

Slovak Hygienic Paper Group

The Member of Eco-Invest



**Annual Report
2008**



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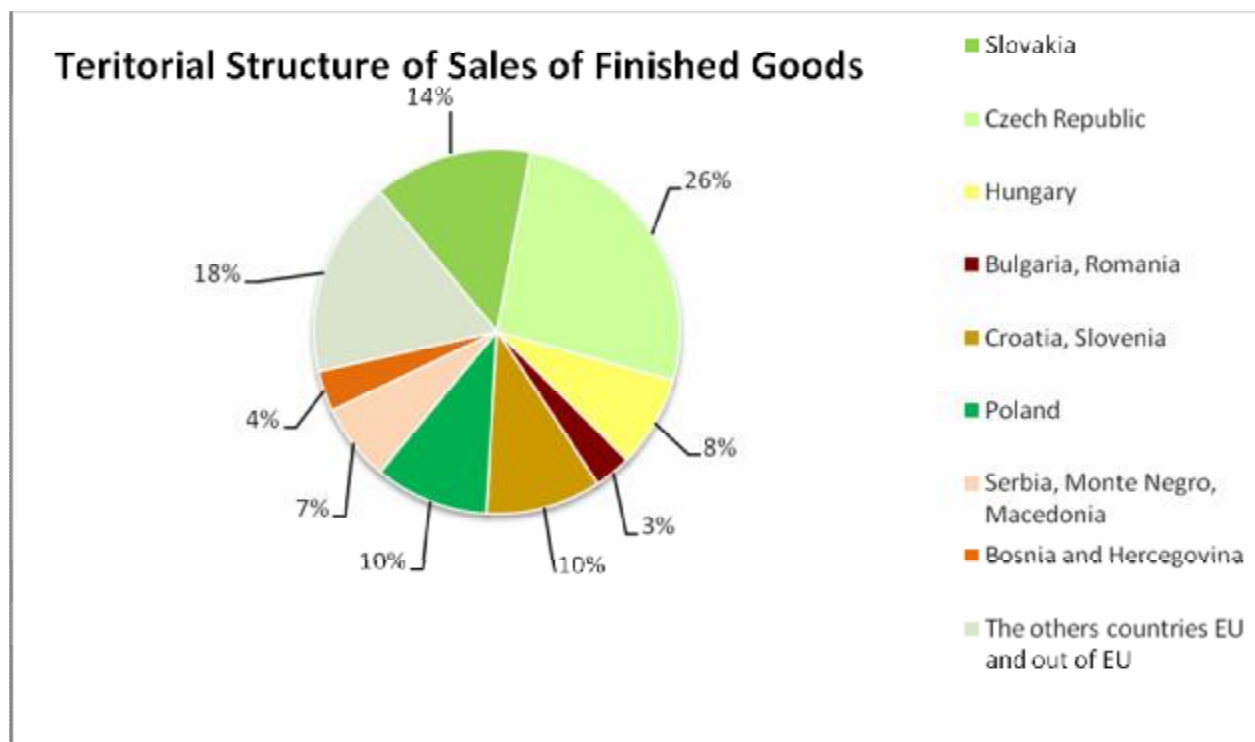
1. Management Report

Dear ladies and gentlemen,

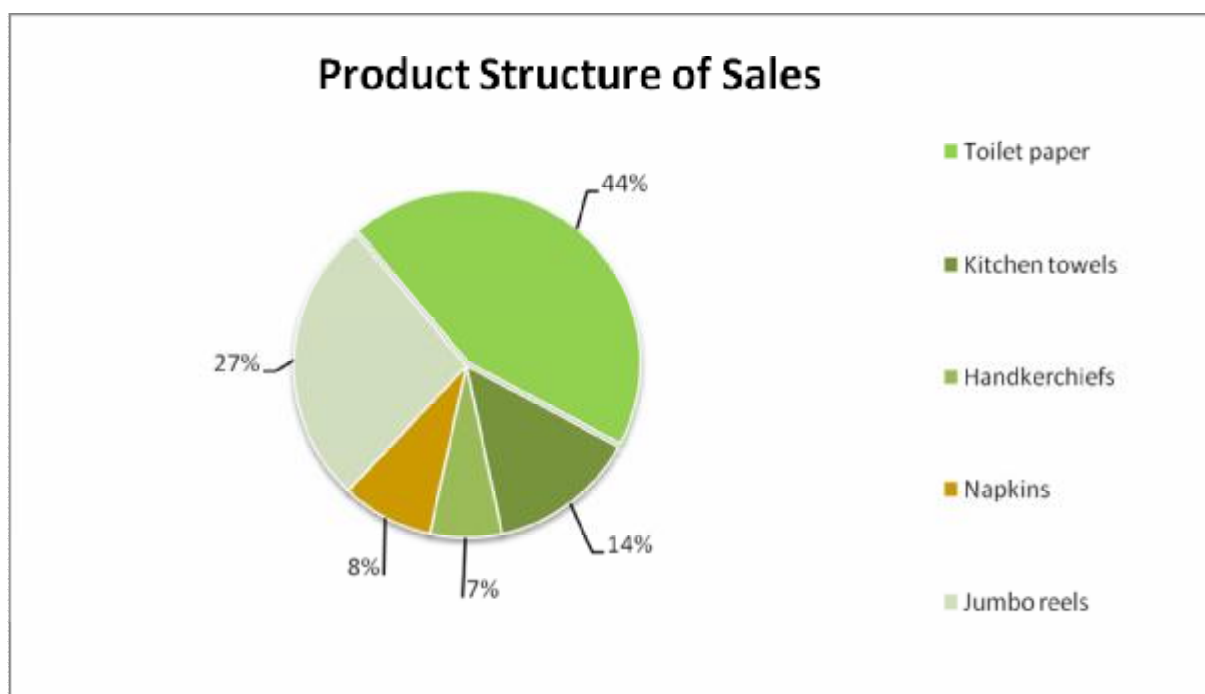
for the group of companies SHP (hereinafter “the Group”), year 2008 was very arduous. The economy of the Group was exposed to turbulent economic development, mainly in the second half-year. The Group recorded positive economic results during the first ten months of the year even despite the extreme growth of input raw materials prices during the first half-year, and persisting strong pressure of retail chains for selling prices. However, the next two months eliminated this positive trend and caused negative income (loss). The economy of the Group was essentially affected by currency exchange rates in surrounding export markets in relation to EURO. In this period, Slovak crown was fixed on EURO that was very close to the official exchange rate. It meant that Slovak crown was extremely strong in relation to weakening Czech crown, Hungary forint, and Polish zloty. In 2008, the overall foreign losses of the Group were 6 091 TEUR. The factors mentioned above predetermined the overall result of the Group in 2008 (EBIT= -1 565 TEUR; EBT= -749 TEUR).

The Group has kept its leader position in the area of production and sale of hygienic paper products in markets of Central and Southeast Europe, namely thanks to marketing campaigns on bringing brand Harmony to customers' notice, support sale of the brand, and strengthen its position on markets of Bosnia and Herzegovina, and Croatia. In Slovak and Czech markets, the Group strengthens its position through customer's loyalty club and direct activities on selling places. We keep the added value of the Harmony Brand through internet portal Harmonystyle, which is aimed at a target group and supports the brand image and partnership with final users. An internet shop named Harmonyshop was put into operation in 2008. It supports sales of printed napkins – a specific segment of product portfolio.

The essential part of sales remained in retail chains (Tesco, Lidl, Kaufland, Makro/Metro, Ahold etc).



The production plants of the Group manufactured 105 221 tons of paper. The Group's sales to third parties amounted 102 406 tons of paper – sales of finished goods represent 73,0 % (in 2007 it was 69,9 %). The Group sold together 74 780 tons of paper hygienic products and 27 626 tons of semi-finished goods (jumbo reels).



At the end of 2008, cash and cash equivalents balance on the account of the Group was 3 203 TEUR. Despite the mentioned difficulties, during all the accounting period of 2008, the Group was financially stable, fulfilling all its financial commitments in time and amounts.

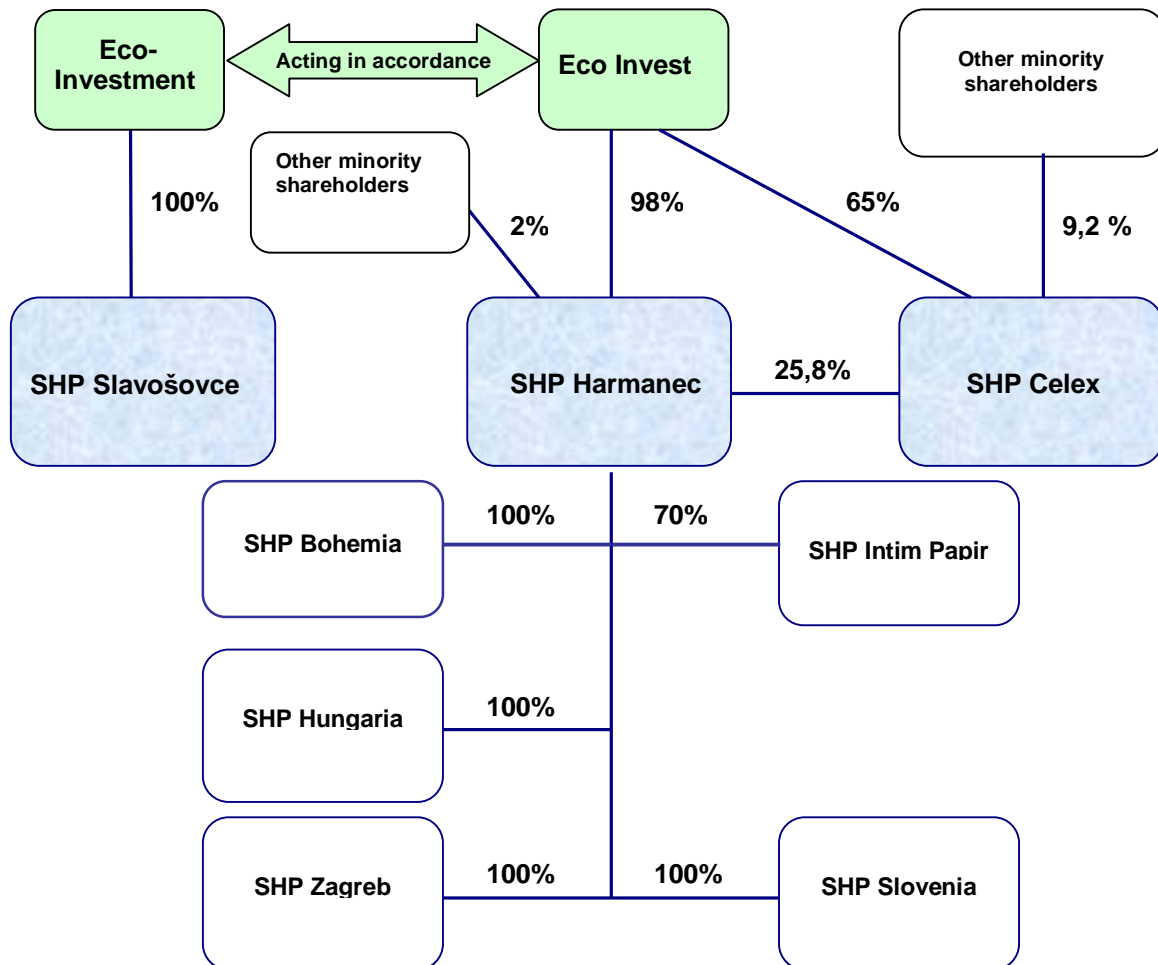
The Group fulfilled – without any problems – all parameters resulting from the Loan Agreement concluded between the Group and the Syndicate of Financing Banks. The trade receivables were healthy and covered with insurance on approx. 94%. The evidence of the strong property structure is also percentage of owner's equity (including shares of minority owners) in total assets – 46,5 %.

In 2008, significant rationalization measures were performed in the Group under guidance of prestigious world-known company Deloitte. The result of the activity is higher effectiveness of processes and working procedures what means less number of workers. On the other side, maintenance for the Group was originally performed by an external company (out-sourcing) and within these rationalization measures, the cooperation with the company was ended and now the maintenance is performed by workers of the Group taken over from the outsourcer. At the end of 2008 the Group employed 1 069 workers.

On basis of realistic assumptions that our selling prices will not be exposed by negative changes as well as realistic estimations of price development of input materials and energy prices, Group management forecasts decidedly more positive economic results in 2009 in comparison with 2008. The expected results could overcome the actual results achieved in 2007 and primarily planned results for 2009.

Dipl. Ing. Daniel Krchňavý
President of SHP Group

Proprietorship Relation Structure in SHP Group



Supply Chain Management

In 2008 the Group concentrated on quick implementation of modern ways of supply chain management (SCM). At the beginning of the year, the Group formed SCM division for application of modern logistic-distribution processes and operations helping effectively adjust costs and better respond to requirements (demands) of our customers. The division focuses on service level improvement, reducing error rate, implementation of modern warehouse management system (WMS). The division in its activities respects so called „lean warehouse concept“ means satisfying requirements of customers´ with as minimal inventory as possible. Within “quick response to demands of customers”, the division developed a method for regular forecasts of demands, a method for quick automatic rebalancing of production, and a specific procedure A specific procedure to prevent „out of stock“ situations when deliveries are not being fulfilled because the required product is not available in warehouse. The division regularly evaluates distribution channels in view of reliability and cost effectiveness. At the same time, the division looks out and implements new optimal ways of distribution.

2. Consolidated Balance Sheets

SHP Harmanec, a. s.

CONSOLIDATED BALANCE SHEETS

as at 31 December 2008 and 31 December 2007 (in SKK '000)

	2008	2007
ASSETS:		
NON-CURRENT ASSETS		
Property, plant and equipment	1 979 494	2 050 586
Intangible fixed assets	5 583	6 010
Investments in securities	264	1 452
Non-current receivables	2 855	-
Total non-current assets	<u>1 988 196</u>	<u>2 058 048</u>
CURRENT ASSETS		
Inventories	648 064	655 863
Receivables	845 662	895 866
Income tax receivables	3 365	1 957
Cash and cash equivalents	96 505	101 703
Total current assets	<u>1 593 596</u>	<u>1 655 389</u>
TOTAL ASSETS	<u>3 581 792</u>	<u>3 713 437</u>
EQUITY AND LIABILITIES:		
EQUITY		
Registered capital	631 456	631 456
Other reserves	192 050	177 739
Translation reserve	(19 795)	(11 464)
Retained earnings	278 482	286 175
Total equity attributable to the shareholders of the Company	<u>1 082 193</u>	<u>1 083 906</u>
Minority interest of other subsidiary owners	583 287	628 787
Total equity	<u>1 665 480</u>	<u>1 712 693</u>
NON-CURRENT LIABILITIES		
Interest-bearing borrowings	445 843	567 488
Deferred tax liability	55 012	48 923
Other non-current liabilities	69 032	79 202
Total non-current liabilities	<u>569 887</u>	<u>695 613</u>
CURRENT LIABILITIES		
Trade and other payables	695 128	714 512
Interest-bearing borrowings	609 746	534 969
Income tax payable	822	1 562
Other current liabilities	40 729	54 088
Total current liabilities	<u>1 346 425</u>	<u>1 305 131</u>
Total liabilities	<u>1 916 312</u>	<u>2 000 744</u>
TOTAL EQUITY AND LIABILITIES	<u>3 581 792</u>	<u>3 713 437</u>

3. Consolidated Statements of Profit and Loss

SHP Harmanec, a. s.

CONSOLIDATED STATEMENTS OF PROFIT AND LOSS

Years ended 31 December 2008 and 31 December 2007 (in SKK '000)

	<i>2008</i>	<i>2007</i>
Sales of own products and merchandise	3 644 709	3 498 126
Other revenues	12 330	13 688
Change in inventory	35 573	30 185
Own work capitalized	16 698	6 761
Consumption of material and energy	(2 443 763)	(2 323 358)
Costs of merchandise sold	(13 185)	(14 863)
Services	(650 562)	(655 812)
Staff costs	(349 051)	(296 204)
Depreciation and amortisation	(187 388)	(169 953)
Other costs – net	(18 225)	(30 550)
Interest income	722	1 220
Interest expense	(57 248)	(50 573)
Other financial income – net	(8 599)	48 564
	<hr/>	<hr/>
INCOME/(LOSS) BEFORE INCOME TAXES	(17 989)	57 231
Income taxes	(4 569)	(10 844)
	<hr/>	<hr/>
NET INCOME/(LOSS)	(22 558)	46 387
Attributable to:		
Minority interest of other owners of subsidiaries	(8 355)	10 716
Shareholders of the Company	(14 203)	35 671

4. Independent Auditor's Report

Deloitte.

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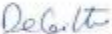
Registered at the Municipal
Court in Bratislava I
Section Sro, File 4444/B
Id. No. 31 343 414
VAT Id. No. SK2020325516

INDEPENDENT AUDITOR'S REPORT ON ANNUAL REPORT

To members of the Board of Directors of SHP Harmanec, akciová spoločnosť

1. We have audited the consolidated financial statements of SHP Harmanec, akciová spoločnosť and its subsidiaries (hereinafter as the "Company") prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union, which comprise the consolidated balance sheet as of 31 December 2008, the consolidated income statement, the consolidated statement of changes in equity and consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.
2. The simplified consolidated financial statements included in the Annual Report were derived from the audited consolidated financial statements. The simplified consolidated financial statements comprise the consolidated balance sheet as of 31 December 2008 and the consolidated income statement for the year then ended. The completeness and correctness of the information included in the annual report is the responsibility of the Company's Board of Directors.
3. In our report dated 27 May 2009, we expressed an opinion that the consolidated financial statements from which the simplified consolidated financial statements included in this Annual Report were derived, present fairly, in all material respects, the financial position of SHP Harmanec a.s. and its subsidiaries, as of 31 December 2008, and their financial performance and cash flows for the year then ended in accordance with IFRS as adopted by European Union, except for the effects of such adjustments, if any, as might have been determined to be necessary, had we been able to satisfy ourselves as to the matter described in paragraph 4.
4. SHP Celex, a.d., a consolidated subsidiary, revalued its property, plant and equipment in 2003 based on an independent appraisal. This revaluation was not performed in accordance with International Financial Reporting Standards as adopted by the European Union. There was no sufficient information that would enable us to quantify the impact of this matter on the valuation of property, plant and equipment related to this subsidiary (as at 31 December 2008, its net book value represented SKK 566 million). We were unable to satisfy ourselves as to the valuation of property, plant and equipment and related depreciation of this subsidiary by other audit procedures.
5. In our opinion, the Company's simplified consolidated financial statements included in the annual report are, in all material respects, consistent with the audited consolidated financial statements referred to above, from which they were derived.
6. For a better understanding of the financial position of the Company as at 31. December 2008, its financial performance and cash flows for the year then ended and the scope of our audit, the simplified consolidated financial statements and other financial information included in this Annual Report should be read in conjunction with our audit report and the consolidated financial statements from which they were derived.

Bratislava 10 July 2009


Deloitte Audit s.r.o.
Licence SKAu No. 014


Ing. Walds Kidan Grant, FCCA
Responsible auditor
Licence SKAu No. 921

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5. Production Companies of SHP Group

SHP Harmanec, a.s., Harmanec, Slovak Republic

PAPER MILL PM 7 : capacity: **45 000 t/year**

Production: toilet paper, handkerchiefs, kitchen towels

Basic data		2004	2005	2006	2007	2008	2008/2007 (%)
Production of paper	t	45 126	44 992	45 042	46 406	45 978	99,08
Production of final products	t	41 089	41 801	43 135	42 484	41 115	96,78
Investments	TEUR	1 037	2 630	1 560	4 485	2 931	65,35
Headcount	persons	504*	472*	453*	441*	439*	99,55

*adjustment in individual years according to common methodology taking into account termination of outsourcing activities

The most significant projects of the year were related to hygienic paper production technology – mainly further modernization of equipments for waste paper stock preparation – further to innovation of final products and actions connected with achievement of conformity with valid legislation.

The works and deliveries within action Deinking, Stage II was in value 1 740 TEUR.

The second stage of “Deinking II” will continue even in 2009 – 2011. Higher use value of products that are manufactured on basis of waste paper and lower costs connected with this production are expected as the final result of the action. It means that it will be possible to respond to market requirements more flexibly in view of brightness of products, even products based on paper-pulp combination.

SHP Slavošovce, a.s., Slavošovce, Slovak Republic

PAPER MILL PM 8: **19 000 t/year**

Production: paper napkins, kitchen towels

Basic data		2003	2004	2005	2006	2007	2008	2008/2007 (%)
Production of paper	t	16 634	17 716	18 253	17 797	19 060	18 842	98,90
Production of final products	t	4 359	4 078	4 818	6 002	12 179	15 960	131,05
Investments	TEUR	719	1 546	2 071	923	3 897	1 334	34,22
Headcount	persons	265	220	194	197	226	226	100,00

The biggest investment in 2008 has been orientated towards improvement in purification of waste water from paper mill PM 8 – to the primary cleaning equipment KROFTA and the equipment for mechanical purification has been added a biological stage. The works connected with the action were carried out in 2008 and thanks to this fact the biological sewerage plant can be put in test operation in December 2008. Total costs were 929 TEUR.

SHP Celex, a.d., Banja Luka, Bosnia and Herzegovina

PAPER MILL PM 2: 40 000 t/year

Production: toilet paper, kitchen towels, handkerchiefs, paper napkins

Basic data		2003	2004	2005	2006	2007	2008	2008/2007 (%)
Production of paper	t	22 388	28 889	31 530	33 438	33 552	35882	115,88
Production of final products	t	4 514	6 985	10 670	10 998	16 029	16 090	100,38
Investments	TEUR	345	559	2857	3 199	927	1 252	135,05
Headcount	persons	405	412	390	378	387	372	96,12

Year 2008 is connected with several important investment actions. The actions are beneficial in view of the future stable development of the company. Most significant actions were:

- § Transformer station 110/20/6,3 kV (560 TEUR).
- § Pulp stock preparation reconstruction. The objective of this action was to achieve required beating degree, higher capacity, and savings (256 TEUR).
- § Original analogue system in BBC equipment has been replaced by digital one – Stage II (143 TEUR).
- § Automatic press machine and electronic system for registration of wastes (74 TEUR).
- § Reconstruction of the crane of paper mill PM 2 (106 TEUR).

SHP Intim Papir, d.o.o., Pazin, Croatia

Production: folded towels, folded toilet paper, paper napkins, industrial rolls, toilet paper and rolled towels

Basic data		2005	2006	2007	2008	2008/2007 (%)
Production of final products	t	421	447	894	1178	131,77
Investments	T EUR	43	36	80	63	78,75
Headcount	persons	8	8	19	19	100,00

Investment actions have been orientated towards achievement of higher production capacity and sales, higher flexibility and better paper exploitation.

In 2008 the essential part of means has been used on machinery modernization in the way of purchase of parts and used machine assemblies: unwinding machine for industrial reels, wrapping machine for napkins, a line for production of napkins (47 TEUR).

6. Environment

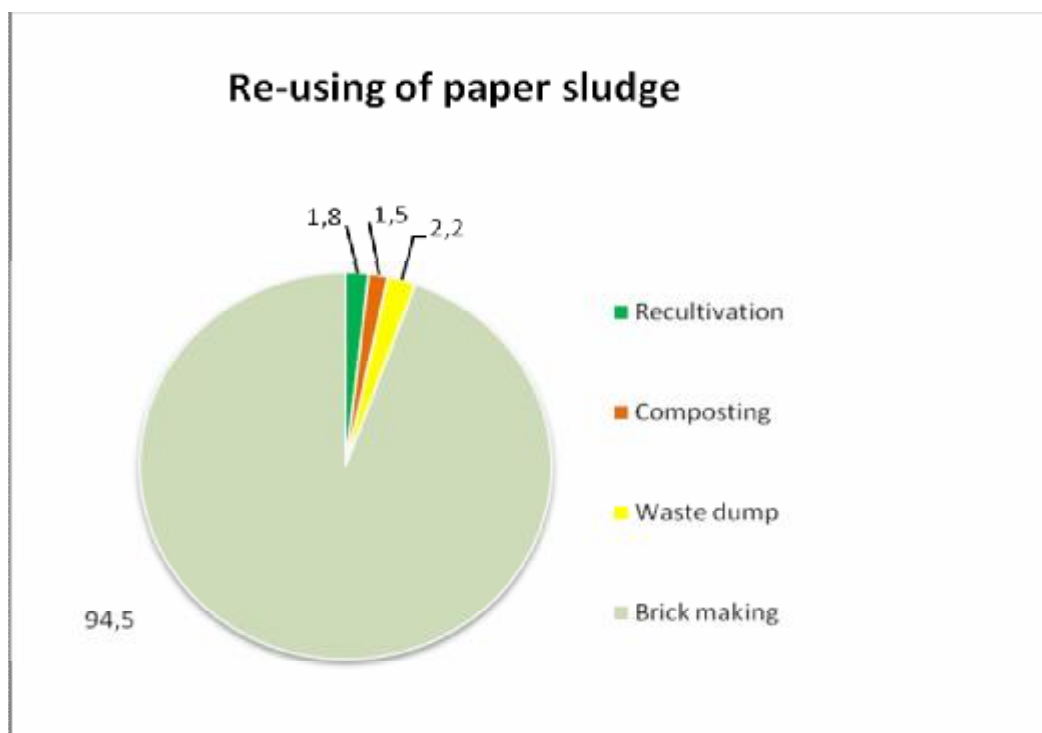
In 2008 it was recorded that Group policy in the area of environment - implemented all members of the Group - began to have positive influence on environment. The result of environmental behaviour of single members of the Group is the fact that the amount of generated waste matters has gradually decreasing tendency, and percentage of exploitation of own waste matters is still higher. The amount of technological waste - so called paper-making sludge - was less. The sledge was used in brick-making industry and at composting - 97,8 % of all generated sludge has been treated in this way.

The most environmental benefit is that SHP Harmanec has put into 2-year test operation a new biological water cleaning plant. It means radical decrease of water pollution (almost by 85 %) of Bystrička stream. The modern water purification technology on basis of anaerobic and aerobic processes connected with biogas production is gradually becoming a stable element with possibility to use biogas within own energy production.

Consumption of fresh water per a ton of raw paper was decreased by intensification of processes in the circle of technological water being used in paper-making process.

In 2008 the water cleaning plant of SHP Slavošovce has been reconstructed including its biological stage. The objective of this action was reduction of contaminants on values required by legislation.

SHP Celex has minimized creation of waste matters and costs connected with manipulation and liquidation of waste in the way of suitable separation and press compaction of municipal waste.



The brand Harmony is ecological

Three production plants of SHP Group process 50 thousand tons of waste paper a year what means saving of 100 up to 150 thousand of wood mass. Since 1972 when Group began to produce paper hygiene even from waste paper, it has been saved wood mass equal to 185 km² of mature forest – this area represents about ¼ of the Low Tatras National Park. Using products made from recycled paper, we all can save trees and help maintain environmental balance on our planet.

There are those, who think about nature and we do too.



7. SHP Group Management

SHP Group Management

Daniel Krchňavý (President of SHP Group)

Jozef Horák

Anna Mončeková

Oldrich Lauko

Rastislav Petřík

Milan Hadač

Predrag Zgonjanin

SHP Harmanec, a.s.

Board of Directors:

Daniel Krchňavý (Chairman), Jozef Horák, Anna Mončeková

Supervisory Board:

Milan Fiľo (Chairman), Miroslav Vajs, Peter Švec

SHP Slavošovce, a.s.

Board of Directors:

Daniel Krchňavý (Chairman), Jozef Horák, Milan Hadač,

Supervisory Board:

Milan Fiľo (Chairman), Miroslav Vajs, Janka Genderová

SHP Celex, a.d.

Board of Directors:

Daniel Krchňavý (Chairman), Jozef Horák, Oldrich Lauko

Supervisory Board:

Milan Fiľo (Chairman), Dragan Matič, Miljenko Brajković

8. Contacts

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