Translation from Bulgarian

INTERIM REPORT

ON THE ACTIVITY OF BULGARTABAC GROUP
AS OF 31 MARCH 2011
(prepared in accordance with Art. 100o, para.4, i.2 of Public Offering of Securities Act (POSA))

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

- ***New procedure for privatisation of Bulgartabac-Holding AD***

By a decision No 1646-A of 18 December 2009 (published in "Pari" newspaper of 21 December 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.

By a decision № 3219-П dated 18 April 2011 (promulgated in the State Gazette, issue 34 of 10 May 2011), on the grounds of Art. 1, para. 2, Art. 3, para. 1, Art. 4, para 1, and Art. 32, para. 1, i. 3 of the Privatisation and Post-privatisation Act, Ar. 2, para. 1, i. 1, Art. 3, para 3, Art. 5, Art. 7, and Art. 10 of the Ordinance on the Tenders and Competitions, and a protocol decision No 777 dated 18 April 2011 of the Executive Board, the Privatisation and Post-privatisation Agency has determined the method for sale of 5, 881,380 shares being approximately 79.83 % of the capital of Bulgartabac-Holding AD, Sofia – a publicly announced tender to be held in one stage. The decision specifies also the preliminary qualification requirements that shall be met by the interested parties – participants in the tender, as also the main procedural terms. Pursuant to this decision, the participants in the tender shall submit their bids by the 110 day as of the date of promulgation of the decision in the State Gazette.

- **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 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.

2. Development of the activity during Q'1 of 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 agreed tobacco of Variety group Virginia, crop 2010, was bought-out on behalf and on account of Pleven BT AD. Tobaccos of this crop have been purchased for the period from the end of 2010 to 31 March 2011. The purchasing of groups Basma, Kaba Koulak and Burley varieties was also done by Pleven-BT AD in accordance with the purchase contracts concluded.

Tobaccos of this crop were purchased at market prices determined by the companies – tobacco processors. 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, crop 2010, 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 Pleven BT AD took a decision to determine the purchasing prices for Variety group Virginia, and that of Bulgartabac-Holding for groups Basma, Kaba Koulak and Burley, respectively. The approved purchasing prices by classes for crop 2010 are as follows:

Class	Virginia	Burley	Kaba Koulak	Basma
I	6.10 BGN/kg.	3.90 BGN/kg.	3.80 BGN/kg.	7.35 BGN/kg.
II	4.00 BGN/kg.	2.60 BGN/kg.	3.10 BGN/kg.	4.85 BGN/kg.
III	1.80 BGN/kg.	1.40 BGN/kg.	1.85 BGN/kg.	1.90 BGN/kg.

The quantities of raw tobacco, crop 2010, purchased during the first quarter of 2011 by the Group were as follows:

Virginia	- 44 tons
Basma	- 2 317 tons
Kaba Koulak	- 540 tons
Burley	- 874 tons
Total	3 775 tons

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

Finished products manufactured during the period under review, by variety groups, were as follows:

Virginia	883 tons
Burley	814 tons
Kaba Kulak	260 tons
Expanded stems	311 tons
Total	2 268 tons with carrying amount of BGN 10,228 thousand.

- ***Trade in tobacco***

The operating results as of 31 March 2011 relating to tobacco sales /export, Intra Community Supplies and domestic sales/ aggregated for Bulgartabac Group as a whole, are presented in the tables below:

Sales of tobacco for Export and Intra Community Supplies - total for BULGARTABAC Group	
31 March 2010	31 March 2011
325 tons	206 tons
Sales of tobacco in the domestic market to third parties outside BULGARTABAC Group	
31 March 2010	31 March 2011
94 tons	76 tons
Total sales of tobacco /Export, Intra Community Supplies and domestic market/ for BULGARTABAC Group	
31 March 2010	31 March 2011
419 tons	282 tons

Tobacco export

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, 2010 as also in the beginning of 2011. Compared with the same reporting period of 2010, during Q’1 of 2011 there was a decrease in the total volume of tobacco sold outside the Group in terms of quantity. The total quantity of tobacco sold by Bulgartabac Group during Q’1 of 2011 was 282,126 kg of tobacco amounting to BGN 1,528,930.74 thousand.

Tobacco import

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 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, 2,858,200.0 kg of raw tobacco were imported for the amount of USD 19,730,808.00 and EUR 387,695.00.

- ***Domestic market of tobacco products***

Domestic market

The trade 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 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 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.

- ***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.

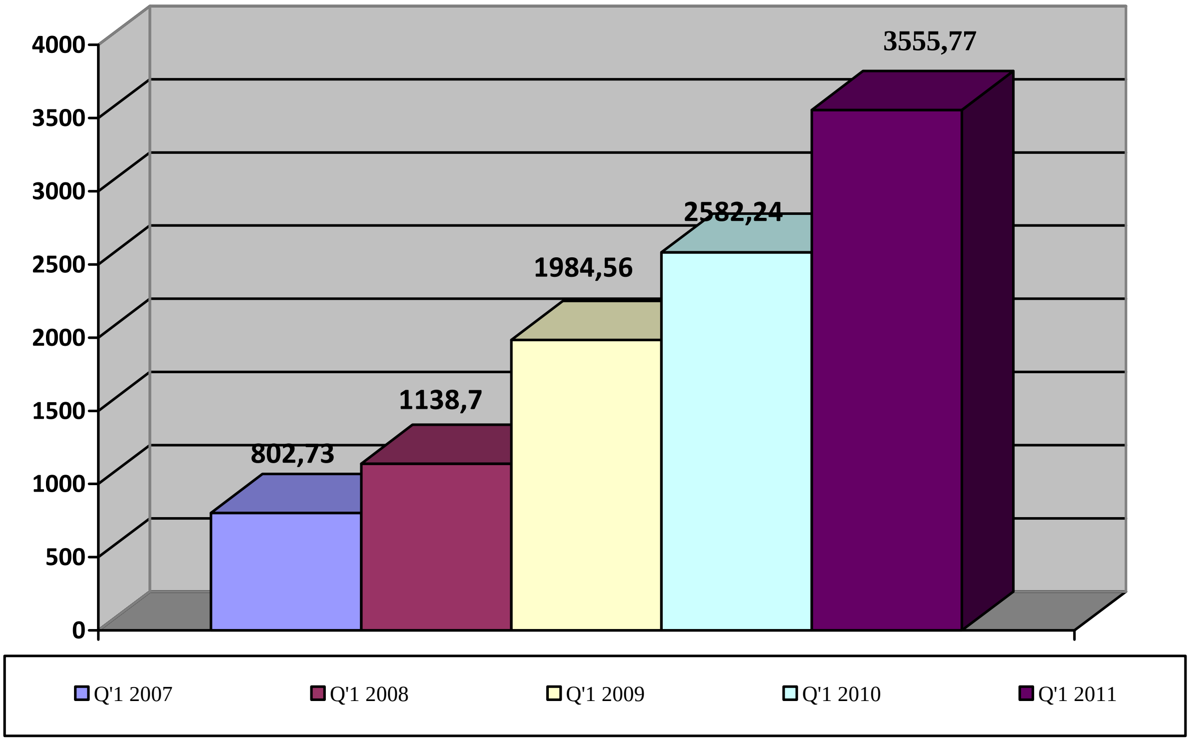
Over the years Bulgartabac-Holding AD transformed into a flexible market-oriented structure, manufacturing market-oriented products compliant with the main demand factors in the specific region. In this connection and in order to strengthen the positions already conquered in 2010, expenses for implementation 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 %**

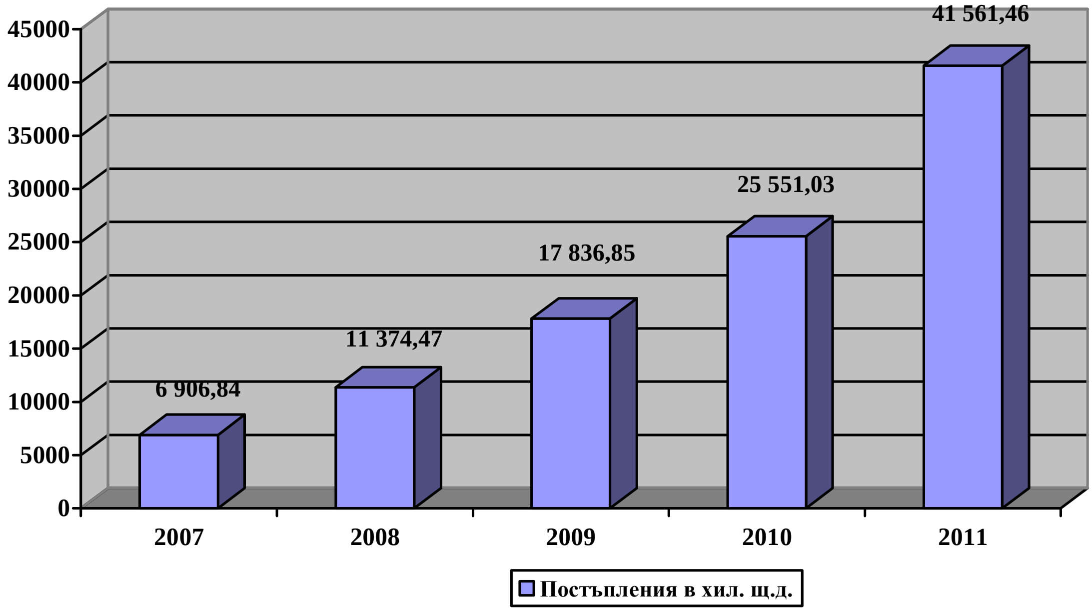
Growth in volumes sold 2011 vs. 2010: **38 %**

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 %**

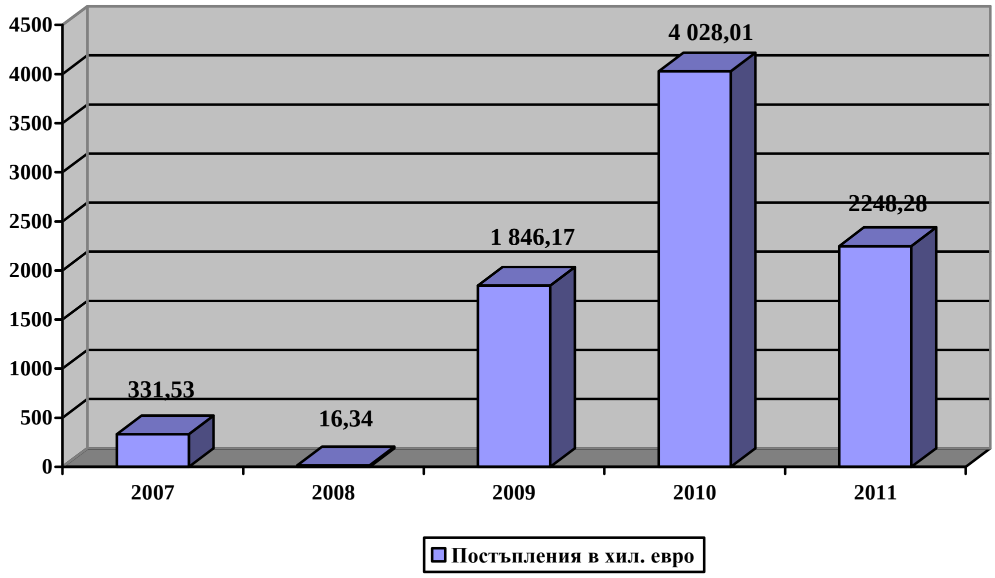
Growth in revenue in USD 2009 vs. 2008: **57 %**

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 : **1,120 %**

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.

- ***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.

- ***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.

- ***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.

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 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.

3. **Financial result of Bulgartabac Group as of 31 March 2011**

I. CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

	1.01-31.03.2011	**1.01-31.03.2010**	**Change**	
	BGN'000	**BGN'000**	**BGN'000**	**%**
Sales revenue	81,380	51,311	30,069	58.60
Cost of products and services sold	(61,803)	(40,677)	21,126	51.94
	19,577	**10,634**	**8,943**	**84.10**
Cost of production below the normal capacity	(1,532)	(1,736)	(204)	(11.75)
Gross profit (margin)	**18,045**	**8,898**	**9,147**	**102.80**
Other operating income / (losses), net	878	613	265	43.23
Distribution and realisation expenses	(2,981)	(2,203)	778	35.32
Administrative expenses	(7,147)	(7,018)	129	1.84
Other operating expenses	(3,394)	(2,369)	1,025	43.27
Operating profit / (loss)	**5,401**	**(2,079)**	**7,480**	**359.79**
Finance income	736	577	159	27.56
Finance costs	(3,782)	(736)	3,046	413.86
Operating profit / (loss) after finance items	**2,355**	**(2,238)**	**4,593**	**205.23**
Expenses on stopped production activities in subsidiaries	(55)	(60)	(5)	(8.33)
Profit / (loss) before income tax	**2,300**	**(2,298)**	**4,598**	**200.09**
Income tax expense	(133)	(46)	87	189.13
Net profit / (loss) for the period	**2,167**	**(2,344)**	**4,511**	**192.45**
Attributable to :				
The owners of the equity of the parent company	**1,938**	**(2,267)**	**4,205**	**185.49**
Non-controlling interest	**229**	**(77)**	**306**	**397.40**

For the period from 1 January to 31 March 2011, the financial result of Bulgartabac Group is a profit amounting to BGN 2,167 thousand, including – attributable to the owners of the equity of the parent company – BGN 1,938 thousand and of non-controlling interest – BGN 229 thousand.

If compared with the same period of 2010, the financial result has increased by BGN 4,511 thousand (192.45%), including an increase for both the owners of the equity of the parent company by BGN 4,205 thousand (185.49%) and the non-controlling interest by BGN 306 thousand (397.40%).

The gross profit of Bulgartabac Group for the period from 1 January to 31 March 2011 amounted to BGN 18,045 thousand; if compared with the same period of 2010, the increase is by BGN 9,147 thousand (102.80%). The increase in gross profit for the current period, compensated, is due mainly to:

- <u>the increase</u> in **net sales revenue** by BGN 30,069 thousand (58.60%) – mostly affected by the compensated influence of:
  - ***domestic market:*** the decrease in sales of tobacco products (cigarettes) by BGN 11,326 thousand (258.23%); decrease in sales of tobacco by BGN 143 thousand (46.13%); decrease in revenue from services by BGN 80 thousand (89.89%) and increase in revenue from ROY tobacco by BGN 32 thousand;
  - ***foreign market:*** the increase in sales of tobacco products (cigarettes) by BGN 19,734 thousand (44.77%) and decrease in sales of tobacco by BGN 1,067 thousand (47.23%).
- <u>the increase</u> in **cost of goods and services sold** during the period under review is by BGN 21,126 thousand (51.94%). The slower pace of increase (51.94%) compared with the pace of increase in net revenue (58.60%) leads to increasing the gross financial result for the current period.

  The following have also affected the change in gross profit for the period from 1 January to 31 March 2011 vs. the same period of 2010:
- <u>the decrease</u> in **costs of production below normal capacity during the current period compared with the previous one** by BGN 204 thousand (11.75%) %) is affected mainly by the decrease in expenses on salaries and wages by BGN 41 thousand, decrease in depreciation / amortization expenses by BGN 128 thousand, decrease in social security expenses by BGN 15 thousand, decrease in costs of hired services by BGN 5 thousand, and by decrease in costs of protective food by BGN 10 thousand.

The operating profit of Bulgartabac Group for the period from 1 January to 31 March 2011 amounts to BGN 5,401 thousand. The increase in operating financial result for the current period compared with the previous one is by BGN 7,480 thousand (359.79%), which is due, compensated, to:

- <u>the increase</u> in **gross profit;**
- <u>the increase</u> in amount of **other operating profits / (losses), net** by BGN 265 thousand (43.23%) is mainly due to the compensated effect of:

  ● the net decrease in foreign exchange gains (↑ BGN 1,196 thousand) and losses (↑ BGN 381 thousand) related to trade receivables and payables;

  ● the decrease in gain on sales of services by BGN 447 thousand;

  ● the decrease in interest income and liquidated damages under contracts by BGN 55 thousand; and

  ● the decrease in rental income by BGN 46 thousand .
- <u>the increase</u> in **distribution and selling expenses** by BGN 778 thousand (35.32%) is mainly due to the increase in advertising costs by BGN 506 thousand, the increase in costs of commissions by BGN 70 thousand, the increase in costs of salaries and wages by BGN 121 thousand, and the increase in expenses on security by BGN 50 thousand;
- <u>the increase</u> in **administrative expenses** by BGN 129 thousand (1.84%) is mainly due to:

  ● the increase in business trip expenses by BGN 101 thousand (240.48%); and

  ● the increase in expenses on repair and maintenance by 33 thousand (80.49%);
- <u>the increase</u> in **other operating expenses** by BGN 1,025 thousand (43.27%), is mainly due to:

  ● the increase in fixed overheads upon prophylaxis by BGN 666 thousand;

● the increase in costs of social activity by BGN 269 thousand (17.05%);

● the increase in expenses on scrap and shortage of assets by BGN 55 thousand;

● the decrease in expenses on severance pay by BGN 50 thousand (20.24%);

The operating profit after financial items of Bulgartabac Group for the period from 1 January to 31 March 2011 amounts to BGN 2,355 thousand. If compared with the same period of 2010, the increase in the financial result is by BGN 4,593 thousand (205.23%), which is due to the compensated effect of :

- **the increase in the operating financial result for the period from 1 January to 31 March 2011, and**
- the increase **in finance income** by BGN 159 thousand compared with the previous period (27.56 %) is mainly due to the increase in interest income on term deposits by BGN 196 thousand and the decrease in income from liquidated damages on loan contracts by BGN 33 thousand;
- the increase **in finance costs** compared with the previous period by BGN 3,046 thousand (413.86%) is mainly due to the increase in foreign currency losses by BGN 3,508 thousand (100%), the decrease in interest costs on bank loans received by BGN 316 thousand and the decrease in expenses on bank charges on loans and guarantees by BGN 113 thousand;

The profit before income taxes of Bulgartabac Group for the period from 1 January to 31 March 2011 amounts to BGN 2,300 thousand. The increase in financial result vs. that for the same period of 2010 is by BGN 4,598 thousand (200.09%) and is mainly due to:

- **the increase in earned operating profit after financial items for 2011, and**
- the decrease in **costs of discontinued production activities** by BGN 5 thousand (8.33%);

The net profit for the period from 1 January to 31 March 2011 amounts to BGN 2,167 thousand, the increase in net profit vs. that for the same period of 2010 is by BGN 4,511 thousand (192.45%).

II. CONSOLIDATED STATEMENT OF FINANCIAL POSITION

	31.03.2011	31.12.2010	Change	
	BGN '000	BGN '000	BGN '000	%
ASSETS				
Non-current assets				
Property, plant and equipment, incl.	220,470	212,350	8,120	3.82
1. Land	13,690	13,690	-	0.00
2. Buildings	65,018	65,669	(651)	(0.99)
3. Plant	98,157	100,313	(2,156)	(2.15)
4. Equipment	4,971	4,984	(13)	(0.26)
5. Motor vehicles	1,223	1,280	(57)	(4.45)
6. Fixtures & Fittings	1,294	1,372	(78)	(5.69)
7. TFA in progress	34,930	23,825	11,105	46.61
8. Other assets	1,187	1,217	(30)	(2.47)
Intangible assets	207	163	44	26.99
Investments available for sale	320	320	-	0.00
Deferred tax assets	460	460	-	0.00
Other non-current assets	1,144	1,218	(74)	(6.08)
	222,601	**214,511**	**8,090**	**3.77**
Current assets				
Inventories	147,028	132,351	14,677	11.09
Receivables from clients and suppliers, incl.	24,096	25,523	(1,427)	(5.59)
1. Receivables from clients	21,101	22,913	(1,812)	(7.91)
2. Advances to suppliers	2,995	2,610	385	14.75
Other current assets, incl.	5,370	4,003	1,367	34.15
1. Taxes refundable	2,887	3,073	(186)	(6.05)
2. Court and awarded receivables	257	194	63	32.47
3. Other receivables	776	308	468	151.95
4. Prepayments	1,450	428	1,022	238.79
Cash and cash equivalents	151,941	183,595	(31,654)	(17.24)
	328,435	**345,472**	**(17,037)**	**(4.93)**
TOTAL ASSETS	**551,036**	**559,983**	**(8,947)**	**(1.60)**

EQUITY AND LIABILITIES

Capital attributable to the owners of the equity of the parent company				
Share capital	7,367	7,367	-	0.00
Reserves	106,773	106,815	(42)	(0.04)
Retained earnings	215,739	213,759	1,980	0.93
	329,879	**327,941**	**1,938**	**0.59**
Non-controlling interest	**45,529**	**45,301**	**228**	**0.50**
Total equity	**375,408**	**373,242**	**2,166**	**0.58**
LIABILITIES				
Non-current liabilities				
Long-term bank loans	11,717	6,782	4,935	72.77
Deferred tax liabilities	3,531	3,531	-	0.00
Retirement benefit obligations	17,202	16,838	364	2.16
	32,450	**27,151**	**5,299**	**19.52**
Current liabilities				
Payables to suppliers and clients	28,092	38,277	(10,185)	(26.61)
Short-term bank loans	6,487	6,486	1	0.02
Short-term portion of long-term bank loans	5,572	4,054	1,518	37.44
Tax liabilities	91,046	98,402	(7,356)	(7.48)
Payables to personnel	7,662	8,128	(466)	(5.73)
Payables to social security	1,964	1,907	57	2.99
Other current liabilities	2,355	2,336	19	0.81
	143,178	**159,590**	**(16,412)**	**(10.28)**
TOTAL LIABILITIES	**175,628**	**186,741**	**(11,113)**	**(5.95)**
TOTAL EQUITY AND LIABILITIES	**551,036**	**559,983**	**(8,947)**	**(1.60)**

At 31 March 2011, the balance sheet figure of Bulgartabac Group is BGN 551,036 thousand and if compared with the figure as of 31 December 2010 it has decreased by BGN 8,947 thousand (1.60%).

The change in the amounts of Group’s assets is due to the increase in non-current assets by BGN 8,090 thousand (3.77%), as also to the decrease in current assets by BGN 17,037 thousand (4.93%).

The increase in non-current assets is mainly due to the increase of carrying amounts of items of **property, plant and equipment** by BGN 8,120 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 11,849 thousand;
- the decrease due to depreciation accrued for the period from 1 January 2011 to 31 March 2011 – BGN 3,675 thousand and assets derecognised – BGN 54 thousand.

The decrease in **intangible assets** by BGN 44 thousand (26.99%) is due to the compensated effect of:

- the increase due to newly acquired intangible assets – BGN 59 thousand
- the decrease due to depreciation accrued for the period from 01 January 2011 to 31 March 2011 – BGN 15 thousand.

Other non-current assets have decreased by BGN 74 thousand (6.08%).

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

- <u>the decrease in</u> carrying amounts of **receivables of clients and suppliers** – BGN 1,427 thousand (5.59%);
- <u>the decrease</u> in **cash and cash equivalents** by BGN 31,654 thousand (17.24 %);
- <u>the increase in</u> carrying amounts of **inventories** – BGN 14,677 thousand (11.09%);
- <u>the increase</u> in **other current assets** – BGN 1,367 thousand (34.15%).

The changes in equity and liabilities of the Group are due to the changes in the amounts of equity –an increase by BGN 2,166 thousand (0.58%) and to the decrease in liabilities by BGN 11,113 thousand (5.95%). The change in the Group's liabilities is due to both the increase in **non-current liabilities** by BGN 5,299 thousand (19.52%) and the decrease **in current liabilities** by BGN 16,412 thousand (10.28%).

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

- <u>the increase in</u> carrying amounts of: **long-term bank loans** – by BGN 4,935 thousand (72.77%) and **long-term retirement benefit obligations** by BGN 364 thousand (2.16%);

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

- <u>the decrease in</u> carrying amounts of: **payables to suppliers and clients** by BGN 10,185 thousand (26.61%), **tax liabilities** by BGN 7,356 thousand (7.48%); **payables to personnel** by BGN 466 thousand (5.73%).
- <u>the increase in</u> carrying amounts of: **short-term portion of long-term bank loans** by BGN 1,518 thousand (37.44%), **short-term bank loans** by BGN 1 thousand (0.02 %); **social security payables by** BGN 57 thousand (2.99 %); **other current liabilities** by BGN 19 thousand (0.81 %).

The increase in **equity** is due to:

- <u>the higher</u> carrying amount of **equity attributable to the owners of the equity of the parent company** by BGN 1,938 thousand (0.59%) – arising out of the increase in **retained earnings** by BGN 1,980 thousand and the decrease in **reserves** by BGN 42 thousand;

The increase in **retained earnings** is due to the effects of the financial result – ↑ BGN 1,938 thousand, transfer to retained earnings upon withdrawal from use of items of property, plant and equipment – ↑ BGN 42 thousand.

The decrease in **reserves** by BGN 42 thousand is due to the effect of transfer to retained earnings upon disposal of items of property, plant and equipment – ↓ BGN 42 thousand.

- <u>the increased</u> carrying amount of **non-controlling interest** by BGN 228 thousand (0.50%) is primarily a result of the financial result attributable to non-controlling interest– ↑ BGN 229 thousand.

<u>4. Major risks and uncertainties faced by Bulgartabac group companies in 2011</u>

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 operating goals for the 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.

Factors that will have an impact on the group companies' operations throughout the year:

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 in oil prices 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 increase in oil prices;
- 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 company licensed to conduct tobacco processing.

2. By issue 19 of the State Gazette of 08 March 2011 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.

3. 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 as well, 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.

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 in fair value, 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 the Group 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, 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 notify that the interim consolidated financial statements for the year ending 31 March 2011 of Bulgartabac Group have neither been certified nor audited.

Ivan Bilarev
Executive Director
of Bulgartabac-Holding AD