Translation from Bulgarian

INTERIM REPORT

ON THE ACTIVITY OF BULGARTABAC-HOLDING AD
FOR THE THIRD 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 third quarter of 2011 and their impact on the results reported in the financial statements

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

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

On 14 October 2011, the Agency of Privatisation and Post Privatisation Control (APPC), in its capacity of a seller, transferred to BT Invest GmbH, Austria, 5,881,380 shares, or 79.83% of the capital of Bulgartabac-Holding AD. The transfer of shares took place when the buyer had paid the remaining 80% of the purchase price into the account of APPC. This was the last condition preceding the finalisation of the transaction. According to the announcement made by the press centre of APPC, the financial proceeds from the privatisation of Bulgartabac-Holding AD will be deposited into the State Budget where they will be allocated in full to the Silver Fund in pursuance of the law.
The transaction was registered with Central Depository on 14 October 2011.

Herein below we will remember the milestones in the implementation of the 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.

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, para.1 and Art. 28, para. 1 and para. 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 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 specified also the preliminary qualification requirements to 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 were required to submit their bids by the 110 day as of the date of promulgation of the decision in the State Gazette (29 August 2011).
Within the term for purchasing tender documents - 09 June 2011, such have been purchased by ten companies: Djingov, Gouginski, Kyutchukov & Velichkov AD, Kamburov & Partners AD, Kings Tobacco EAD, Plovdiv, British American Tobacco Ltd, London, Japan Tobacco International S.A., Switzerland, CB Family Office Services GmbH, Austria, BT Invest GmbH, Austria, Phillip Morris Bulgaria EOOD, Science Capital Management LLC, USA, and KT&G Corporation, Korea.
Within the term for submission of documents for admission – 04 July 2011, out of all companies which have bought tender documents, three companies submitted documents in compliance with the pre-qualification requirements of the tender - CB Family Office Services GmbH, Austria, BT Invest GmbH, Austria, and British American Tobacco Ltd, London.
On 14 July, the Privatisation and Post-privatisation Control Agency allowed BT Invest GmbH, Austria, to continue its participation in the next stages of the procedure, and with regard to the documents filed by British American (Holdings) Tobacco Ltd, London, and CB Family Office Services GmbH, Austria, the Agency required the applicants, by 19 July, to provide clarifications and additional documents in respect with documents already filed by them in compliance with the pre-qualification requirements.
After reviewing the additional information filed to the compliance documents, the Privatisation and Post-privatisation Control Agency allowed British American (Holdings) Tobacco Ltd, London, and CB Family Office Services GmbH, Austria, to continue their participation in the next stages of the procedure.
By the expiry of the deadline – 25 July 2011, two companies both the information memorandum for the sale of Bulgartabac-Holding AD, Sofia, namely British American (Holdings) Tobacco Ltd, London, and BT Invest GmbH, Austria. The third company, which was allowed to this stage of tender procedure - CB Family Office Services GmbH, Austria, dropped out of further participation.
On 1 August, APPC announced that a formal letter was received from British American (Holdings) Tobacco Ltd, stating that the company took a decision to discontinue its further participation in the tender procedure. The arguments laid down in the letter included "reasons of commercial and strategic nature".
The deadline for making the required deposit and filing a binding offer by the only applicant who had left, and namely BT Invest GmbH, Austria, expired on 29 August 2011, at 3 p.m.

On 29 August 2011, the binding offer was opened by APPC, the main parameters of the offer being as follows:

- Amount of the proposed purchase price – EUR 100 100 000;
- Proposal to buy-out minimum quantities of Bulgarian tobacco for a mandatory term of five years - 5 000 tones in each one of the 5 years;
- Investment proposal for a 2-year term: year 1 – BGN 2 million, and year 2 – BGN 5 million.

On 31 August 2011, APPC designated BT Invest GmbH, Austria, as the participant that has won the tender for the privatisation of 79.83% of the capital of Bulgartabac-Holding AD. The transaction was approved by the Supervisory Board of APPC and on 12 September 2011 the contract between APPC and BT Invest GmbH, Austria, was signed. The contract price is EUR 100 100 000 and is to be paid via a bank transfer into the account of APPC, as follows – 20% on the date of signature of the contract and the remaining 80% - prior to the completion of the transaction. The final transfer of the property right over the shares, subject to sale, will be made upon closing the deal, after the remaining amount of the purchase price is paid and the permission of the Commission on Protection of Competition is obtained.

Obligations of the buyer under the privatisation contract:

• for a term of 10 years to preserve the principal object of activity of the company and not to allow its liquidation and insolvency;

• for a term of 5 years not to reduce its shareholding in the company and its subsidiaries;

• for a term of 5 years not to make structural changes or transformations within the group;

• for a term of 5 years to purchase minimum quantities of Bulgarian tobacco in the amount of 5 000 tones in each one of the 5 years;

• for a term of 3 years to keep the average number of staff of the company and its subsidiaries at the levels of the year 2010;

• for a term of 3 years to maintain the personnel costs of the company and its subsidiaries at the levels of the year 2010;

• for a term of 2 years to make investments of BGN 7 000 000 as proposed in its offer.

On 27 September, the Commission on Protection of Competition approved the concentration via acquisition of direct sole control by BT Invest GmbH, Vienna, Austria, over Bulgartabac-Holding AD, Sofia, and through it, of indirect control over the Holding’s subsidiaries. The Commission enacted the immediate implementation of the decision.

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

In pursuance of a letter of the Minister of Economy, Energy and Tourism of 20 September 2011 regarding setting dates for the extraordinary General Meetings of Shareholders of Bulgartabac-Holding AD and its subsidiaries, in accordance with the agreements reached by the signed contract for privatisation sale of shares in the capital of Bulgartabac-Holding AD, the Board of Directors of Bulgartabac-Holding AD, at its meeting held on 27 September 2011, took a decision to call an extraordinary General Meeting of Shareholders of Bulgartabac-Holding AD to be held on 01 November 2011, as also decisions, in its capacity of a shareholder who holds shares representing at least 5 per cent of the capital for more than three months, to request that extraordinary General Meetings of Shareholders of its subsidiaries, Sofia-BT AD (on 21 November 2011), Blagoevgrad-BT AD (on 23 November 2011), and Pleven-Bulgartabac AD (on 22 November 2011), be called as well, and a decision to hold a meeting of the Board of Directors of Bulgartabac-Holding AD as a sole owner of the capital of Bulgartabac-Trading EAD on 23 November 2011.

The invitations to call the extraordinary GMS were registered with the Trade Register at the Registry Agency as follows:

- of Bulgartabac-Holding AD – on 29 September 2011;
- of Sofia-BT AD – on 07 October 2011;
- of Blagoevgrad-BT AD – on 11 October 2011;

- of Pleven-BT AD – on 10 October 2011.

Dividends

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

Blagoevgrad-BT AD	BGN 31 158 447.1
Sofia-BT AD	BGN 7 001 259.03
Total	BGN 38 159 706.13

Out of dividends approved, the amount of BGN 32,034,897.41 will be paid to the parent company Bulgartabac-Holding AD, and the amount of BGN 6,124,808.72 will be paid to minority shareholders.

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

- The total amount of dividends under items 5, 6 and 16 of the agenda is BGN 52,983,360.41, incl. for the State, represented by the Ministry Economy, Energy and Tourism – BGN 42,297,527.65 and for the minority dividends – BGN 10,685,832.76.
- Gross amount of dividends per share – BGN 7.191769219;
- Net amount of dividends per share /less tax on dividends of 5% for the persons under Art.194, para.1 of Personal Income Taxation Act /PITA/ - BGN 6.832180758.

Pursuant to the Public Offering of Securities Act, the company is bound to secure payment of the dividends voted at the General Meetings within 3 months of the date the General Meeting was held.

The initial date of payment of dividends to the shareholders of Bulgartabac-Holding AD was 24 August 2011.

Dividends to shareholders – individuals and legal entities that are clients of an investment broker will be paid through the investment broker whereat they hold subaccounts, within a three-month period as of 24 August 2011. After the expiry of the above term, the method and procedure for their payment will be additionally specified by us.

Dividends to individuals and legal entities that are not clients of an investment broker will be paid at the counters of all branches and offices of UniCredit Bulbank AD as of 24 August 2011.

The terms and conditions for dividend payment are published on the website of the company at: www.bulgartabac.bg, section „For investors", subsection „Internal information", as well as on the websites of FSC, BSE-Sofia and X3 News.

Regular General Meeting of Shareholders held in June 2011

At the regular General Meeting of Bulgartabac-Holding AD, Sofia, held on 23 June 2011, the following resolutions were passed in accordance with the previously announced agenda:

- The General Meeting approves the report of the registered auditor on the results of the audit of the company's financial statements for 2010.
- The General Meeting approves the report of the registered auditor on the results of the audit of the company's financial statements for 2010.
- The General Meeting approves the audited annual financial statements of the company for 2010.
- The General Meeting approves the proposal of the Board of Directors for distribution of the Company's profit for 2010, as follows:

  - 10% to Reserve Fund in accordance with Art. 246, para. 2, i.1 of the Commercial Act;

  - after deducting the allocations for Reserve Fund, 80% of the profit to be distributed as dividends to the shareholders on the grounds of Art. 26 of a Council of Ministers Decree /CMD/ No. 334 of 29 December 2010 for execution of the State Budget of Republic of Bulgaria for 2011;

- on the grounds of Art. 33, para. 9 of Regulation for the Order for Exercising of the rights of the State in the Commercial Companies with State Participation in the Capital, approved by CMD No 112 of 23 May 2003 /promulgated in State Gazette issue 51 of 03 June 2003/, latest amendment SG issue 72 of 14 September 2010, effective 14 September 2010, tantiemmes to be allocated to the members of the Board of Directors of the company in an amount of one average salary as received during the year;

- the remaining amount of the 2010 profit, after the above distributions, to be transferred to Other Reserves Fund.

- General Meeting of Shareholders takes a decision for distribution of the company's retained earnings among the shareholders of Bulgartabac-Holding AD proportionately to their shares.
- The General Meeting approves the Report of the Board of Directors on the activity of Bulgartabac Group for 2010.
- The General Meeting approves the report of the registered auditor on the results of the audit of the consolidated financial statements for 2010 of Bulgartabac Group.
- The General Meeting approves the audited consolidated annual financial statements of Bulgartabac Group for 2010.
- The General Meeting approves the report of the Investors Relations Director on his activity in 2010.
- The General Meeting approves the transactions carried out under Art. 114, para. 4 of POSA, which are disclosed in detail in the substantiated report, as follows:

- Annex 47 of 01 February 2010 to the Trademark License Agreement No 005-L of 01 January 1995 regarding royalties for sales of tobacco products in the domestic market in the amount of BGN 4 672 797.00, VAT excluded;

- Annex 48 of 14 June 2010 to Trademark License Agreement No 005-L of 01 January 1995 regarding royalties for sales of tobacco products in the domestic market in the amount of BGN 2 302 938.00, VAT excluded;

- Annex 2 of 19 May 2010 to the Contract No 133-Ц of 03 July 2000 on the trade representation remunerations upon sales under intra-Community supplies and supplies to third countries (export) of tobacco products and cut tobacco manufactured by Blagoevgrad-BT AD in the amount of BGN 4 031 102.31, VAT excluded;

- Contract No 347 – DP of 15 November 2010 on the sale of tobaccos owned by Bulgartabac-Holding AD in the amount of BGN 2 230 000.00, VAT excluded;

- Contract No 353 – DP of 15 November 2010 on the sale of tobaccos owned by Bulgartabac-Holding AD in the amount of BGN 470 000.00, VAT excluded."

- The General Meeting is against the approval of decisions under item 12.
- The General Meeting exonerates from responsibility the members of the company's Board of Directors for their activity in 2010, as follows:

- Ivan Atanasov Bilarev
- Alexander Dimitrov Manolev
- Georgi Serafimov Kostov

- The General Meeting appoints the specialized audit firm HLB Bulgaria OOD, Sofia, registered auditor No 017, to audit and certify the separate and consolidated financial statements for 2011 of Bulgartabac-Holding AD.
- The General Meeting determines the remuneration of the members of the Board of Directors who will not be entrusted with the company's governance shall be determined in accordance with the principles, indicators, criteria and amounts stipulated in Art.33 of the Regulation for the Order for Exercising of the rights of the State in the Commercial Companies with State Participation in the Capital, in compliance with the requirements of Art.19, para.7 of the Administration Act, effective 01 January 2009, and Art.7, para.3 of the Civil Servants Act, effective 01 January 2009.

- The General Meeting of Shareholders takes a decision for payment of dividends to the shareholders of Bulgartabac-Holding AD, proportionately to their shares, on account of item “retained earnings”, account 117 “Additional Reserves” of the company, in the amount of BGN 30,193,124 (thirty million one hundred ninety-three thousand one hundred and twenty-four Bulgarian leva).

2. Development of the activity for the period 01 January – 30 September 2011

- **Tobacco buy-up and processing**

During Q’4 of 2010, 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 by 31 March 2011 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		
	Burlay	Kaba Koulak	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**

In July 2011, based on the service contracts concluded, Pleven-BT AD completed the processing of tobacco of Burley, Kaba Koulak and Basma variety groups, crop 2010, owned by Bulgartabac-Holding AD.

The manufactured finished products of crop 2010 were as follows:

Variety group Burley	814 tons
Variety group Kaba Kulak	445 tons
Variety group Basma	2285 tons
Total:	**3 544 tons**

During Q’1 of 2011, Bulgartabac-Holding AD concluded a contract with Pleven-BT AD for the sale of tobacco stems for the amount of BGN 118 thousand, VAT excluded, which impacted the financial result of the Holding for the same quarter.

During Q'3 of the year, Bulgartabac-Holding AD concluded contracts for the sale of Burley strips, crop 2010, with Blagoevgrad-BT AD and Sofia-BT AD for the amount of BGN 1 259 thousand, VAT excluded, and BGN 1 717 thousand, VAT excluded, respectively.

- **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 tobacco sold are cut down to the minimum and no tobacco deliveries are made under deferred payment conditions to markets and firms at risk.

In the first nine months of 2011, tobaccos were sold under contracts concluded in 2009, 2010 and 2011. Lots from crops 2008, 2009 and 2010 were included in the export structure during this period, as also some small remaining quantities from crop 2006. In the first nine months 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 the first nine months of 2011 there was an increase 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 the first nine months of 2011 was 760.6 tons, or BGN 3 749.6 thousand.

The total quantity of tobacco sold by Bulgartabac Group during the first nine months of 2011 was 1,550 tons amounting to BGN 7,477 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 the first nine months of 2011, 6 910 tons of raw tobacco were imported for the amount of USD 37 346 thousand and EUR 1 828 thousand.

It may be concluded that by the end of 2011 Bulgartabac-Holding AD will continue to actively implement and carry out a flexible trade policy on offering and selling Bulgarian tobacco in international markets, as well as its activity on continuous supply of raw tobacco needed for the cigarette production.

The operating results from the sales of tobacco (exports, Intra Community Supplies and domestic sales to unrelated parties) by Bulgartabac-Holding AD at 30 September 2011, accumulated as of the beginning of the year 2011, were as follows:

Sales of own tobacco by Bulgartabac-Holding AD	
30.09.2011	*30.09.2010*
760.6 tons	527 tons
BGN 3,749.6 thousand	BGN 3,279.2 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)	
30.09.2011	*30.09.2010*
BGN 885 thousand	BGN 785 thousand

- **Trade in tobacco products**

Subsidiaries pay fees to Bulgartabac-Holding AD for rights over trademarks (royalties), as well as fees for trade representation for export of cigarettes made by Bulgartabac-Holding AD on their account.

Royalties for Bulgartabac-Holding AD in relation to rights of trademarks	
30.09.2011	*30.09.2010*
BGN 9 782 thousand	BGN 7 438 thousand

Fees for Bulgartabac-Holding AD under contracts for trade representation in export of cigarettes	
30.09.2011	*30.09.2010*
BGN 6 023 thousand	BGN 4 511 thousand

Domestic market of tobacco products

The policy pursued by Bulgartabac-Holding AD during 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.

The Holding reports growth in sales of cigarettes for the first nine months of 2011 on the domestic market compared to the same period of 2010.

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.

In Q'3 of 2011 Bulgartabac-Holding AD commenced the production of Reduced Ignition Propensity cigarettes, or the so called "RIP cigarettes", which comply with Standard EN 16156:2010 for fire safety in accordance with the new regulation adopted within the European Union and the introduction, as of 17 November 2011, of a new standard for tobacco products manufacturing by using special cigarette paper.

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

- *Pricing policy and competition*

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

- *Unregulated trade*

During the first nine 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 the first nine months of 2011 has shrunk by almost 12% compared to the same period of 2010.

- *The financial and economic crisis*

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

Retailers experience some difficulties in ensuring the required working capital due on the one hand to the expensive credit resources and on the other hand to the significant decline in 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.

- *Distribution*

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

During the reporting period, the 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

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

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

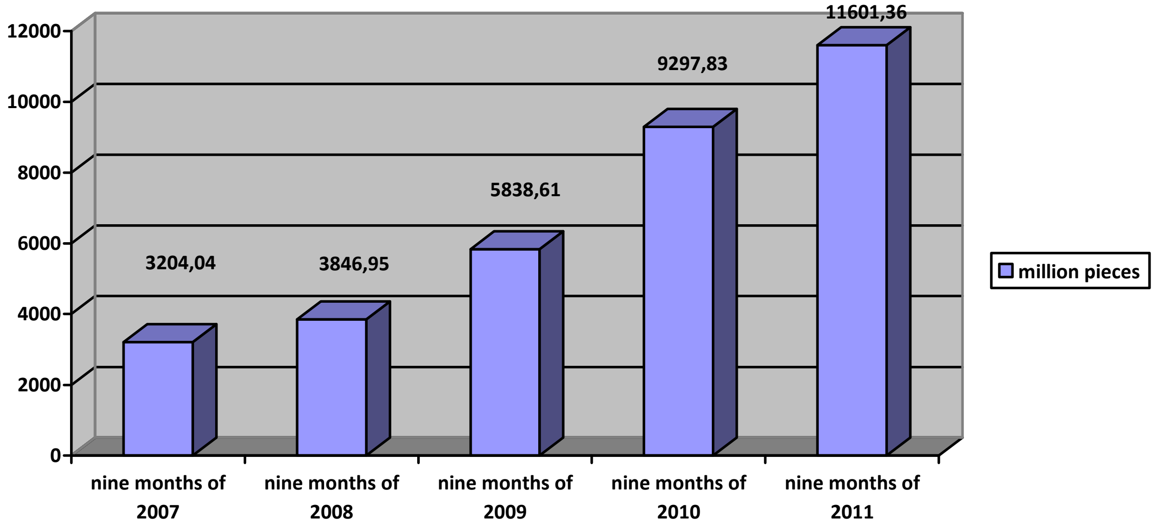
- Setting up of a product portfolio of brands enjoying legal protection within the respective region.

During the reporting period, the export policy of Bulgartabac-Holding AD covered the targeted markets in the following regions: Middle East, Africa, Balkan countries, CIS, Far East, EU, Duty Free Zones.

During first nine months of 2011, the export of Bulgartabac-Holding AD reached **11 601 million pieces**, while for the same period of 2010 it was **9 297 million pieces**. There is a growth of **24.78%** in the natural volumes, or **74.47%** of volumes budgeted in the export programme of the company for 2011.

(Million pieces)

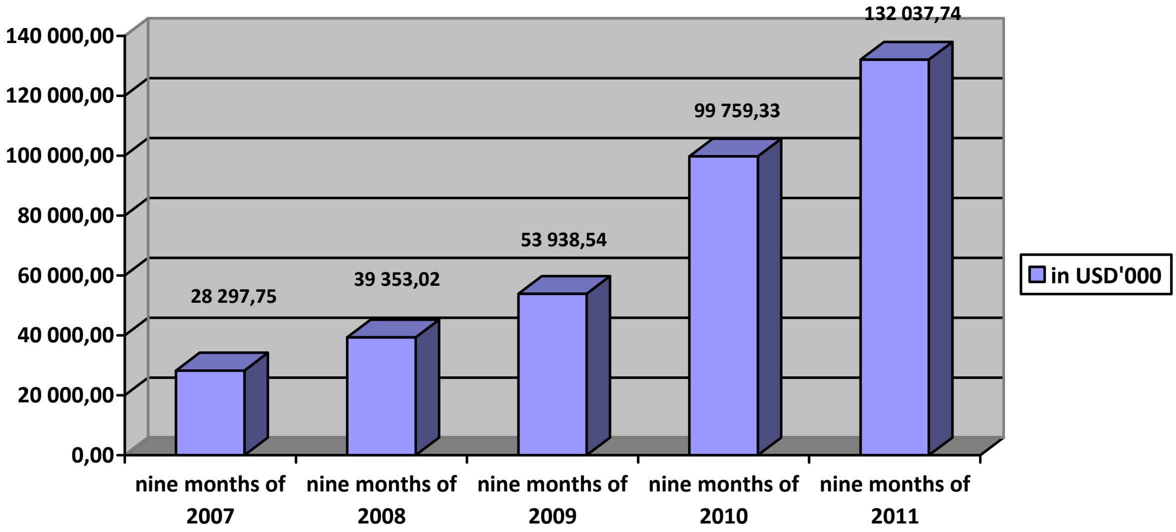
Nine months of 2007	3,204.04
Nine months of 2008	3,846.95
Nine months of 2009	5,838.61
Nine months of 2010	9,297.83
Nine months of 2011	11,601.36



Sales revenue for ***the first nine months*** of 2011 amounted to USD 132 037.74 thousand and EUR 8 698 thousand vs. USD 99 759.33 thousand and EUR 10 200.18 thousand for ***the first nine months*** of 2010.

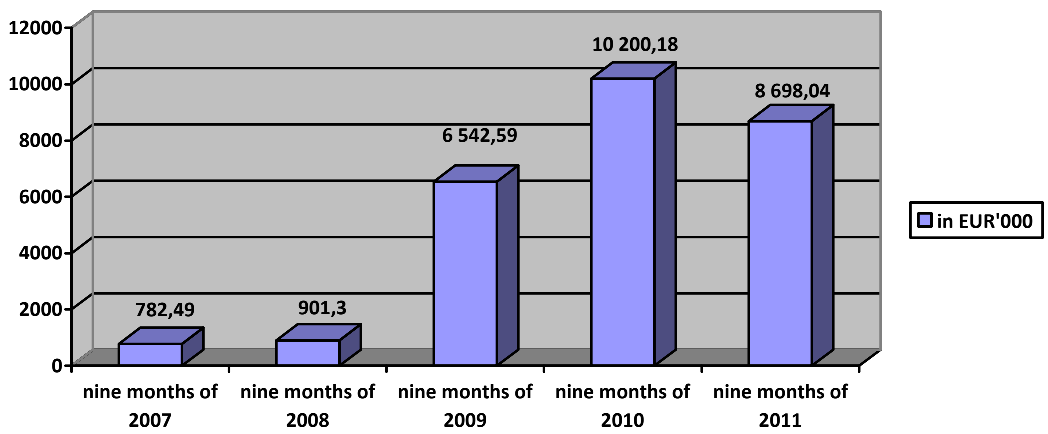
(in USD’000)

nine months of 2007	28 297.75
nine months of 2008	39 353.02
nine months of 2009	53 938.54
nine months of 2010	99 759.33
nine months of 2011	132 037.74



(EUR’000)

nine months of 2007	782.49
nine months of 2008	901.30
nine months of 2009	6 542.59
nine months of 2010	10 200.18
nine months of 2011	8 698.04



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

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

- Contracts were concluded and discussions were held with strategic partners operating well-developed distribution networks in each of the above-mentioned regions;
- The domestic competition of our brands offered in one and same region was successfully neutralised;
- During the period under review, the negotiations were finalised and cigarettes were exported for the first time to Poland, Croatia (duty free shops), Israel, Turkmenistan and Moldova. It is expected the first export to Russian to take place in Q'4 of 2011;
- Negotiations are ongoing for expanding the markets in the Far East region, as also in the region of Africa;
- We have started the development of cigarettes super slims 83 mm for export.

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

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

In the short-term run, the activity of Bulgartabac-Holding AD will be focused on the following activities:

- 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;
- Development of cigarettes super slims 83 mm for export.

The objective analysis of the markets and potential of our brands reveals that it is quite possible to achieve sales volumes in foreign markets of 15 579 240 thousand pieces by the end of 2011, or a growth of 19% compared with the volumes sold in 2010.

- **Auxiliary materials and spare parts**

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

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

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

In view of the drastic raise of PP resin prices – the main raw material for PP foil production and the increase of PP foil world prices, the foil prices are by approx. 3% 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 the first nine months 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 2010 levels.

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

In connection with Directive No 001/95/EC for safety of goods of the European Union and the introduction of Standard EN 16156, as of 17 November 2011 all cigarettes to be sold in the domestic market and in the markets of the EU Member States must be produced using a LIP cigarette paper.

The subsidiaries commenced the production of cigarettes with this quality of paper in the end of September. This trend will continue in the future as well.

Fees to Bulgartabac-Holding AD under contracts for trade representation in Intra Community Acquisitions and Imports of auxiliary materials and spare parts	
30.09.2011	*30.09.2010*
BGN 693 thousand	BGN 486 thousand

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

During Q’3 of 2011 activities aimed at securing cigarette manufacturing with tobaccos and reconstituted tobacco, and technological developments for expansion of cut tobacco, design of cigarettes for export, production tests of self extinguishing cigarettes, as well as actualization of the technological documentation, were carried out:

Provision of tobaccos and reconstituted tobacco for the production.

1. Visual assessment and selection of selected samples of leafs Virginia, crop 2011, origin Africa, were carried out. Taste evaluations and chemical analyses of selected samples of leafs Virginia, origin Zimbabwe, Zambia, Malawi, and Uganda, were carried out as well. A specification of the approved quality groups of tobacco and a schedule for supply of tobaccos by classes and suppliers were drawn up with the aim to cover the needs of cigarettes manufacturing for the years of 2011 and 2012.

2. Expert evaluations and analyses of regular samples of reconstituted tobacco, quality AZ6N of “LTR”, France, were made.

Technological developments

1. Implementation of a technology for expansion of cigarette blends cut tobacco at Sofia-BT AD.

Trial tests for drying and expansion of cigarette blends cut tobacco, continuous production, were conducted at Sofia-BT AD. Expert assessments, taste evaluations, physical and chemical analyses of the blend and of cigarettes manufactured through adding expanded cut tobacco were carried out. The recipes of all current cigarette brands produced at 100% cut tobacco expansion were updated and customised. An assessment of the effectiveness of the process of expansion of tobacco and of the quality characteristics and indicators of cigarette brands manufactured by Sofia-BT AD was made. The main tobacco blends for production of cigarettes of Virginia and American blend were commissioned into regular production for processing through expansion.

2. Dossiers of all the cigarettes brands produced by Sofia-BT AD for clients of Bulgartabac-Holding AD and for export were approved.

3. The program for carrying out production tests of self extinguishing cigarettes manufactured with LIP cigarette paper was completed. A complex quality evaluation was made – chemical indicators and taste evaluation of cigarettes manufactured with LIP cigarette papers supplied by various suppliers. A specification of the approved qualities of LIP cigarette paper was prepared by specific formats, blend types, and cigarette brands. In September, Sofia-BT AD and Blagoevgrad-BT AD commenced the production of self extinguishing cigarettes – brands intended for sale in the domestic market and for export to the markets of the EU Member States. Tests of cigarettes under the ASTM method were carried out with the purpose to assess their compliance with the requirement for extinguishment. The reported results were in line with the normative requirements of the European Standard EN 16156:2010.

Cigarettes

Tobacco blends were developed and production tests were carried out of cigarettes 84 mm and Slims 97 mm for export, manufactured upon requests of Bulgartabac-Holding AD’s clients. Production samples of varieties of cigarettes Slims, 97 mm, hard octagonal box, Virginia blend, and cigarettes 84 mm, hard pack, American blend, to be manufactured by Blagoevgrad-BT AD, were prepared. The developed cigarette blends are of smoking and taste characteristics approved for the export markets; they have been produced in varieties with different levels of smoke and taste indicators, and have been approved by the Holding’s clients.

- **Quality Management System**

In Q’3 of 2011, the process of maintenance and development of the Quality Management System (QMS) of Bulgartabac-Holding AD in accordance with the requirements of ISO 9001:2008 continued. The decisions of management and the implementation of specific recommendations in relation to the system’s development were subject to periodical reviews. The work with the two working groups New assortments – blend and design on implementing new developments pursuant to the requirements of the Standard continued as well.

It was scheduled in the QMS audit plan that AFNOR International Bulgaria would carry out a supervisory audit on 6 October 2011. The preparation commenced by drawing up reports on the fulfilment of quality goals by directorates, departments, and units. Client satisfaction reports were drawn up, as well as reports on the activities with clients. The above reports indicated that there were no claims against the company and it worked well with its clients. The summarized reports and statements on the fulfilment of quality goals reported that the half-year goals were accomplished.

The supervisory audit held on 6 October 2011 by AFNOR International Bulgaria concluded that the Quality Management System of Bulgartabac-Holding AD was applied in compliance with the requirements of the Standards, and there were no inconsistencies. The recommendations made in the course of the certification audit held in 2010 were implemented.

An important task in maintaining the required competence of internal auditors is their periodical training. It has been reported that the updated QMS published in the intranet of Bulgartabac-Holding AD is used.

The well operating Quality Management System of Bulgartabac-Holding AD s an additional quality assurance tool that is provided to our clients.

3. Analysis of the financial status and financial result of Bulgartabac Holding AD as of 30 September 2011

Bulgartabac-Holding AD closed the first nine months of 2011 with a positive financial result of BGN 34,705 thousand. In comparison, the result for the same interim period of 2010 was a loss amounting to BGN 1,862 thousand.

Revenue for the first nine months of the current year amounts to BGN 56,274 thousand, a significant increase compared with the revenue reported for the comparative period of 2010. The above increase is a result of the accrued higher amount of dividends which have been distributed among the shareholders of the two cigarette factories – Blagoevgrad-BT AD and Sofia-BT AD. The positive trend in the Company's business activity and the consistent measures to maintain financial discipline also contributed positively to the results achieved.

A number of factors and events have affected the financial performance of Bulgartabac-Holding AD during the first nine-months of 2011, the major ones being the following:

1. The General Meetings of Shareholders of Sofia-BT AD and Blagoevgrad-BT AD held in June 2011, whereat much higher dividends were approved for distribution compared to dividends distributed in 2010. The higher amounts of dividends were the natural result of the improved financial ratios of both cigarette factories in 2010 compared with the results for 2009, and a consequence of the additional dividends from prior year retained earnings distributed by Blagoevgrad-BT AD:

Company	*Dividends approved for distribution among shareholders (in BGN)*	*incl. for Bulgartabac-Holding AD (in BGN)*
Blagoevgrad-BT AD – the 2010 profit	7 103 890,09	6 055 218,17
Blagoevgrad-BT AD – prior year retained earnings	24 054 557,01	20 503 637,99
Sofia-BT AD – the 2010 profit	7 001 259,03	5 476 041,25
Total:	38 159 706,13	32 034 897,41

2. At the General Meeting of Shareholders of Bulgartabac-Holding AD held on 23 June 2011, it was decided to distribute dividends against the 2010 profit, prior year retained earnings and additional reserves, as follows:

(BGN)

Against the 2010 profit	4 194 224,99
Against the retained earnings	18 596 011,42
Against the additional reserves	30 193 124
Total distributed amount, incl. to the State	52 983 360,41 42 297 527,65

3. The terms for purchasing crop 2009 were changed (delayed) in the previous period, which combined with the higher volumes and prices connected to the tobacco buy-up and processing impacted the structure of financial balances in the reported interim period. Higher costs of materials (used in the process of tobacco processing), buy-up and processing were reported, as also higher stock of finished products.

Analysis of the Statement of Comprehensive Income

The company reports higher revenue (by BGN 34,264 thousand) for the current interim period of 2011, an increase from BGN 22,010 thousand for the nine months of 2010 to BGN 56,274 thousand for the nine months of 2011. The above increase, by components, is due to:

- growth in dividend income from subsidiaries, as described above. In comparison, for the first nine months of 2010 dividends amounting to BGN 1 108 thousand were reported.

- growth in royalties from BGN 7 438 thousand in the first nine months of 2010 to BGN 9 782 thousand in the first nine months of 2011, or by 31.51%. This favourite trend is due to the much higher volumes of tobacco products sold by the two cigarette factories in the domestic market and for export:

million pieces

Tobacco products sold		Nine months of 2011	Nine months of 2010	Change, %
Blagoevgrad-BT AD	Domestic market	1 786	1 386	28,86
	Export	5 809	4 621	25,71
Sofia-BT AD	Domestic market	1 280	801	59,80
	Export	5 793	4 677	23,86

The higher share of products sold for export has led to growth in revenue from trade representation fees on export of cigarettes – from BGN 4 511 thousand at 30 September 2010 to BGN 6 023 thousand at 30 September 2011. The implementation of the production program has been accompanied by an increase in the supplies of tobacco and auxiliary materials for the needs of both cigarette factories. 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 10.31%, as also to the import of auxiliary materials – by 38.00% compared with the levels reported for the comparative period of 2010.

Another factor contributing to the final financial result is the higher amount of **the reported investment income by BGN 214 thousand (or by 17.53%)** compared with the amounts reported for the same period of the previous year. The positive contribution is due to the bigger monetary base (temporary free cash) managed by the Company by applying procedures daily analysis and control with the aim to achieve maximum yield. Interest income on deposits at 30 September 2011 amounted to BGN 1 437 thousand vs. BGN 1 220 thousand at 30 September 2010.

For the generation of the above revenue, the Company has made the following auxiliary expenses, which, as compared with the same nine-month period of 2010, indicate:

- increase in costs of hired services as a whole by BGN 3 694 thousand, or by 44.93% (mainly of advertising costs which report an increase by BGN 1 258 thousand, or a 33.78% growth). The above increase was due to the active intervention policy aimed at maintaining sustainable market positions and loyal consumers of products of Bulgartabac Group under conditions of high competition.

Out of the costs of hired services, there is also an increase in costs of consulting services by 13.60% and in costs of trademark registration by 80.53% compared with the same period of the previous year.

- **increase in costs of materials** – raw tobacco, which has passed through the manipulation processes, by **BGN 3 107 thousand** (**or by 27.25%**) and **increase in costs of tobacco processing** by **BGN 1 364 thousand, or by 61.08%.** Related to the above cost item are also **the higher administrative costs, by BGN 500 thousand, which relate to the buy-up and processing of tobacco, reported in the statement for the nine months of 2010.** The higher costs reported in the period under review were due to the higher tobacco needs of the increased production of the cigarette factories. Naturally, as not all finished products have been sold yet and in view of the above described trend, **there is an increase in stock of finished products by BGN 5 572 thousand;**

- increase in other operating expenses by BGN 255 thousand vs. that as of 30 September 2010 (primarily business trips, training, and donations);

- decrease in other operating income and expenses by BGN 348 thousand vs. that as of 30 September 2010 (primarily rental income, interest income and income from penalties under contracts).

For the nine months of 2011 the Company has reported a decrease in its depreciation / amortization expenses by BGN 541 thousand, or by 35.20%.

Cash flows analysis

Cash of Bulgartabac - Holding AD at 30 September 2011 amounted to BGN 22 058 thousand, or by BGN 10 699 thousand less than cash available in the same interim period of 2010, the main reason being the dividend paid to the shareholders, and in particular, to the Bulgarian State. During the analysed period (the first nine months of 2011) Bulgartabac - Holding AD has paid dividends amounting to BGN 52 883 thousand, while the dividends paid in 2010 amounted to BGN 10 249 thousand.

For the first nine months of 2011 Bulgartabac - Holding AD reported a net decrease in cash and cash equivalents by BGN 27 502 thousand, or only by BGN 2 293 thousand more than the decrease reported in the same interim period of 2010.

During the period under review, the Company reported **positive net cash flows from operating activity** amounting to BGN 24 441 thousand. In comparison, at 30 September 2010 net cash flows from operating activity amounted to BGN 7 197 thousand. The positive value of this indicator at 30 September 2011 was an indication of effectiveness, i.e. cash inflows (proceeds from clients and dividends from the subsidiaries – joint stock companies) exceeded cash outflows of the Company.

For the period 01 January - 30 September 2011, the Company reported **positive net cash flows from investing activity**, primarily due to the interest received on structured deposits of the company's temporary free cash. This indicator was a positive figure for the comparative interim period of 2010 as well.

During the first nine months of 2011, Bulgartabac-Holding AD reported **negative net cash flows from financing activity,** primarily due to the dividends paid.

Analysis of the Statement of Financial Position

The balance sheet figure of Bulgartabac-Holding AD at 30 September 2011 was BGN 80 279 thousand. In comparison, it amounted to BGN 99,459 thousand at 31 December 2010.

During the first nine months of 2011, the equity decreased by 19.48% (or by BGN 18 283 thousand) due to the distributed profits and additional reserves that are equity-supporting items in the Company's equity.

Current assets reported a decline by 25.80% vs. 31 December 2010, which is a compensated result of:

- the higher stock by BGN 12 135 thousand, or by 135.95%, as a result of the higher stock of raw tobacco and finished products, respectively, and

- the decrease in both cash and cash equivalents by BGN 27 651 thousand and receivables from related companies by BGN 4 293 thousand.

Financial ratio analysis

Financial ratios	**Report 30.09.2011**	**Report 31.12.2010**	**Report 30.09.2010**
Price / Earnings (loss) per share (P/E)	5,53	38,98	79,6
Market capitalisation / Sales revenue (P/S)	3,41	5,39	6,66
Price / Accounting value (P/B)	2,54	2,41	1,63
Return on equity (ROE)	45,93%	6,21 %	2,07%
Return on assets (ROA)	43,23%	5,86 %	1,95%
Earnings (loss) before taxes and interest expense – BGN'000 (EBIT)	35 006	6 356	1862
Earnings (loss) before taxes and interest expense / Equity (ROE using EBIT)	46,33%	6,78 %	2,07%
Earnings (loss) before taxes and interest expense / Assets (ROA using EBIT)	43,61%	6,39 %	1,95%
Market capitalisation / Earnings (loss) before taxes and interest expense (P/EBIT)	5,48	35,70	78,74
Debt-Equity ratio	0,06	0,06	0,06
Coefficient of liquidity (COL)	16,52	17,35	17,58
Assets – Turnover	0,70	0,42	0,23

During the first nine months of 2011, Bulgartabac – Holding AD preserved its financial stability and independence. The higher profit, in contrast to that reported for the comparative period of the previous year, has had a positive impact on the improved financial ratios.

The low levels (below 1) of gearing ratio were some of the most important features of the company and of its ability to cover current and non-current liabilities which occur in the course of its normal business activity. The higher values of liquidity ratios support this statement.

The average-weighted price at which the company's shares were traded in the stock exchange at 30 September 2011 was BGN *26.06* per share, while at 30 September 2010 it was BGN *19.90* 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 (2012-2013);
- 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 growers of large leaf tobacco first reacted to the legislative amendments and reduced their production by about 46% for crop 2010 vs. crop 2009. The production of oriental tobacco remained almost the same. With regard to crop 2011, the studies show that there is a significant decrease in tobacco produced of variety groups Basma and Burley, relatively the same quantities produced of variety group Kaba Koulak, and higher quantities of Virginia tobacco in comparison with tobacco produced, crop 2010. The lower volumes of domestic production require the application of flexible buy-up policies with regard to Bulgarian tobaccos, crop 2011, if the volumes planned are to be achieved.

Risks in the area of tobacco trade

In 2011 as well, Bulgartabac-Holding AD will continue 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 information being announced publicly by the company, as also 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.

Bulgartabac-Holding AD was included, effective 21 March 2011 in the database of two stock exchange indices: **BG TOTAL RETURN 30** and **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 during the last 6 months, and free-float.

BG 40 is an index based on the price performance if the issues and comprises 40 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.

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

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

During **the third quarter of 2011** Bulgartabac-Holding AD concluded contracts with Blagoevgrad-BT AD and Sofia-BT AD, as follows:

- Contract dated 30 June 2011 with Blagoevgrad-BT AD for the sale of tobacco of variety group Burley – strips, crop 2010, for the amount of BGN 1 259 thousand (VAT excluded). The contract was completed in July 2011.
- Contract dated 30 June 2011 with Sofia-BT AD for the sale of tobacco of variety group Burley – strips, crop 2010, for the amount of BGN 1 717 thousand (VAT excluded). The contract was completed in August 2011.

On the grounds of Art.100o, para.7 of POSA we hereby inform that the interim financial statements as at 30 September 2011 of Bulgartabac-Holding AD have not been certified and audited.

Ivan Bilarev
Executive Director
Bulgartabac-Holding AD