

# Pet industry - short-term profitability pressures, long-term potential

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**Bloomberg Adria**

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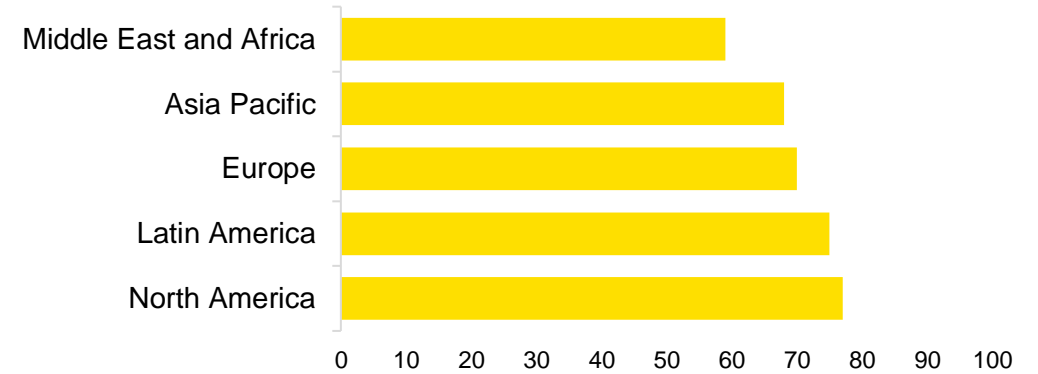


# Industry highlights

Pet industry was growing steadily in the recent decade, while ongoing demography and lifestyle changes support the expectations of the further growth of the industry. Covid-19 pandemic and working from home has especially fuelled the industry growth. Social distancing and excess time led to the rise in demand for pets as companions while more time spend with them resulted in pet humanization. Majority part of pet owners nowadays consider their pets as family members, which is popularly called “pet parenting”. **Treating pets similarly to children has direct effect on level of spending** – besides foods and other non-discretionary categories, household spending is moving more towards other product segments, especially pet health care. The trend towards pet care is especially evident with demographic changes and growing share of younger population of pet owners which are willing to spend more on higher quality and recreation products to maintain well-being of their pets. **In the analysis we also highlight our view that the industry will continue to grow, albeit with the near term headwinds from persistently high inflation hitting on discretionary spending by households.**

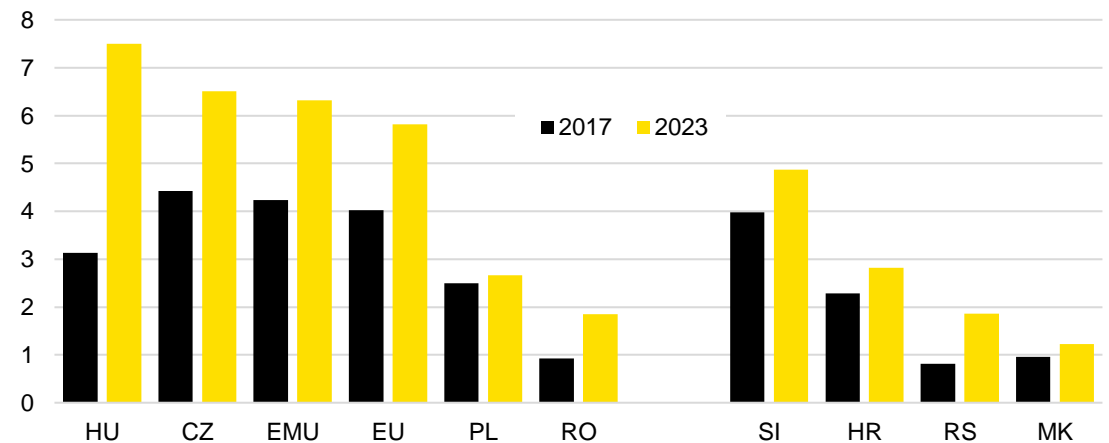
**Spending on pets is strongly correlated with the overall wealth level – the higher personal incomes, the more money people spend on pets.** The Eurostat data present that in CESEE the biggest share of households’ expenditure on pet products is obtained in Hungary (7.5% in 2023), with **households in Adria countries spending between 1.2-4.9% on pet products.** Also, spending on pet products in Adria countries is below both the EU and Euro area averages, not only in terms of level but the momentum as well – the rise in households’ expenditure on pet products in Adria countries has since 2017 underperformed the increases in both the EU and EM, but CEE peers as well. The reasons behind we find in Adria countries seeing comparatively weaker increase in personal incomes compared to CEE peers. Also, there is a higher number of pets per inhabitant in CEE peers, which we link to social cultural specifics. As for countries such as Serbia, North Macedonia and Bosnia and Herzegovina, we think that lower personal incomes and the need to account higher share of household spending pool onto non-discretionary goods stands largely behind the weakest numbers in broader international comparisons.

**Exhibit 1. Pet owners perceiving their pets as family members 2022**  
as % of total number of pet owners



Source: Euromonitor International's Voice of the Consumer: Lifestyle Survey

**Exhibit 2. Household spending on products for pets**  
as % of total expenditure

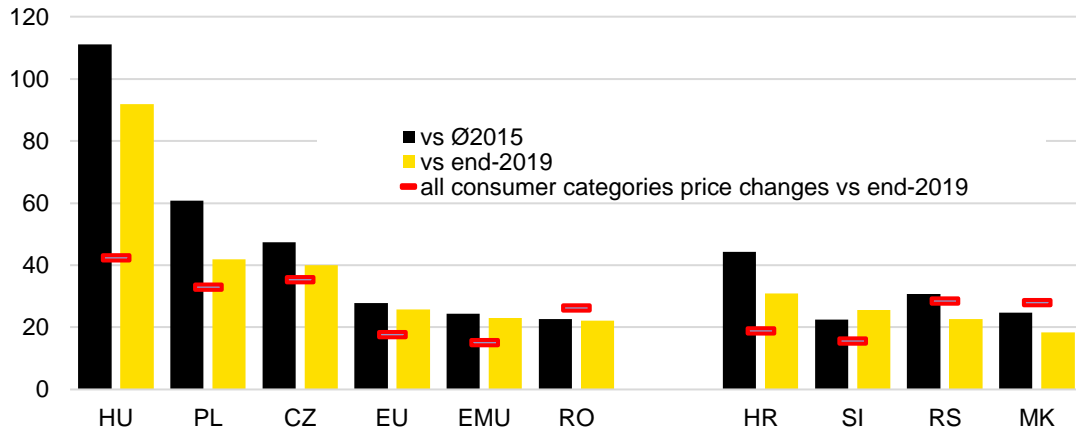


Source: Eurostat, Bloomberg Adria analytics



**Consumer prices of pet products have increased materially since mid-2010s**, with Croatia posting the biggest rise (+44%) in the named period among Adria countries. Price changes were dominantly driven by increased input costs, with the **most of price increases taking place in the recent couple of years**. **Serbia and North Macedonia** have seen the **increase in pet product prices underperforming that of the overall consumer prices**, which we see directly affected by less spending on pet products in those countries i.e. retailers' thus having less room to transfer increased input costs on the end-prices, while higher share of costlier food spending also played a role in the overall consumer price changes.

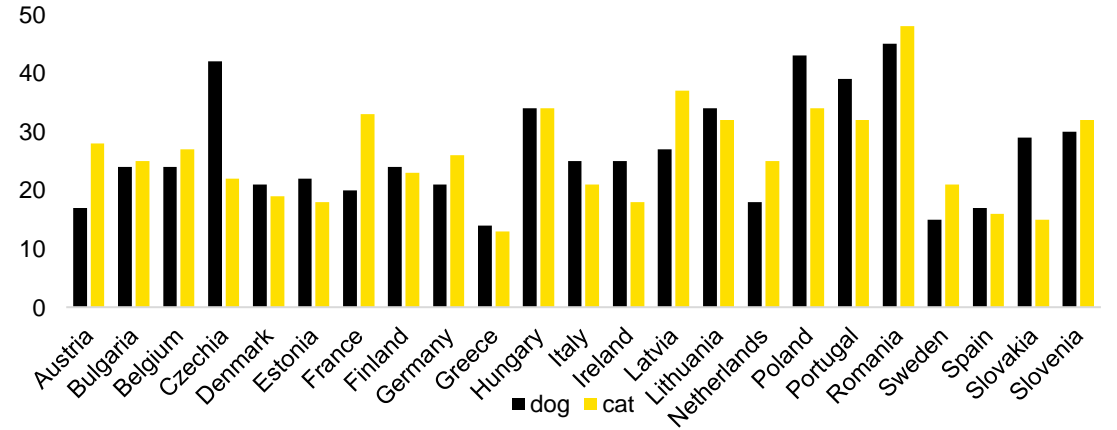
**Exhibit 3. PRODUCTS FOR PETS – CONSUMER PRICE CHANGES** compared with overall consumer price inflation since pre-pandemic period



Source: Eurostat, Bloomberg Adria analytics

Looking globally, North America is the largest pet industry market with a global revenue share of over 40%, while Europe is the second largest with the share of 30%. This is because of high percentage of pet ownership and good development of pet food industry in these regions. In 2021, Europe was the largest pet food producing region. **Almost 50% of households in Europe owns at least one pet while in US nearly 70%.**

**Exhibit 4. Share of households owning at least one pet in 2021 in Europe** as % of total households



Source: Euromonitor International's Voice of the Consumer: Lifestyle Survey





## Industry highlights

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**Within the overall pet industry, the key category is pet food, which is characterized by high concentration of multinational brands:** Pedigree, Whiskas and Royal Canin are produced by Mars Pet Care, Purina produced by Nestle or Hills produced by Colgate Palmolive/ Hills Pet Nutrition. Multinationals are responsible for product innovations in the market due to high budgets intended for research and development. They are often in acquisitions to expand market reach or to enter the distribution business. Despite high concentration, entry barriers are moderate and **newcomers must differentiate the offer to be able to compete for market share.**

In Adria region, **production sector is rather weak** and mainly comprised of relatively small **private-owned companies with a low volume of production and sales.** The **single outlier is Farmina Pet Foods Serbia**, part of Italian Farmina Group, which in 2021 was **amongst 10 leading European producers by the sales volume.** Producers emerging in Adria region are mainly focused on premium segment products. This strategy could assure easier positioning, as competing in lower price segment could prove too ambitious against large-scale competitors. Customers indeed prefer less unknown brands, however building of brand is demanding and time consuming process. Besides food, industry includes pet care (oral care, veterinary care, dietary supplements), pet grooming, supplies and animal sales.

Specialized pet shops are the key sales channel because of the importance they have for the end customers. Dedicated product lines, knowledge about pets and advice and assistance services offered during the process of the purchase are the key reasons why customers give the priority to this channel. Stores are usually of big format, with a wide sales assortment. **Trends are going towards inclusion of veterinary and grooming services within one store.** In the Adria region we see more formats with veterinary service, but grooming is still not part of the offer. We see the latter as a market potential given that these services attract more customers and make them attached to the company. This is especially important in the era of digital activities, when

online sales is becoming more favoured not only by younger customers (as a dominantly growing target group) since grooming services still require to go to the store.

Competition from the supermarkets is becoming more pronounced. With daily supplies of own needs in supermarkets, customers can procure goods for their pets as well. But **the real treat we see in online private channels such as Amazon or Walmart globally, e-Kupi, Mimovrste or Ananas locally.** Pure online players have better coverage of the market and faster delivery while retailers are hardly to have the same economy of transportation costs. Data show that half of e-commerce sales occurs on the marketplaces, while the sales through digital channels is rising steadily. It is more interesting that Amazon introduced own private label pet brand and it will certainly mean further pressure on the middleman margins. Obviously, Amazon sees potential to grow in this market and it will be on account of legacy players.



# Peer comparison

Our peer analysis includes representatives from the biggest part of pet economy - from numerous retailers present in the market to rare pure distribution business and production companies. We chose retailers with the biggest number of stores and largest market share as the best representatives of market trends. In the distribution segment, level of sales was the key criteria, however pet product retailers are still buying many of their selling products directly from abroad (either via foreign middleman or directly from producer), meaning that the distribution business in the region is not as concentrated into big companies as for other product categories. In the short list of existing production companies, we choose those few with the highest sales but given the fact that even then the sub-segment is dominated by Farmina Pet Foods Serbia, our focus is on retail companies.

Sales growth of distribution companies in high teen figures for the past three years is a real evidence of the industry development and its resilience to market turbulences. Covid pandemic even strengthened the industry – social distancing measures affected the increase of the number of pet owners, which consequently reflected on the growth of the volumes in industry.

Looking at the peer sample, pet business appears to be lucrative with all parties recording solid profitability margins and high returns on invested capital. Unsurprisingly, producers from the region have stronger margins than retail companies as i) they are focused on premium food segments which have higher margins, ii) demand on the market was continually growing, especially towards this business segment iii) there is weak competition on the local production market and iv) regional producers benefit from near and quality raw material base (such as cereals) providing lower production costs.

Company name - retail & distribution	Sales EUR in millions			Sales growth %			EBITDA margin %			EBIT margin %			ROIC %			Net debt/EBITDA			CCC in days		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Pet Network (RS) R	10.6	14.3	15.5	19.9	34.8	8.4	14.6	20.2	20.4	13.7	18.8	19.0	40.9	46.3	51.4	(0.8)	(1.3)	(0.3)	53	56	59
Vet.apoteka PlusPlus (RS) R&D	11.9	13.5	15.6	13.7	13.0	15.8	10.0	12.7	11.3	8.4	11.2	9.4	21.4	24.0	17.3	0.8	1.0	1.3	95	93	107
M&J Trade (RS) D	4.3	5.2	7.1	17.2	21.3	37.0	8.7	11.3	18.0	6.5	9.4	16.4	7.4	11.5	23.0	1.7	0.4	0.6	205	203	180
Zoo Centar (BH) R	1.3	1.4	1.8	25.1	12.3	22.1	9.7	9.7	12.8	8.8	8.3	11.1	20.3	19.0	27.6	1.8	1.4	0.7	88	85	71
Royal Pet Co (BH) R	1.1	1.5	2.0	19.9	31.5	31.6	13.5	18.2	23.0	11.9	16.3	21.2	23.4	31.6	43.2	1.7	1.5	0.8	203	139	107
Pet Network (SI) R	19.8	22.9	28.6	28.2	16.0	24.7	21.0	23.9	18.5	14.9	17.6	12.9	35.7	31.5	27.1	1.4	1.1	0.9	32	32	38
DJ Plus (SI) R	5.8	6.3	6.9	19.6	8.0	10.0	8.1	10.2	9.2	6.3	8.6	7.7	33.2	38.7	29.5	0.9	0.3	0.4	18	34	58
DDL Zagreb (HR) D	5.8	6.6	7.7	21.7	14.5	15.6	3.3	8.8	10.2	2.1	8.0	9.6	4.0	17.6	25.9	(0.9)	(0.7)	(0.1)	126	116	114
Unconditional (HR) R&D	15.3	17.5	21.6	36.7	14.4	23.7	6.0	6.3	4.9	4.4	4.8	3.5	35.2	35.9	24.1	2.2	1.9	2.1	39	37	32
Pet Network (HR)* R	20.3	24.1	26.5	11.8	18.4	10.1	11.2	11.6	(52.5)	10.9	(18.4)	(80.3)	8.1	(9.1)	(35.7)	8.0	9.7	0.1	46	51	59
<b>Average</b>	<b>9.6</b>	<b>11.3</b>	<b>13.3</b>	<b>21.4</b>	<b>17.8</b>	<b>17.6</b>	<b>10.6</b>	<b>13.3</b>	<b>7.6</b>	<b>8.8</b>	<b>8.5</b>	<b>3.0</b>	<b>23.0</b>	<b>24.7</b>	<b>23.3</b>	<b>1.7</b>	<b>1.5</b>	<b>0.7</b>	<b>90.4</b>	<b>84.5</b>	<b>82.6</b>
<b>Median</b>	<b>8.2</b>	<b>10.0</b>	<b>11.6</b>	<b>19.9</b>	<b>15.3</b>	<b>18.9</b>	<b>9.9</b>	<b>11.4</b>	<b>12.1</b>	<b>8.6</b>	<b>9.0</b>	<b>10.4</b>	<b>22.4</b>	<b>27.7</b>	<b>26.5</b>	<b>1.6</b>	<b>1.0</b>	<b>0.6</b>	<b>70.4</b>	<b>70.0</b>	<b>65.0</b>

R - retail; D - distribution; R&D - retail and distribution; \*from 2002 to 2019 activities were organized by Pet Centar doo when the company was closed /merged to Trg Pluto 2. Newly established company took over activities. Therefore, financial data for 2019 refer to Pet Centar doo and for 2020 and 2021 to Trg Pluto 2, later renamed to Pet Network International doo.

Company name - producers	Sales EUR in millions			Sales growth %			EBITDA margin %			EBIT margin %			ROIC %			Net debt/EBITDA			CCC in days		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Farmina Pet Foods (RS)	67.7	87.4	121.5	34.1	29.1	39.0	32.6	36.7	35.6	29.7	34.4	34.0	39.4	48.1	49.9	0.0	(0.4)	(0.5)	85	89	85
Premil (RS)	7.8	9.4	10.8	10.8	20.8	14.5	27.3	28.6	19.2	25.1	26.6	17.4	18.7	19.9	12.8	0.1	(0.3)	(0.4)	131	136	137
Prodex IRL (SI)	2.1	1.8	2.4	7.0	(15.9)	33.9	7.7	8.1	29.3	4.0	3.7	26.1	44.7	39.5	129.8	0.0	(0.3)	(0.1)	(257)	(323)	(172)

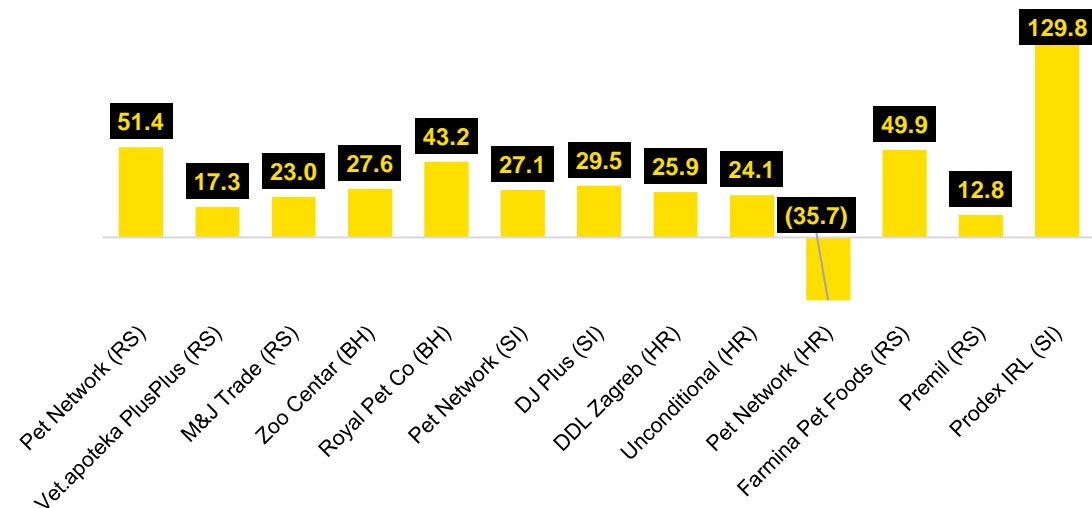


# Peer comparison

**Retailers, generally focused on sales volumes and somewhat lower margins, and faced with high competition, managed to achieve high returns** thanks to good profitability and generally lower capital base required in the business. Strong household spending fundamentals fuelled strong financials at retailers in the recent years. This also explains why **pet product retailers deliver approx. 2x higher EBIT margins than wide-range grocery retailers**. The biggest share in the operating costs have costs of goods accounting for 60-70% in average, followed by 15% share of employees' expenses.

For the most of sales companies, there is a gap between inventory + receivables' days ratio and suppliers' days ratio, on average 80 to 90 days. It seems that fast settlement of liabilities towards suppliers is the model retailers prefer, most probably due to better discounts and the potential for generating higher profitability. Although this would suggest more need for working capital, **indebtedness remains low with favourable average net debt/EBITDA ratio at 0.4x in 2021**.

**Exhibit 5. Return on invested capital – 2021 (in %)**



Source: company financial statements, Bloomberg Adria analytics

Croatia-based Pet Network group has the highest market share in the retail business, with operations developed in 5 SEE countries: Croatia, Slovenia, Serbia, Romania, and Bulgaria. Consolidated sales of the Group in 2020 amounted to EUR 122mIn and net profit margin 7% (no available data for 2021). Omnichannel business model follows the trends seen in more developed European markets. Today, retail network is hard to imagine without veterinary in store, being the key tool for stronger relationship with customer and higher customer retention. All stores in the Group are offering veterinary services. They are organized in a big format, able to provide wide assortment of goods. Customers are offered with private label products, which for any retailer is a leverage for higher profitability but also important driver for sales growth, due to lower price of private label goods. Customers can join the pet club getting more favourable purchases. Slightly lower sales growth was recorded by Pet Network Serbia amid growing competition in the market. Still, the company is more profitable than other 2 members of the group and generates the highest returns to the owners. Negative profitability of mother company from Croatia is not an operating issue but rather a result of high one-off expenses from the due diligence process and ownership changes in 2021. Appetite for further expansion of the business is confirmed by the new announcement of the two acquisitions, Croatian speciality chain Zvjerinjak and leading pet store chain in Bulgaria Zoo Group Stefanov.

Acquisition and development aspirations we saw also with Veterinarska apoteka Plus Plus, which in 2018 acquired 80% stake in Slovenian company DJ Plus. Starting as exclusive distributor of Farmina Pet Foods, Plus Plus doo expanded activities to wholesale of other pet brands, e-commerce and today operates through the network of 29 retail stores in Serbia and 11 in Slovenia under the brand Premium Pet. Veterinary is the part of the service in store. Expansion of retail business started in 2021 so the effect on sales and margins is yet to be seen in financials for 2022.



# Peer comparison

Another similar example is Unconditional, the leading distributor of pet foods and veterinary pharmaceuticals in Croatia market. They expanded their business case towards retail and now today they operate as the widest retail network in Croatia (31 pet shops). Further expansion was recently announced by opening of 20 new stores. Ambitious development plan is a result of new cooperation with the leading German pet retail chain Fressnupf, which entered the Unconditional's ownership structure in the share of 30%. Fressnupf is present in 11 countries in Europe and generates sales of EUR 4bln. Building a such large retail network has taken its toll on profitability - costs of equipping of new stores, training and hiring of new staff we see as the key reason for low profitability margins. Negative ROE is the reason of accumulated losses from previous period, while in 2020 they were covered by generated profit.

## Global peers

Global peers were chosen from the world-wide retail market. The idea was also to include companies which cover big retail markets – as such in the peer group we have Pet Valu from Canada, then Pet Center Comercio from Brazil. We did not include the biggest global producers such as Nestle, Mars and similar since their financials are not comparable due to he overall product mix influences.

Average sales increase of almost 13% during past three years and similar level of profitability to Adria region peers testifies the expansion course and favourable position of pet industry across the globe. With a sample of companies from Finland, UK, Canada, US, Brazil we come to conclusion that market conditions and business models are pretty the same. Faced with stronger competition than companies in Adria region, they still managed to achieve sales increase and good profitability.

However, **returns are somehow lower than in Adria region, mostly because of higher amount of capital engaged for doing business.** Borrowings are more used than by regional peers, but indebtedness ratios are within favourable values confirming low credit risk profile.

Pets at Home, as a retail chain leader in the UK, is probably the best example of doing business in this specific product segment on a bigger scale. They run an omnichannel sales business, comprised of 457 pet care centres, 443 vet practices (in-store and standalone practices) and 337 groom rooms. The last two represent the key pool for reaching higher profitability. Veterinary services generate one third of profits, with a less than 10% participation in sales.

Company name - retailers	Sales EUR in millions			Sales growth %			EBITDA margin %			EBIT margin %			ROIC %			Net debt/EBITDA			CCC in days		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Petco Health&Wellness Co	3971.9	4284.3	4940.7	1.0	11.0	18.0	16.3	16.1	14.7	2.5	4.0	4.6	2.1	3.0	4.0	6.3	3.6	3.3	n/a	28	30
Musti Group	284.4	340.9	391.1	15.3	19.9	14.8	15.4	16.7	16.7	6.8	8.3	7.9	6.7	8.0	8.0	2.2	2.0	2.2	38	41	56
Pets at Home	1211.8	1280.3	1549.5	10.2	7.9	15.3	20.1	20.1	20.3	9.8	10.9	12.4	6.0	6.8	8.9	2.6	1.8	1.2	(24)	(15)	(12)
Pet Valu	386.1	424.0	523.8	8.3	13.1	19.7	23.3	20.8	21.0	17.4	15.8	16.7	n/a	16.4	21.7	6.7	6.3	3.3	n/a	n/a	n/a
Pet Center Comercio	223.6	247.2	329.2	28.4	45.7	46.0	18.6	18.0	16.0	8.0	8.1	7.0	6.9	7.5	5.2	3.7	2.3	1.3	31	34	43
<b>Average</b>	<b>1215.6</b>	<b>1315.3</b>	<b>1546.9</b>	<b>12.6</b>	<b>8.2</b>	<b>17.6</b>	<b>18.7</b>	<b>18.3</b>	<b>17.8</b>	<b>8.9</b>	<b>9.4</b>	<b>9.7</b>	<b>5.4</b>	<b>8.3</b>	<b>9.6</b>	<b>4.3</b>	<b>3.2</b>	<b>2.2</b>	<b>15</b>	<b>22</b>	<b>29</b>
<b>Median</b>	<b>386.1</b>	<b>424.0</b>	<b>523.8</b>	<b>10.2</b>	<b>19.9</b>	<b>19.7</b>	<b>18.6</b>	<b>18.0</b>	<b>16.7</b>	<b>8.0</b>	<b>8.3</b>	<b>7.9</b>	<b>6.3</b>	<b>7.5</b>	<b>8.0</b>	<b>3.7</b>	<b>2.3</b>	<b>2.2</b>	<b>31</b>	<b>31</b>	<b>36</b>

Company name - producers	Sales EUR in millions			Sales growth %			EBITDA margin %			EBIT margin %			ROIC %			Net debt/EBITDA			CCC in days		
	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021	2019	2020	2021
Freshpet	219.7	279.6	359.9	27.2	29.7	33.5	7.0	6.6	1.8	(0.1)	(0.6)	(5.8)	(0.4)	(0.8)	(4.9)	3.2	(2.8)	(8.7)	16	19	22
Sweden care	12.0	22.9	75.9	27.9	89.3	221.1	31.6	22.9	17.8	29.1	17.3	8.4	24.2	5.5	2.7	(1.1)	(1.9)	4.3	141	200	127

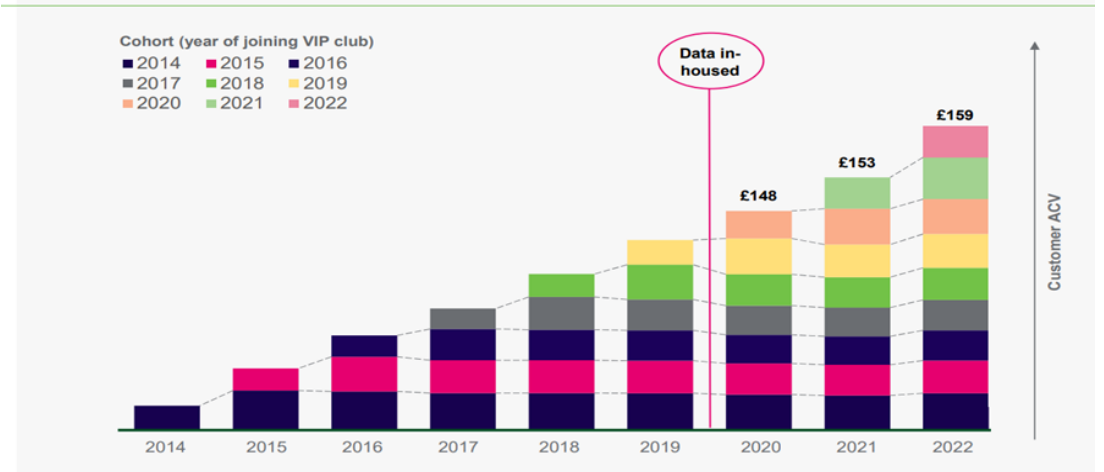


## Peer comparison

Pets at Home runs a joint venture vet practice, unique on the market, which boosts the results even further. Via e-commerce sale, remote veterinary consultations are offered to customers as well, and this is important tool to keep customers close. Pets at Home developed multiple-options delivery system which means greater choice for the customer and higher cost delivery efficiency for the company. Besides free home delivery in two working days for online sales, they also offer the Click & Collection service (pick up the goods in store 1-hour after ordering) and contactless collection service at specific places. Furthermore, 30% of total food sales is generated from sales of own private label (PL) products and over 50% of PL accessories. Loyalty of customers is strong, with 90% of members of their Puppy and Kitten club remaining active over two years, while 95% of those Puppy and Kitten club active customers spend in the steady amount during multiple years.

**Exhibit 6. Pets at Home - Average customer spending**  
snapshot from the company web site

**Retain: Average customer spend is compounding, with >95% of active customer spend maintained in outer years**







On the **outlook for the pet industry in Adria region**, we expect a **slowdown in the sales growth uptrend**, as **people are gradually (but not fully) returning to work from the office**, and there is additional **pressure of persistently high inflation and weakening of customers' purchasing power**. After the boom of the market during covid pandemic, based on increased number of pets and owners, we now see the opposite trends with a higher number of abandoned pets and pets in shelters. Although household spending fundamentals are still quite strong, these are poised for weakening at least in 2023 and purchasing habits are changing as a result, with the biggest hit taken by discretionary goods. We expect that **usage of premium pet products will be lower**, with **private label products benefiting as customers turn towards cheaper products**. **Although the volumes could be lower, sales are still expected at similar level due to inflated prices**.

Increase of input costs during 2022, both, ingredients (meat and crops) and packaging material is hardly to be fully transferred on final customers, especially in some countries of the region as we have already seen in the previous years. This will result in **increased pressure on profitability margins in the sales segment**. Producers in Adria region have good access to raw material base, due to geographical position, and that could be mitigating factor in circumstances of growing prices. However, their pricing power will also be tested.

On a positive side, **changes in demography and social changes, are the buffers on all potential contractions in the market**. **With ageing population, people living alone for longer period than before and growing personal incomes, pet economy has strong positive prospects to grow in the long run**. In more developed countries, older population spends more on their pets than other age groups. Younger people delay entry into parenthood and there is a rise of single-person households, which even more increases the need for companionship which they find in pets.

Increasing pet ownership and humanization of the pets is a long-term trend, which will return the course of the industry with weakening of inflation. **We see Adria region moving faster than rest of the Europe in this respect, notably thanks to much lower base than in CEE peers. These are also positive elements for the industry in the long run.**

Further consolidation of the market can be expected in the coming period with a growing role of e-commerce sales. Economy of smaller independent pet shops is becoming more under question. Today almost every supermarket offers pet foods on the shelves next to the food for humans, while bigger specialized stores are becoming more present. In such environment, closure of independent smaller pet shops is rather inevitable.

Faced with competition on several sides, we see a potential for retailers in improving their service in stores, increase mix of e-commerce services and advancing customer experience to be able to retain current position on the market.

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