to Bulgartabac-Trading EAD, and the decrease of BGN 28 thousand in the long-term portion of the deferred trade receivable of Bulgartabac-Holding AD from Dupnitsa Tabac AD).

The decrease in current assets is mainly due to the compensated effect of:

- the decrease in **cash and cash equivalents** by BGN 60,002 thousand (32.68%);
- the increase in carrying amounts of **inventories** by BGN 27,895 thousand (21.08%);
- the increase in carrying amounts of **receivables of clients and suppliers** by BGN 6,795 thousand (26.62%)
- the increase in other current assets by BGN 4,269 thousand (106.65%), originating primarily from the increase in taxes refundable by BGN 3,912 thousand, court and awarded receivables by BGN 261 thousand, other receivables by BGN 57 thousand, and prepayments by BGN 39 thousand.

The changes in the Group's equity and liabilities are due to the changes in the amounts of equity – a decrease by BGN 56,761 thousand (15.21%) and an increase in the liabilities by BGN 47,485 thousand (25.43%). The change in the Group's liabilities is due to both the increase in **non-current liabilities** by BGN 8,907 thousand (32.81%) and the increase in **current liabilities** by BGN 38,578 thousand (24.17%).

The increase in **non-current liabilities** is due to the effect of:

- the increase in the carrying amounts of: **long-term bank loans** – by BGN 6,367 thousand (93.88%) and **long-term retirement benefit obligations** by BGN 3,167 thousand (18.81%);
- the decrease in the carrying amounts of **deferred tax liabilities** by BGN 627 thousand.

The increase in **current liabilities** is due to the compensated effect of :

- the increase in the carrying amounts of: **payables to suppliers and clients** by BGN 43,504 thousand (113.66%); **short-term portion of long-term bank loans** by BGN 3,072 thousand (75.78%); **short-term bank loans** by BGN 8 ??? (0.12%); and **other current liabilities** by BGN 1,287 thousand (55.09%);
- the decrease in the carrying amounts of: **tax liabilities** by BGN 7,600 thousand (7.72%), **payables to personnel** by BGN 1,675 thousand (20.61%); **payables to social security** by BGN 18 thousand (0.94%).

The decrease in the **equity** is due to:

- the lower carrying amount of **equity attributable to the equity owners of the parent company** by BGN 51,319 thousand (15.65%) – arising out of the decrease in **retained earnings** by BGN 52,758 thousand and the increase in **reserves** by BGN 1,439 thousand;

The decrease in **retained earnings** is due to the compensated effects of profit distribution for dividends – ↓ BGN 52,983 thousand, profit distribution for reserves – ↓ BGN 2,184 thousand, profit distribution for tantiemmes – ↓ BGN 17 thousand, the current financial result – ↑ BGN 1,976 thousand, the loss cover against reserves – ↑ 254 thousand, and the transfer to accumulated profits upon withdrawal from use of items of property, plant and equipment – ↑ BGN 196 thousand.

The increase in **reserves** by BGN 1,439 thousand is due to the compensated effect of profit distribution for reserves – ↑ BGN 2,184 thousand, other comprehensive income - ↓ BGN 295 thousand, the loss cover against reserves – ↓ BGN 254 thousand, and the transfer to accumulated profits upon withdrawal from use of items of property, plant and equipment – ↓ BGN 196 thousand.

- the decreased carrying amount of **non-controlling interest** by BGN 5,442 thousand (12.01%) is primarily a result of the compensated effect of profit distribution for dividends ↓ 6,126 thousand, other comprehensive income - ↓ BGN 31 thousand, profit distribution for tantiemmes – ↓ BGN 1 thousand, and the current financial result attributable to non-controlling interest– ↑ BGN 716 thousand.

4. Major risks and uncertainties faced by the companies of Bulgartabac Group in 2011

Analysis of the conditions in which Bulgartabac-Holding AD will work during 2011

Political factors

- Strong political will for the privatization of Bulgartabac-Holding AD;
- Legislative changes concerning the manufacturing, storage and sales of excise goods on the territory of the country;

- Presidential and local elections in 2011;
- Legislative measures for restriction of tobacco smoking and advertising of cigarettes;
- Ambition of the Government to apply anti-crisis measures and incentives that should lead to positive trade balance of the country already during 2011;
- Political changes in some Arab countries, which have brought about an increase of the price of petrol in the beginning of 2011.

Economic factors

- Gradual transition of the Bulgarian economy to a model of development, in which export is the main growth factor;
- Increased excise rates of cigarettes (during 2011 only for the sizes that are not manufactured by Bulgartabac Group) and of roll-your-own tobacco - from BGN 100/kg to BGN 130/kg (2011);
- Considerable share of sales of cigarettes without excise stamp or with foreign excise stamp in the country;
- Expected increase in prices of basic raw materials due to the appreciation of petrol;
- Increased sensitivity of the cash flows of the cigarette manufacturing companies of Bulgartabac Group due to the fluctuations of the USD exchange rate against that of the other world's currencies.

Social Factors

- Worldwide social and health policy of fighting tobacco smoking;
- Restrictive law on smoking in public places and restaurants;
- Drop in employment, although with subsiding rate of reduction, due to the continuing process of restructuring of the companies in the country;
- Binding the policy on income growth with the growth of labour productivity and the potential of the economy and the budget of the country;
- Potential threat of social tension with the progress of the process of privatization and restructuring of Bulgartabac-Holding AD;
- Need to cut down expenses, including personnel expenses, which also lead to the respective negative social consequences.

Technological factors

- Legislative restrictions on advertising and marketing of tobacco products, leading to intensification of the competition among manufacturers in the area of quality, sizes and outer appearance of the products and, respectively, to introduction of still newer technologies;
- Production of self extinguishing cigarettes (LIP paper) for the brands to be sold on the territory of EU starting as of 17 November 2011;
- Bulgartabac Group companies have modern technological equipment at their disposal which guarantees the manufacturing of high quality competitive products and enables them to develop and update their product ranges, in conformity with market trends;
- Consistent policy regarding the outer appearance of the products of Bulgartabac Group.

Risk factors specific to the Growing and Buying-up of Raw Tobacco Sector

The production of Basma variety group was the most affected by the liberalisation of the raw tobacco market. The overall production volumes were reduced by about 30% compared with the previous crop, which, when combined with the relatively higher quality of the crop, has led to an increase in the purchase

prices of the raw tobacco. A higher price is observed also for the variety groups Burley and Kaba Koulak, whereas the production volumes were kept within those produced in the previous year. An estimate could be made that the market of raw tobacco of these three variety groups will continue being unstable in the short-term and mid-term run in view of the large number of growers. Due to the relatively lower number of growers of Virginia tobacco, there is a balance between the market demand and supply with regard to this type of tobacco.

Risks in the area of tobacco trade

Despite of the severe global financial and economic crisis in 2011 as well, Bulgartabac Group continued to implement actively and carry out a flexible trade policy of offering and selling Bulgarian tobaccos on the international market, as well as supplying continuously cigarette production with the required raw tobacco.

Financial risk management

In the ordinary course of its business activities, the companies of Bulgartabac Group are exposed to a variety of financial risks the most important of which are market risk (including currency risk, risk of changes of exchange rates and price risk), credit risk, liquidity risk, and risk of interest-bearing cash flows. The general risk management is focused on the difficulties of forecasting the financial markets and minimizing the potential negative effects that might affect the financial results and position of the company. The financial risks are currently identified, measured and monitored through various control mechanisms introduced in order to establish adequate prices for the services, provided by the company, to appropriately assess the market circumstances related to its investments and the forms for maintenance of free liquid funds through preventing undue concentration of a particular risk.

Risk management in each one of the group companies is currently executed by management and the respective structural units, depending on the type and specific features of various risks to which the company is exposed in its operations, and respectively by the respective structural units of the parent company – the Group as a whole.

Financial risk management is described in detail in the notes to the interim financial statements.

On the grounds of Art.100o, para.7 of POSA we hereby inform that the interim financial statements as at 31 December 2011 of Bulgartabac Group have neither been certified nor audited.

Angel Dimitrov
Executive Director
of Bulgartabac-Holding AD

Ventsislav Cholakov
Executive Director
of Bulgartabac-Holding AD