Translation from Bulgarian

INTERIM REPORT

ON THE ACTIVITY OF BULGARTABAC-HOLDING AD FOR THE FIRST QUARTER OF 2011 in accordance with Art. 100o, para.4, i.2 of Public Offering of Securities Act (POSA) and Art.33 of Ordinance No 2

1. Important events, which have occurred during the first quarter of 2011 and their impact on the results reported in the financial statements

New procedure for privatisation/sale of Bulgartabac-Holding AD

By a decision No 1646-A of 18 December 2009 (published in “Pari” newspaper of 21.12.2009), an open tender procedure was opened by the Privatisation Agency for the selection of a consultant on the privatisation of Bulgartabac-Holding AD. The consultant would be entrusted with the entire consulting process and with the task to provide support to the PA in connection with the preparation and execution of the privatisation deal for the company in compliance with the privatisation method selected and the legislation in force.

By the expiration of the deadline on 1 February 2011, 4 companies had submitted their bids: Citigroup Global Markets Limited, the consortium KBC Securities and Tokushev& Co., Raiffeisen Investments – Kamburov and Renaissance Securities Ltd. Upon examination of the submitted bids, the Agency of Privatisation and Post Privatisation Control (APPC) had taken a decision to ask the participants to submit additional information and clarifications on their bids in the tender. Upon submission of the required supplements and their examination, the Tender Committee would have to prepare a report on which basis APPC should come out with a decision ranking the bidders in the tender.

On 25 February 2010 APPC announced that Citigroup Global Markets Limited was selected to be the consultant for the privatisation of Bulgartabac-Holding AD.

On 13 September 2010 APPC published information that the Supervisory Board of the Agency had approved the contract for entrusting Citigroup Global Markets Limited with the implementation of Bulgartabac-Holding AD’s privatisation. The consultant should carry out a marketing research for the needs of Bulgartabac-Holding AD’s privatisation, overall consultancy and support of APPC with regard to the preparation and implementation of the privatisation deal for the company in compliance with the privatisation method selected and the effective legislation.

Pursuant to the Contract, on 18 November 2010 the consultant deposited to APPC an information memorandum, legal analysis and privatisation evaluation of Bulgartabac-Holding AD, while the actual sale procedure was expected to commence within a short period of time.

With regard to the announced procedure for sale of the state-owned interest in Bulgartabac-Holding AD’s capital, by a Decision No. 1490 of 17 February 2009, on the grounds of Art. 4, Par.1 and Art. 28, Par. 1 and Par. 2 of the of Privatisation and Post Privatisation Control Act (PPPCA), pursuant to a Protocol Decision No.12503 of 17 February 2009 of the Executive Board, the Privatisation Agency informed Bulgartabac-Holding AD that it was forbidden to perform disposal transactions with long-term assets of the company, to conclude contracts for the acquisition of shares, rental contracts, contracts for joint operations, loan contracts, contracts for securing receivables, as well as to undertake any bill-of-exchange obligations, except with the permission of the Privatisation Agency.

By a letter of APPC dated 23 November 2010, Bulgartabac-Holding AD was informed that the prohibition under Art. 28 PPPCA for conclusion of transactions and performance of activities should apply also to its subsidiaries, except for those that were undergoing liquidation or insolvency proceedings.

Subsidiaries in insolvency procedure

Harmanli Tabac 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 doe 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.

Dulovo Tabac AD

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, the effective date being 17 November 2008; an insolvency proceeding was opened as regards the company; collateral was allowed in the form of pledge and interdiction imposed on the entire property of Dulovo-Tabac AD; the activity of the entity „Dulovo Tabac" AD was terminated. By a decision of 28 April 2010 of the Varna Appellate Court, the decision of the Silistra District Court enacted on 22 January 2010 was repealed in its part, according to which on the grounds of Art.630, para.1, i.1 of the Commercial Act the initial date of insolvency of Dulovo-Tabac AD was set and instead, it ruled that the date 26 April 2002 should be considered the initial date of insolvency of Dulovo-Tabac AD. In January 2011, two appeals were filed for the re-initiation of proceedings – by the National Revenue Agency and CIDITAB EOOD. At present, a term for implementing the instructions of the court is ongoing with regard to the advance payment of costs related to the proceedings.

Development of the activity during the period 01 January – 31 March 2011

- **Tobacco buy-out and processing**

During Q'4, 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 2010. The purchasing of group Burley started late in the year and 99 tons of raw tobacco were purchased by its end. The purchasing of these three groups of varieties was done by Pleven-BT AD in accordance with the purchase contracts concluded.

With regard to the calculations of the quantities of Bulgarian tobaccos required by Bulgartabac Group and the market situation, the purchasing prices of large leaf tobaccos were increased as compared to the minimum purchasing prices of the same variety groups valid for crop 2009. Taking into consideration the balance on the market, purchasing prices by classes for the variety group Basma were preserved at the levels of crop 2009. The purchasing prices of Kaba Kulak variety group were not changed as well.

The Board of Directors of Bulgartabac-Holding AD approved the following purchase prices by classes in BGN/kg of purchased tobacco for groups Basma, Kaba Koulak and Burley, crop 2010:

Class	Variety group		
	Burley	Kaba Kulak	Basma
I class	3.90 BGN/kg	3.80 BGN/kg	7.35 BGN/kg
II class	2.60 BGN/kg	3.10 BGN/kg	4.85 BGN/kg
III class	1.40 BGN/kg	1.85 BGN/kg	1.90 BGN/kg

The quantities of tobacco, crop 2010, purchased on behalf and on account of Bulgartabac-Holding AD, were as follows:

Basma - 2 317 tons

Kaba Koulak - 540 tons

Burley - 973 tons

Total 3 830 tons amounting to BGN 13 567 thousand

During Q'1 of 2011, based on the service contracts concluded, Pleven-BT AD made the industrial processing of tobacco of Burley tobacco and commenced the processing of Kaba Kulak variety group, crop 2010.

Finished products manufactured at 31 March 2011 are as follows:

Burley 814 tons

Kaba Kulak 260 tons

The total amount of finished products was BGN 4 915, 6 thousand.

- **Trade in tobacco**

Tobacco export

Bulgartabac-Holding AD traditionally exports oriental and large leaf tobacco under conditions of high competition and performs its activity in selling tobacco under conditions of liberalized tobacco market. Tobacco supply is 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 Q'1 of 2011, tobaccos were sold under contracts concluded in 2009 and 2010. Lots from crops 2008 and 2009 were included in the export structure during this period, as also some small quantities from crop 2006. In Q'1 of 2011, Bulgartabac-Holding AD directed its efforts towards offering and binding by contracts these quantities of tobacco that were available for sale. New contracts were signed, and contracts with traditional clients of the Holding were renewed. Compared with the same reporting period of 2010, during Q'1 of 2011 there was a decrease in the total volume of tobacco sold in terms of quantity and increase in revenue from trade representation fees. The total quantity of own tobacco sold through export, intra-Community supplies and domestic sales during Q'1 of 2011 was 188 686 kg, or BGN 990 446.92.

The total quantity of tobacco sold by Bulgartabac Group during Q'1 of 2011 was 282 126 kg amounting to BGN 1 528 930,74 thousand.

Tobacco import

For the needs of cigarette production and on the grounds of contracts of trade representation, Bulgartabac-Holding AD is mediating in the overall process of purchasing by the subsidiaries of the required quantities of raw tobaccos from imports, and its activities cover the selection of tobaccos by regions and qualities, contracting, delivery and coordination of payments to sellers. Virginia and Burley tobaccos, tobacco stems and reconstituted tobacco are imported for the needs of manufacturing. 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 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 Q'1 of 2011, 2 858 200 kg of raw tobacco were imported for the amount of USD 19 730 808 and EUR 387 695.

The operating results from the sales of tobacco (exports, Intra Community Supplies and domestic sales to unrelated parties) by Bulgartabac-Holding AD at 31 March 2011 are as follows:

Sales of own tobaccos (Exports, Intra Community Supplies and Domestic Sales to unrelated parties) by Bulgartabac-Holding AD	
31 March 2011	31 March 2010
189 tons	298 tons
BGN 990 thousand	BGN 2 057 thousand

Intra-Group sales of Bulgarian tobacco

In Q'1 of 2011, Bulgartabac-Holding AD sold to Pleven-BT AD tobacco stems and pool in the total amount of BGN 118 thousand, VAT excluded:

Total revenue from tobacco sales	
31 March 2011	31 March 2010
BGN 1 108 thousand	BGN 2 057 thousand

Fees from trade representation paid to Bulgartabac Holding AD re: Exports, Imports, Intra Community Supplies & Acquisitions and Domestic Sales to unrelated parties (in BGN, VAT excluded)	
31 March 2011	31 March 2010
BGN 61 thousand	BGN 991 thousand

Fees for trade representation paid to Bulgartabac Holding AD re: Exports, Imports, Intra-Community Supplies& Acquisitions and Domestic Sales of tobaccos to unrelated parties (in BGN, VAT excluded)	
31 March 2011	
Exports, Imports, Intra-Community Supplies& Acquisitions and Domestic Sales	Import and Intra-Community Purchases
BGN 6 thousand	BGN 444 thousand

- **Domestic market of tobacco products**

Domestic market

The policy pursued by Bulgartabac-Holding AD during Q'1 of 2011 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.

Cigarettes sold in Q'1 of 2011 on the domestic market approximate the sales made during the same period of the previous year, with an insignificant decline in certain assortments.

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 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:

1. Pricing policy and competition

During the current 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 the entire Q'1 of this year as well.

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

During the current 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 last six months of 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.

2. Unregulated trade

During the first three months of 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 Q'1 of 2011 has shrunk by almost 30%.

3. 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 competitor's cigarette brands. The sensible 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 business. This reflects on the range of tobacco products offered in the points of sale. Only the best selling brands are supplied in limited quantities.

4. Distribution

The marketing studies of the reporting period /data covers the period until March 2011/ show that the distribution of Bulgartabac-Holding AD covers 96.1% of the points of sale of tobacco products in the country. Therefore, we believe that the decline in sales is due mainly to the above-mentioned objective factors.

During the reporting period, the Holding 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.

Subsidiaries pay royalties to the Holding as follows.

Royalties of Bulgartabac-Holding AD	
31 March 2011	31 March 2010
BGN 2 926 thousand	BGN 1 091 thousand

- **Export of tobacco products**

Based on the objective analysis of the markets and the potential of our brands, the aim of Bulgartabac-Holding AD is to reach a sales volume of 15 549 240 thousand pcs., or a growth of 19 % compared to the volumes in 2010.

On the ground of its long lasting experience and traditions, the production of Bulgartabac group is well known on the Middle and Far East, Africa, Balkan countries and CIS markets. Our standing market presence in these regions allows us to sell quality products at prices that guarantee constant net income and makes it possible to meet the companies' fixed costs.

The good results achieved during the years in the Middle East, the Far East and the Balkans region depend directly on the right choice of partners with well developed distribution networks in each of the regions.

In the conditions of an ever-growing competition on the part of the multinational companies and changing factors on micro-and-macro level, Bulgartabac-Holding AD has to increase its competitiveness and enter new markets.

When launching new products on the foreign markets, Bulgartabac-Holding AD needs to analyse thoroughly the market specifics as well as the intra-company prerequisites for development of the company.

The creation of an overall strategy from a marketing point of view, setting the pattern for product launch will minimize the risk upon entering new markets. Factors that facilitate the success of new products like orientation on the changing consumer needs, establishment of consumers' tastes and preferences, analysis of the consumers' sensitivity to the prices of the products have also to be accounted for.

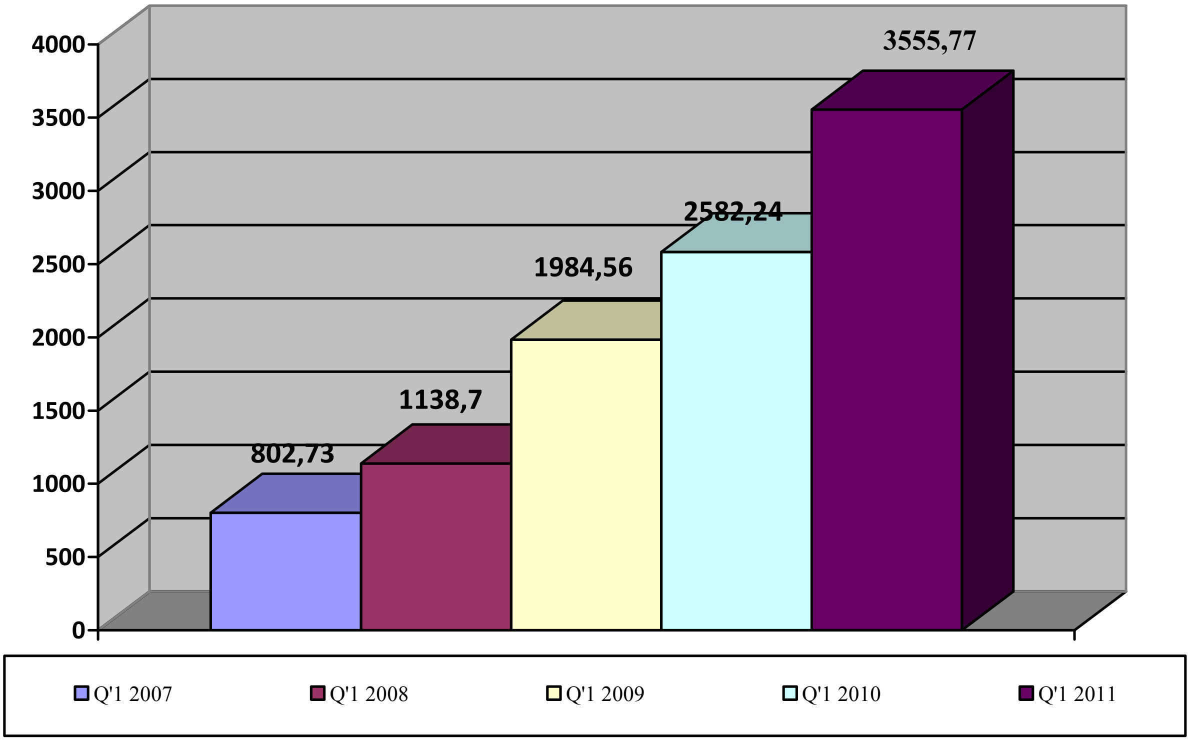
Over the years Bulgartabac-Holding AD transformed into a flexible market-oriented structure, manufacturing market-oriented products compliant with the main demand factors in the specific region. In this connection and in order to strengthen the positions already conquered in 2010, expenses for implementation of the strategies of launching new products on established markets and new products on new markets have to be provided for.

The types of products included in the export list of Bulgartabac-Holding AD for 2011 are in full compliance with the requests, needs and preferences of the clients of each of the regions. Special attention is paid to consumer packing of cigarettes – the quality of design and print of the pack, corresponding to the consumers' preferences on the specific markets.

The results achieved during Q'1 2011 compared with those for the same period of previous years are as follows:

1. Volumes sold – in million pieces:

During Q'1 of 2011, the export of Bulgartabac-Holding AD reached **3 555.77 million pieces**, while in Q'1 of 2010 it was **2 582.24 million pieces**. There is a growth of **37.70%** in the natural volumes, or **93%** of volumes budgeted in the export programme of the company for 2011. Respectively, Blagoevgrad-BT AD manufactured and exported 1 980.48 million pieces during Q'1 of 2011 vs. 1 442.01 million pieces in 2010, or a growth by almost 37.3%, while Sofia-BT AD manufactured and exported 1 575.60 million pieces during Q'1 of 2011 vs. 1 140.23 million pieces in 2010, or a growth by 38.18% in the volumes sold.



Growth in volumes sold 2008 vs. 2007: **42 %**

Growth in volumes sold 2009 vs. 2008: **74 %**

Growth in volumes sold 2010 vs. 2009: **30 %**

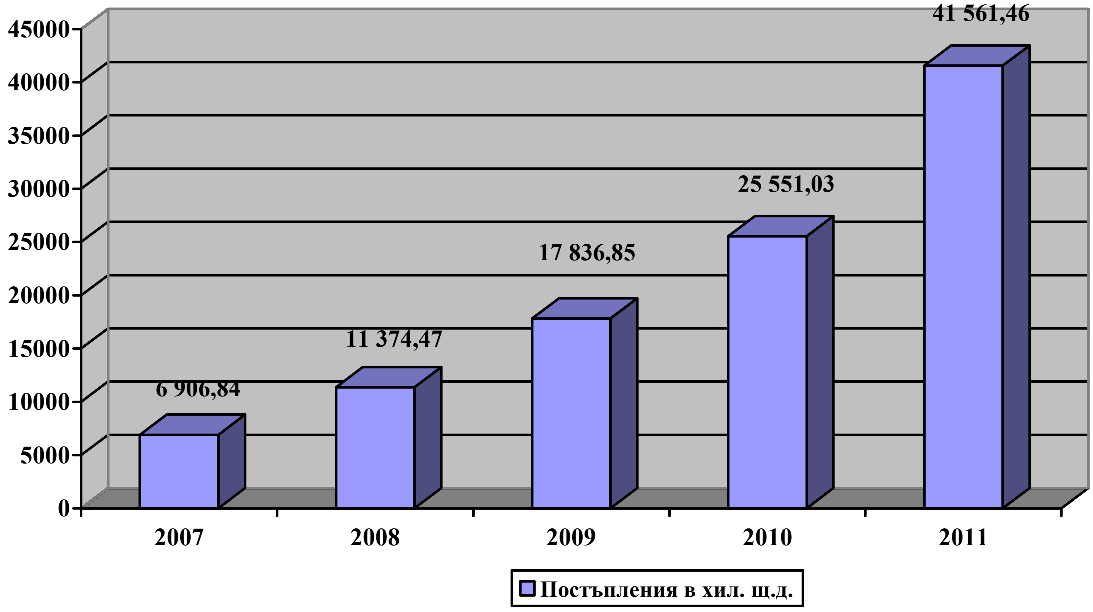
Growth in volumes sold 2011 vs. 2010: **38 %**

2. Sales revenue from export of cigarettes

Sales revenue from export of cigarettes for Q'1 of 2011 amounted to USD 41 561 463 and EUR 2 248 280 vs. USD 25 551 025 and EUR 4 028 006 for Q'1 of 2010, or there is a growth in revenue by about 41%. Respectively, sales revenue from export of cigarettes of Blagoevgrad-BT AD for Q'1 of 2011 amounted to USD 24 996 000 and EUR 363 558 vs. USD 17 341 130 and EUR 635 510 for Q'1 of 2010. With regard to Sofia-BT AD, sales revenue from export of cigarettes for Q'1 of 2011 amounted to USD 16 565 460 and EUR 1 884 720 vs. USD 8 209 900 and EUR 3 392 490 for Q'1 of 2010.

(in USD'000)

2007	6 906,84
2008	11 374,47
2009	17 836,85
2010	25 551,03
2011	41 561,46



Growth in revenue in USD 2008 vs. 2007: **65 %**

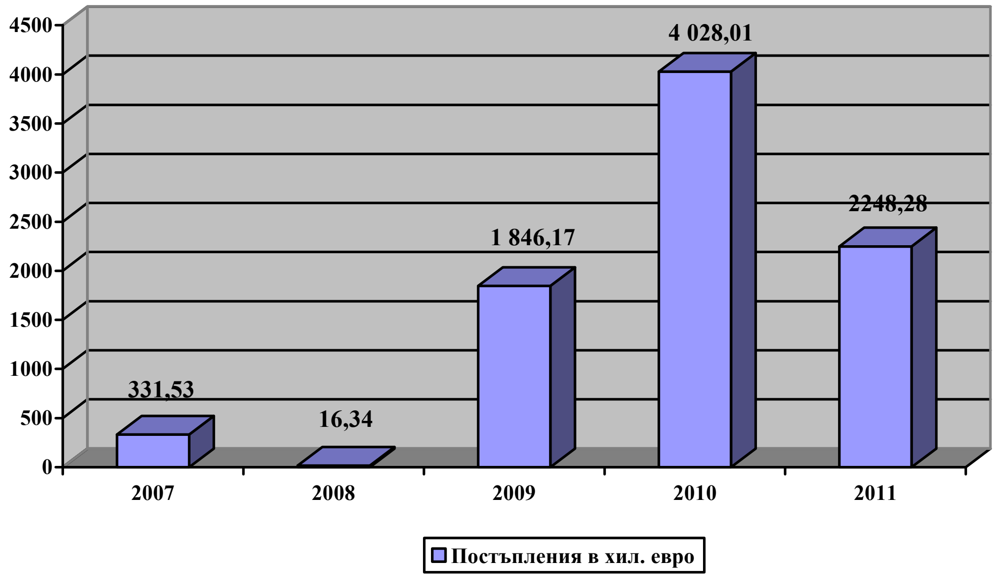
Growth in revenue in USD 2009 vs. 2008: **57 %**

Growth in revenue in USD 2010 vs. 2009: **43 %**

Growth in revenue in USD 2011 vs. 2010: **63 %**

(in EUR'000)

2007	331,53
2008	16,34
2009	1 846,17
2010	4 028,01
2011	2 248,28



Growth in revenue in EUR 2008 vs. 2007 : **- 95 %**

Growth in revenue in EUR 2009 vs. 2008 : **1120 %**

Growth in revenue in EUR 2010 vs. 2009 : **118 %**

Growth in revenue in EUR 2011 vs. 2010 : **- 44%**

Market perspectives:

During Q 1 of 2011, in order to accomplish the goals set in the export program, the optimization of the export activities of Bulgartabac-Holding AD continued through:

- Creation of a database of the main competitor companies in each region;
- Creation of a database of the main competitor brands in each region;
- Identification of new markets for the company;
- Identification of changes in consumer demand on each of the existing markets as well as the consumer characteristics of the new ones;
- Continued development and updating (customisation) of the portfolio - entirely customer-oriented;
- Analysis of customer's sensitivity to quality.

During the first quarter of 2011, we accomplished the set forecast volumes, as follows:

- Volume set for Q1 of 2011 – 3 834 mln. pcs.; execution as of 31 March 2011 – 3 555,24 mln. pcs., or 93% of the planned volume, the non-execution coming mainly from decreased volumes of export to CIS and Balkans region as well as the drop in cigarettes export– own trademark of the client (volumes carried forward to Q 3);
- We have concluded contracts and carry out negotiations with strategic partners operating well-developed distribution networks in each of the regions;
- We neutralized successfully the internal completion of our brands in one and the same region;
- We strengthened our positions on the markets new to the company in EU countries as well as the CIS.

The results achieved at present are based on Bulgartabac-Holding AD's well-developed export portfolio for 2010.

- 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;
- We have developed soft pack cigarettes in the low price segment for export.

The objective analysis of the markets and of the potential of our export brands determines the results achieved during Q 1 and is a prerequisite for reaching the high objectives set for 2011.

One of our main goals in 2011 will be finalizing the developments and starting the export of a new export brand – GLOBAL. The choice of this brand is not accidental – it has a good legal protection and its spelling is easily recognizable by our foreign partners.

The subsidiaries pay fees for trade representation for exports carried out by Bulgartabac-Holding AD on their account that are fixed as percentage of the transaction value.

Fees for trade representation paid to Bulgartabac-Holding AD re: Export of cigarettes (commissions)	
31 March 2011	31 March 2010
BGN 2 234 thousand	BGN 659 thousand

- **In the area of auxiliary materials and spare parts**

The analysis of activity on supplying cigarette production with the required auxiliary materials and spare parts for Q’1 of 2011 revealed the following:

- The main target in 2011 is to expand the range of suppliers in order to maintain the best prices and terms of delivery of auxiliary materials;
- The practice to carry out at the subsidiaries production testing to approve the quality of at least three suppliers for each material and avoid monopolization of supply by one supplier was continued;
- The supply of the required auxiliary materials and spare parts is centralized and carried out by Bulgartabac-Holding AD for all subsidiaries.

During the period 01 January -31 March 2011, the 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% to 5% higher than that in 2010.
- Considering the increased consumption in 2010 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 2011 were 7% lower as compared to the average in 2010.
- Despite the raise in cellulose prices, upon negotiations, we managed to agree on prices for the supply of cigarette paper, wrapping paper and tipping paper for Q’1 of 2011 that are equal to the 2010 supply prices.
- The price of inner frame cardboards has increased by 5% to 7% due to the increase in prices of cellulose.
- 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.
- Recess filters – due to the increased prices of tow, the main raw material for the production of

filters, after negotiations held a minimum increase in prices of 2% to 3% was agreed compared with the 2010 prices.

- 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 aroma products, aluminium foil, printing materials, glues and active charcoal maintained their 2009 levels.

The production process is supplied with spare parts through orders to an approved supplier by the manufacturer of the plant and equipment.

Fees for trade representation to Bulgartabac-Holding AD (commissions) in Intra Community Acquisitions and Imports of auxiliary materials and spare parts		
Intra Community Acquisitions and Imports of auxiliary materials		
	31 March 2011 /BGN'000/	*31 March 2010 /BGN'000/*
Total:	*247*	*117*
Sofia-BT AD	110	55
Blagoevgrad-BT AD	137	62

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

During Q'1 of 2011 activities aimed at securing cigarette manufacturing with tobaccos, tobacco stems and reconstituted tobacco were carried out. Technological developments for expansion of cut tobacco, design of cigarettes for the domestic and export markets as well as actualization of the technological documentation were made:

I. Provision of tobaccos, tobacco stems and reconstituted tobacco for the production.

1. Expert assessments, taste evaluations and chemical analyses of samples of crop 2010 Maryland tobaccos originating from USA were carried out. Specification of the approved quality and schedule for the delivery of the necessary quantities of Maryland tobacco for securing cigarettes manufacturing were prepared and submitted.

2. In order to compensate the shortage of Virginia tobacco, variety BR2 and variety BO2, crop 2010, originating from Brazil, assessments and analyses of submitted tobacco samples were carried out. Specification of the approved quality groups and schedule for the delivery of additional quantities for securing cigarettes manufacturing in 2011 were prepared.

3. Assessment of samples of crop 2010 Virginia tobacco stems, origin China, and Burley tobacco stems, origin Argentina, was carried out. Balance of the necessary quantities was drawn up and schedule for the delivery of the tobacco stems during 2011 to Blagoevgrad-BT AD, Sofia-BT AD and Pleven-BT AD was prepared.

4. Expert assessments and analyses of regular samples of reconstituted tobacco, quality AZ6N of "LTR", France, were made.

II. Technological developments

1. Implementation of a new technology for expansion of cigarette blends cut tobacco that will be introduced in cigarettes manufacturing at Sofia-BT AD.

Preliminary tests for expansion of sample trials of Virginia tobacco blends were conducted at an installation of the company COMAS, Italy. At Sofia-BT AD, production surveys in the process of adding the expanded cut tobacco to cigarettes blends were carried out, as well as evaluation was made of the quality characteristics and indicators of cigarettes.

2. The recipes of all the cigarettes brands produced by Blagoevgrad-BT AD and Sofia-BT AD for the domestic market and for export were updated and approved.

3. A program to commence production tests at the cigarettes factories for using a new quality of cigarette papers for self extinguishing cigarettes was prepared. The standards introduced in the EU Member States that regulate the requirements to the quality of the cigarettes were studied. The term for adoption and implementation of the technology for production of self extinguishing cigarettes of all Bulgartabac-Holding AD's brands sold on the domestic market is November 2011.

III. Cigarettes

1. The design of the packs and the cigarettes of the family VICTORY, 84 mm and 100 mm, was updated. The cigarettes VICTORY 84 mm, in versions Blue, Gold, Silver and Sky, are currently manufactured by Blagoevgrad-BT AD in round corner box, with a new elaborated design of the packs and cigarettes. The new packs of the cigarettes have been put into regular production and introduced on the domestic market since March 2011. At Sofia-BT AD the production of cigarettes VICTORY 100 mm of the same varieties, in hard box, with the updated design of the packs and the cigarettes, started. Dossiers of the brands were prepared, approved and submitted for use by the production for the new varieties of cigarettes of the VICTORY family.

2. New versions of cigarettes of the GD blue, Melnik and MM Charcoal brands, 84 mm, hard box, in 10 pcs. packs, intended for the domestic market, are manufactured by Blagoevgrad-BT AD. Technical specifications of blend, auxiliary materials, packs design and characteristics of the cigarettes have been prepared and approved.

3. Development of cigarettes for export.

Upon requests on behalf of Bulgartabac-Holding AD's clients, development of cigarettes for export in various formats, packs and varieties of tobacco blends and cigarettes' characteristics have started. At this stage, samples of cigarettes are prepared and are submitted to the clients for evaluation of their smoking and taste qualities and approval of the design of the cigarettes and the packs.

- **Quality Management System**

In 2011, the process of planning and implementing the activities connected with the requirements of ISO 9001:2008 started, aiming to achieve the requirements of the standard and to develop the efficiency of the Quality Management System (QMS) of Bulgartabac-Holding AD.

The top management of Bulgartabac-Holding AD planned and set the strategic and operative goals to be achieved during the next few years. The quality objectives for 2011 were formulated and the Quality Policy was confirmed.

The internal audits of QMS, being an important factor of control and preventive work, were planned in detail for the entire certification period until 2013.

The ease of access to the entire volume of documents and the access to QMS were improved as the whole Quality Management System was uploaded on the new internal site of Bulgartabac-Holding AD. Maintaining the system in an electronic version only has advantages related to the fact that references are always made in an up-to-date system and the need to maintain a large volume of paper documents has been eliminated.

The preparation of the Management's review also commenced, being an important element of the system's functioning. Implementing the recommendations of the review and suggestions made guarantee the effective work of the Quality Management System (QMS) of Bulgartabac-Holding AD.

3. <u>Analysis of the financial status and financial result of Bulgartabac Holding AD as of 31 March 2011</u>

Under conditions of highly competitive environment and increase in the share of unregulated sales of tobacco products, Bulgartabac-Holding AD closed Q'1 of 2011 with **a positive financial result of BGN 1,319 thousand.** In comparison, the result for the same interim period of 2010 was a loss amounting to BGN 1,675 thousand.

Revenue for the interim reporting period of the current year amounts to BGN 6 969 thousand. They score a growth of 67.36 % (BGN 2 805 thousand) compared with the sales revenue reported for the comparative period of 2010. The above increase is quite normal considering recent government policies towards preserving the amount of excise duty rates, as well as the activity of Bulgartabac Group designed to boost the sales.

The positive trend in the company's business activity and consistent measures to maintain financial discipline affect positively on the sustainable effectiveness and competitiveness throughout the analysed interim reporting period.

The increase in revenue from BGN 4 164 thousand (for Q'1 of 2010) to BGN 6 969 thousand (for the period 01 January -31 March 2011) is due to:

- growth in royalties by BGN 1 835 thousand; growth in fees under trade representation contracts concluded with subsidiaries by BGN 1 919 thousand; and

- decline in revenue from sale of tobacco by BGN 949 thousand.

The high share of products for export of the two cigarette factories (about 80% of total sales), its growth (by more than 60%) vs. the volumes sold during the comparative interim period of 2010, as well as the higher amount of the trade representation fee (from 1.5% to 3.5%) have led to more than 2.3 times growth in revenue from trade representation fees upon the export of cigarettes reported by Bulgartabac-Holding AD for Q'1 of 2011. In general, the increase in total volume of products sold during the reported interim period of 2011 has led to higher volumes of tobacco and auxiliary materials supplied. This, in turn, has had a positive effect on the higher amount of revenue under trade representation contracts in relation to the import and export of tobaccos (by 89.41%), as also to the import of auxiliary materials (by 103.85%), as a result of the activity of Bulgartabac-Holding AD.

The preservation of excise duty rates in 2011 at the levels and structure of 2010 is a precondition for returning to normal the sales in the first months of 2011 and thus, to accounting for higher revenue from royalties in relation to the domestic sales – by 168.19%. The underlying reason is the fact that in view of the expected increase of excise duty rates from the beginning of 2010 the distributors ordered higher quantities of cigarettes in the end of 2009 that were actually sold in the first quarter of 2010, but accounted for as sales of Bulgartabac Group in the end of 2009.

The implemented effective measures of the restriction-of-cost policy have also contributed to the overall successful performance of the company in Q'1 of 2011. In this regard, the following has been reported, as compared with the same interim period of the previous year:

- a cut down of costs of materials by BGN 599 thousand, or by 13% in the average, primarily due to the delay in buying-out campaign for 2010 and respectively, the manufacturing of finished tobacco products;
- a cut down of personnel expenses by BGN 100 thousand, or by 4.17%, primarily due to lower amounts accrued for long-term benefits of personnel and severance pay;
- a cut down of depreciation / amortization costs by BGN 202 thousand, or by 38.48%.

Besides the above mentioned circumstances, the following factors have also had a direct impact on the financial result for Q'1 of 2011:

- increase in costs of hired services by BGN 1 067 thousand in total, or by 42.63% (mainly of advertising costs which report an increase by BGN 603 thousand, or a 83.63% growth). This is because the active intervention policy aimed at maintaining sustainable market positions and loyal consumer of products of Bulgartabac Group under conditions of high competition.

As contrasted with Q'1 of 2010, when the lower price (at excise duty stamps of 2009) of tobacco products was used as a marketing tool, in Q'1 of 2011 the aggressive advertising campaign of competitors and indications of a price war presume adequate investments in advertising and marketing events with the aim to preserve the leading market share of Bulgartabac;

- increase in investment income by BGN 174 thousand, or by 39.28% vs. the reported figures for Q'1 of 2010. The positive contribution is due to the bigger amount of cash (temporary own cash), which is managed by applying procedures for daily analysis and control with the aim to achieve maximum yield;
- other operating expenses (business trips, training, donations, wastes, etc) report an overall increase of about BGN 82 thousand.

Cash flow analysis

Cash of "Bulgartabac - Holding" AD at 31 March 2011 amounted to BGN 39,600 thousand, or by 36% more than cash available in the same interim period of 2010, the main reason being the increase in the net cash flows from operating activity in 2010 as compared to 2009.

For Q'1 of 2011, Bulgartabac-Holding AD reported negative net cash flows from operating activity amounting to BGN 10,351 thousand. The amount of this indicator is conditioned by the purchases of raw tobacco, crop 2010, which resulted in higher stocks of the company during the interim period of 2011 under review.

For the period 01 January -31 March 2011 the company has reported positive net cash flows from investing activity, primarily due to the interest received on structured deposits of the company's temporarily free cash. This indicator is a positive figure for the comparative interim period of 2010 as well.

Bulgartabac-Holding AD has reported negative cash flows from financing activity for Q'1 of 2011 due to the fact that dividends were paid to minority shareholders based on the 2009 profits.

Analysis of the Statement of Financial Position

The balance sheet figure of Bulgartabac-Holding AD at 31 March 2011 was BGN 100,958 thousand. In comparison, it amounted to BGN 99,459 thousand at 31 December 2010. The reason for this increase was the growth in current assets by 3%, primarily due to the higher stock of raw tobacco and respectively, of finished products. Therefore, the most liquid resources, namely cash and cash equivalents, dropped by about 20% and were transformed into another type of assets - inventories.

In Q'1 of 2011, the equity increased by 1% compared with that at 31 December 2010 due to the higher amounts of retained earnings. The change in this indicator shows that the company has satisfied the financial concept of maintaining the equity, thus increasing the shareholder's wealth.

The current liabilities of the company at the end of Q'1 of 2011 show an insignificant increase by about 2% vs. the levels at 31 December 2010. Payables to personnel score the highest increase by 65%, as well as the payables to related parties. At the same time, other trade payables have dropped by 48%.

Financial ratio analysis

Financial ratios	Report 31.03.2011	Report 31.12.2010	Report 31.03.2010
Price / Earnings (loss) per share (P/E)	169,91	38,98	-78,07
Market capitalisation / Sales revenue (P/S)	32,16	5,39	31,40
Price / Accounting value (P/B)	2,36	2,41	1,48
Return on equity (ROE)	1,39 %	6,21 %	-1,89%
Return on assets (ROA)	1,31 %	5,86 %	-1,81%
Profit (loss) before taxes and interest expense – BGN'000 (EBIT)	1 319	6 356	-1 675
Profit (loss) before taxes and interest expense / Equity (ROE using EBIT)	1,39 %	6,78 %	-1,89%
Profit (loss) before taxes and interest expense / Assets (ROA using EBIT)	1,31 %	6,39 %	-1,81%
Market capitalisation / Profit (loss) before taxes and interest expense (P/EBIT)	169,91	35,70	-78,07
Debt-Equity ratio	0,06	0,06	0,01
Liquidity ratio (COL)	17,56	17,35	22,71
Assets – Turnover	0,07	0,42	0,04

In Q'1 of 2011, Bulgartabac – Holding AD maintained its financial stability and independence. The constantly high values of liquidity ratios confirm this**.**

The low levels (below 1) of gearing ratio are one of the most important features of the company and of its ability to cover current and non-current liabilities which have occurred in the course of its normal business activity, as well as are an indicator of its independence from external capital (borrowings).

The average-weighted price at which the company's shares were traded in the stock exchange at 31 March 2011 was BGN *30,42 per share*, while at 31 December 2010 it was BGN *30,80 per share*.

The movement of shares traded in the stock exchange in the short-term run is shown below:

Source : Infostock.bg

4. **Major risks and uncertainties faced by Bulgartabac-Holding AD in 2011**

The management policy of Bulgartabac-Holding AD for 2011 will be directed towards performance of activities committed to the strategic directions of the company – the long-term and short-term development of Bulgartabac Group:

The long-term goals for development of Bulgartabac Group for the period 2011-2013 are as follows:

- maintaining leading market share of at least 30% of the cigarette market in Bulgaria;
- increasing export volumes – reaching export levels for tobacco products of 20 thousand tons per year (2012-2017).

The operating goal of Bulgartabac-Holding AD is to ensure sustainable effectiveness of the company by improving financial discipline and implementing effective measures aimed at cutting down fixed expenses by 5% as compared with the previous reporting period.

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 and parliamentary elections in 2013;
- 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

- Positive assumptions for the development of the global economy during 2011-2013 and coming out of the recession in 2011 already;
- Gradual transition of the Bulgarian economy to a model of development, in which export is the main growth factor;
- Smooth increase of consumer confidence as well as higher inflow of direct foreign investments (2011-2013);
- 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.

Other risks factors **inherent** to the company's activity may be reviewed in the following directions:

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

The membership of Bulgaria in the EU has led to dynamic changes in the development of the Raw Tobacco Growing Branch in the country and the legislative mechanisms of tobacco buy-up and processing.

1. Starting with crop 2010 the Minimum purchase prices of raw tobacco, earlier being fixed each year by the Council of Ministers, were eliminated. Tobaccos of the crop were bought-up at market prices determined by each licensed company.

2. By issue 19 of the State Gazette of 08 March 2010 Articles 11, 16 and 33 of the Tobacco and Tobacco Products Act were repealed as also the texts of the Act related to the repealed articles. The main

changes are as follows:

- liberalization of the raw tobacco market – this will lead to significant changes in the organization of the process of buying-up of this raw material with many “small” buyers that do not have permits for tobacco processing penetrating the market. This change is forecasted to have an insignificant impact on the tobacco processing companies operating in the country;
- the obligation to carry out the tobacco processing within the territory of the country was eliminated;
- the imperative regulation of the Tobacco and Tobacco Products Act for conclusion of contracts between the tobacco growers and the purchasers of raw tobacco was abolished.
- the suppression of bonuses paid on the quantity of tobacco produced led to a decrease in the production of crop 2010 tobaccos, this decrease being the biggest for the variety group Virginia. The lack of bonuses bound with the quantity of the produced tobacco of a respective crop led to decreased production, which, in turn, affected the purchasing price of raw tobacco.

Risks in the area of tobacco trade

In 2011, Bulgartabac-Holding AD 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.

Risks related to investing in shares of the company

Bulgartabac-Holding AD is a registered public company whose shares are listed for trading on the Unofficial Market of Bulgarian-Stock-Exchange-Sofia AD, segment A. The market value of shares offered is determined on the basis of demand and supply and their price is dependent on both the economic and financial results of the company and the information being announced publicly by the company, and by the common factors having impact on the capital market in the country.

The company cannot guarantee that there will not be any fluctuations in prices of its shares. In a number of cases, these fluctuations neither relate nor correspond to the operating results of the company and therefore, they cannot be predicted.

The positive and consistent trend of good financial indicators of Bulgartabac-Holding AD for the last two quarters of 2010 and the first quarter of 2011 has led to significant growth in the share price – by 52.86% (from BGN 19.90 per share at 30 September 2010 to BGN 30.80 per share at 31 December 2010 and to BGN 30.42 per share at 31 March 2011), which is an indication that investors have gradually returned their interest and confidence in the company’s shares.

To support the above, we would also point our the fact that by a decision of the Board of Directors of Bulgarian-Stock-Exchange-Sofia AD dated 11 March 2011 Bulgartabac-Holding AD was included, effective 21 March 2011 in the database of two indices: **BG TOTAL RETURN 30** and **BG 40**, and the subsidiary Sofia-BT AD in **BG 40.**

BG TOTAL RETURN 30 is an index based on the price performance of the common shares included in the index portfolio. It comprises the biggest and most liquid 30 companies traded in BSE-Sofia classified in accordance with a number of criteria, each one having equal weight: market capitalization, number of transactions during the last 6 months, turnover (value traded) during the last 6 months, free-float.

BG 40 is an index based on the price performance if the issues and comprises 40 (forty) issues of common shares of the companies with the greatest number of transactions and the highest median value of the daily turnover during the last 6 (six) months as the two criteria shall have equal weight.

Financial risk management

In the ordinary course of its business activities, the company is exposed to a variety of financial risks the most important of which are market risk (including currency risk, interest rate risk and other price risk), credit risk and liquidity risk. 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 the company is currently executed by the 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.

Below are presented the various types of risks to which the company is exposed upon performing its commercial transactions as well as the adopted approach for managing these risks.

Market risk

Currency risk

The main part of the economic operations of the company is executed in BGN or EUR. At the same time, in its activities the company performs sales to foreign clients while a significant part thereof is contracted in USD. Thanks to the currency board introduced in Bulgaria and the fixed exchange rate of the Bulgarian lev to EUR, the EUR-based currency risk is immaterial. Therefore, the company is exposed to currency risk mostly in relation to its USD exposure.

An immaterial part of the company's financial assets and liabilities are denominated in USD (incl. cash deposited for long time in escrow accounts (other long-term financial assets) and some of the deposits with commercial banks).

In order to control currency risk, the company has developed and applies the following measures:

- it has implemented a system to plan and monitor on daily basis the movements of USD exchange rate and to exercise control over the forthcoming payments to and from the company;
- the free funds in USD are invested by the company in short-term foreign currency deposits with good yields.

Interest rate risk

Interest rate risk is the risk that the fair value or the future cash flows of the financial instruments, held by the Company, will vary due to changes in market interest rates. Instruments with fixed interest are exposed to interest fair value risk - the price of Group's fixed-rate financial assets will decrease with the increase in the market interest rate, and vice versa.

Floating-rate financial assets and liabilities are exposed to a cash flow risk - the future cash flows from floating-rate financial instruments will vary due to changes in market interest rates.

In general, interest-bearing financial assets are represented mainly, in the structure of the Company's assets, by bank deposits, cash and fixed-rate loans granted. At the same time, the Company neither holds nor maintains interest-bearing liabilities. Therefore, the operating cash flows depend to a large extent to the changes in market interest rates.

With regard to interest-bearing assets, such as fixed-rate deposits with commercial banks, the Company applies the following procedures for current control and risk management:

- the deposit contracts concluded with commercial banks are short-term ones (usually of up to 1 month) with a maximum term of up to 3 months;

- approved procedures are followed when choosing a bank for the purpose of achieving best interest rates, as at the same time taking into consideration the financial soundness of commercial banks and the need to diversify the risk of concentration of financial resources in the separate banks;

- market conditions are constantly analysed with the support of a special department of the Company and the exposure of interest-bearing assets of the Company is controlled.

Funds in the current accounts bear interest rates according to the tariffs of the relevant banks, which remain relatively constant for a longer period of time, although they are affected by the changes in the basic interest rate.

The Company's management currently monitors and analysis the exposure against changed interest rates, and measures the impact on the financial result and equity in case of change with set points or percentage of interest. For each simulation, the same assumption for interest rate shift is used for BGN and USD.

Price risk

The Company is not exposed to a price risk of adverse changes in the prices of goods and services, subject to its operations, because the goods are not traded in stock exchange and as per the contractual arrangements with clients and suppliers, prices are periodically analysed and discussed for revision and update in accordance with market changes. The major sales transactions executed by the Company cover sales of goods and finished products (tobacco), services - commissions related to purchase of raw materials, materials and sales of finished products to subsidiaries, as well as the service to provide a licence for trademarks for the production of tobacco products. As far as the licence service is directly related to the value of tobacco products (determined as a percent of the final selling price), management believes that no price risk exists considering that the prices to tobacco products in the domestic market are determined by the market and are only subject to registration.

In order to manage the price risk as regards the cigarette prices, the Company currently monitors the status and dynamics of the market (monitors the behaviour of the other market participants) for the purposes of adequate pricing of cigarettes depending on the market environment.

Upon sales of goods and finished products (tobacco), the Company was exposed to a specific price risk until the year of 2010 in relation to the minimal purchase prices of tobacco determined by a Council of Ministers (CM) Decree. In 2010 the CM of the Republic of Bulgaria did not determine minimal purchase prices of tobacco, crop 2010, and therefore, the purchase prices had been set by a decision of the Company's management, which minimized this type of risk. Moreover, the Company is exposed to possible negative changes in the tobacco prices in the global market.

The price risk to negative changes in prices is minimized by performing periodic analyses and discussions of the contractual relations in order to re-review and update the prices vs. the market changes.

The Company does not hold a significant portfolio of available-for-sale investments in terms of amount and the available-for-sale investments held by the Company are not traded in a stock exchange, therefore, the Company is not exposed to a risk of changes in the stock prices of securities.

Credit risk

Upon performing its activities, the Company is exposed to a credit risk related to the risk that any of its clients or other counterparts will fail to discharge the obligations, related to due amounts under trade and other receivables, in full and within the normally envisaged terms. The latter are presented in the statement of financial position at net value after deducting the impairment accrued. Such impairment is made where and when events have existed identifying loss due to uncollectability as per previous experience.

The Company's financial assets are mainly concentrated in the following groups: other long-term financial assets, investments available-for-sale investments, cash – cash in hand and in bank accounts (current and deposit), trade receivables, and receivables from related parties (subsidiaries) and other receivables.

In view of the credit risk of cash flows in bank accounts (current and deposit), the risk management in the case of active transactions with temporarily free cash includes the activities on identifying, measuring and controlling any potential events or situations, which may impact negatively the achievement of the company's goals to ensure additional stable source of income. The object of analysis is the possible negative consequence (income outflow) which could occur as a result of an unfavourable event and the resources that will be required to overcome this event.

In view of the long-lasting experience and good practices applied, since 2010 Rules for the procedure, methods and criteria for selection of financial organizations providing cash and cash equivalent management services, payment and related services, financing, purchase of specific financial instruments, hedging transactions and other financial services (the Rules) have been effective. The written procedures (Rules) are a methodology applied by a specialised department of the Company and thus, guaranteeing the achievement of maximum economic effect at minimum financial risk. The procedure for selection of a financial service contractor is detailed to such a materiality level that depends on the specifics and complexity of the particular service/transaction/operation and/or on its interim stages within the general implementation plan or its components. Prior to sending an invitation – request to particular financial organisations, an overall marketing analysis of the market of a given (specific) type of financial services transactions/operations is carrying out, the special attention being directed towards information about the level of specialisation of financial organisations and the evaluations (the opinion expressed) of the effectiveness of their joint operations with other financial organisations – correspondents. The criterion for classification of proposals is the economically most favourable offer in terms of the optimal ratio "yield (benefit)/risk". The complex evaluation is made mandatorily by two groups of criteria – quantitative and non-quantitative ones. A component of the non-quantitative criteria is the diversification policy setting credit limits for the contractors. The diversification policy is applied with the aim to reduce to a minimum the concentration of risks for the Company and to guarantee its stability and steadiness.

The Company does not have a significant concentration of credit risk except for receivables from related parties and companies undergoing insolvency procedures, part of them being risk-bearing due to the worsening financial position of the respective companies. In relation to the credit risk of failure to collect receivables from these subsidiaries (under loan agreements, contracts for trade representation and other) the Company undertakes the following security measures:

- under the loan agreements - a collateral is required (usually at 150% of the principal)on their concluding, which includes pledge of inventories, tangible fixed assets, mortgage of real estate and other. An additional requirement is to issue a promissory note in favour of Bulgartabac-Holding AD - at amount equal to the sum of principal and interest under the loan agreement as per the repayment schedule.

- with regard to trade and other receivables, which are past due and have not been secured on their origination, agreements are being concluded for their deferral and a collateral is agreed at an amount not less than the initially recognised amount of the receivable. The collateral usually represents an established mortgage of real estate(s);

- regarding the remaining agreements, which are not secured in advance, the following common actions are undertaken in cases of overdue payment by the debtor company - setoff of payables to the company against overdue receivables and where the payable amount is not sufficiently large to cover the receivable of Bulgartabac-Holding AD, then other out-of-court options are searched to settle receivables (deals related to purchases of assets - tobacco and fixed assets, ownership of the debtor - which are settled by setoff).

In the Company, the current servicing of receivables, the reasons for being past due and the changes in the financial abilities of debtor companies are currently monitored and analysed, and the status and quality of collateral provided is controlled.

Regarding the other clients, the Company's policy is that deferred payments (credit sales) are offered as an exception only to clients having long account of business relations with the Company, good financial position and no history of credit terms violations. Receivables are controlled jointly by the trade and financial departments in the Company by following the established common practice and monitoring the observance of contractual terms and conditions. Sales to the other clients are mainly performed through prepayment (in part or in full) or payment on transaction date.

Liquidity risk

Liquidity risk is the adverse situation when the Company encounters difficulty in meeting unconditionally its obligations within their maturity.

The liquidity management policy of the Company's is conservative maintaining a constant optimal liquid reserve of cash and a good capability for funding its business activities, continuous control monitoring of the actual and forecasted cash flows by periods ahead and matching maturity profiles of assets and liabilities. The Company usually maintains optimal quantity of available cash so that it is able to meet its obligations at any time pursuant to their maturity. The Company generates and has sufficient working capital and does not need borrowed credit resources for financing its operating activities.

Maturity analysis

The Financial and the Accounting Departments monitor currently the maturity and the timely payments by maintaining daily information on the cash available and analysis of forthcoming payments. Free cash is invested usually in short-term deposits with commercial banks.

Capital risk management

The capital management objectives of the Company are to build and maintain capabilities to continue its operation as a going concern and to provide return on the investments of shareholders and economic benefits to other stakeholders and participants in its business as well as to maintain an optimal capital structure to reduce the cost of capital.

The Company currently monitors the availability and structure of its capital. It is a characteristic feature that it traditionally funds its activities from its own generated profits and working capital.

Fair values

Fair value is generally the amount for which an asset could be exchanged, or a liability settled in an arm's length transaction between independent, willing and knowledgeable parties. The Company's policy is to disclose in its financial statements mostly the fair value of these assets and liabilities for which market quotations are available.

The fair value of financial instruments, which are not traded in active markets, is determined through valuation methods based on various valuation techniques and management assumptions made in accordance with the market circumstances as at the balance sheet date.

The fair value concept presumes realization of the financial instruments through sales. However, in most cases especially with regard to trade receivables and payables as well as provided loans and deposits, the Company expects to realize these financial assets also through their total refund or respectively, settlement over time. Therefore, they are presented at their amortised cost which is accepted as being close to their fair value.

In addition, the large part of the financial assets and liabilities are either short-term in their nature (trade receivables and payables) or are presented in the balance sheet at market value (deposits placed with banks) and therefore, their fair value is almost equal to their carrying amount. The available-for-sale investments for which there are neither markets nor objective conditions for a reliable fair value measurement form an exception to this rule. Therefore, they are presented at acquisition cost (cost), which could be accepted conservatively as not materially different from their fair value.

As far as no sufficient market experience, stability and liquidity exist with regard to purchases and sales of certain financial assets and liabilities, still no adequate and reliable quotes of market prices are available thereof. The Company's management has judged that the estimates of the financial assets and liabilities presented in the balance sheet are as reliable, adequate and trustworthy as possible for financial reporting purposes under the existing circumstances.

5. Information about large-scope transactions concluded among related parties

During **the first quarter of 2011** Bulgartabac-Holding AD did not conclude any contracts for large-scope transactions with related parties.

On the grounds of Art.100o, para.7 of POSA we hereby inform that the interim financial statements as at 31 March 2011 of Bulgartabac-Holding AD have not been certified and audited.

Ivan Bilarev
Executive Director
of Bulgartabac-Holding AD