Summary of the Audited Annual Report for Krka d.d. Novo Mesto and the Krka Group for 2005

Novo Mesto, 26 April 2006

Contents

INTRODUCTION

Opening Clarifications

The publication of the audited non-consolidated and consolidated financial statements of Krka d.d., Novo Mesto, Šmarješka cesta 6, 8501 Novo Mesto and the Krka Group is in accordance with the Rules of the Ljubljana Stock Exchange and the Securities Market Act (ZTVP-1, Official Gazette of the Republic of Slovenia, no 56/99).

The audited annual report of Krka d.d., Novo Mesto (the Krka company) and the Krka Group was approved by the company's supervisory board at its regular session of 24 April 2006.

The Krka company's 2005 financial statements have been prepared in accordance with the Slovenian Accounting Standards (SAS), and the International Financial Reporting Standards (IFRS). The consolidated financial statements of the Krka Group were prepared in accordance with the IFRS only.

The auditor KPMG Slovenija d.o.o. audited each set of the financial statements separately and prepared three reports. It issued a unqualified opinion, confirming that the financial statements give a true and fair view of the financial position of the Krka company pursuant to the SAS and the IFRS and the Krka Group pursuant to the IFRS as at 31 December 2005 and the cash flows for 2005, and that the business report is in line with the audited financial statements. The company received the auditor’s report for the Krka company and Krka Group on 5 April 2006.

The audited financial statements were almost identical to the unaudited financial statements.

The company does not have authorized capital and neither conditional increase in share capital.

The summary of the audited annual report for the Krka company and Krka Group is available from 26 April 2006 on the Ljubljana Stock Exchange's electronic information system (SEOnet) and on the company website: www.krka.si. Summaries of the Annual Report and half-year report are also published in Delo newspaper.

The company regularly makes public any significant change to the data contained in its listing prospectus via the Ljubljana Stock Exchange’s electronic information system SEOnet or the Delo newspaper. These announcements can also be accessed via the official Krka website (www.krka.si).

The audited annual report of the Krka company pursuant to the SAS and IFRS and the Krka Group pursuant to the IFRS can be reviewed at Krka’s registered office at Šmarješka cesta 6, 8501 Novo Mesto, Slovenia every working day from 8am to 3pm. Pursuant to Article 55 of the Companies Act, the 2005 audited annual report of the company and group will be sent with the auditor’s option to the Agency of the Republic of Slovenia for Public and Legal Records and Services.

Profile of the Krka Group

Krka d.d. Novo Mesto (the Krka company) is the controlling company of the Krka Group, which includes the following subsidiaries:

	Ownership share (%)
Subsidiaries in Slovenia	
KRKA ZDRAVILIŠČA, d.o.o., Novo mesto	100
Subsidiaries abroad	
KRKA-FARMA d. o. o., Zagreb, Croatia	100
KRKA-FARMA DOOEL, Skopje, Macedonia	100
KRKA-POLSKA, Sp. z o. o., Warsaw, Poland	100
KRKA Aussenhandels GmbH, Munich, Germany*	100
OOO"KRKA-RUS", Istra, Russian Federation	100
OOO "KRKA FARMA", Sergiev posad, Russian Federation	100
KRKA CR, s. r. o., Prague, Czech Republic*	100
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	100
KRKA Sverige AB, Stockholm, Sweden	100
KRKA Magyarország Kft, Budapest, Hungary	100
"KRKA-FARMA" d.o.o., NOVI SAD, Serbia and Montenegro	100
HELVETIUS-S.R.L., Trieste, Italy**	80

* company not operating
** company in the process of closing

The subsidiary Krka Zdravilišča d.o.o. Novo Mesto, has a participating interest in the following companies:

- Krka - Zdravilišče Strunjan, d.o.o. (51%) and
- Golf Grad Otočec d.o.o. (43.8%).

Financial Highlights

	Krka, d. d., Novo mesto		Krka Group	
	2005	**2004**	**2005**	**2004**
Net sales in SIT million	116,570	97,978	132,758	113,317
EBIT in SIT million	28,801	18,017	28,523	17,950
margin	*24.7%*	*18.4%*	*21.5%*	*15.8%*
EBITDA in SIT million	37,180	25,756	39,494	28,299
margin	*31.9%*	*26.3%*	*29.7%*	*25.0%*
Profit for the period in SIT million	22,459	15,310	23,319	15,661
margin	*19.3%*	*15.6%*	*17.6%*	*13.8%*
R&D expenses in SIT million	9,488	8,314	9,612	8,314
proportion of net sales	*8.1%*	*8.5%*	*7.2%*	*7.3%*
Investments in SIT million	17,985	19,639	21,451	21,075
Non-current assets in SIT million	116,589	104,007	120,455	106,933
Current assets in SIT million	65,351	47,311	68,394	48,663
Equity in SIT million	114,141	97,137	114,897	97,126
Non-current liabilities in SIT million	33,058	35,624	36,048	37,472
Current liabilities in SIT million	34,741	18,556	37,904	20,998
Number of employees (year end)	3,978	3,648	5,224	4,781
Ratios				
Net profit / Revenues	17.0%	14.5%	15.7%	12.9%
ROE	21.3%	16.8%	22.0%	17.4%
ROA	13.5%	10.4%	13.5%	10.5%
Liabilities / Equity	0.594	0.558	0.644	0.602

Exchange Rates	**2005**	**2004**
USD (average)	192.819 SIT	192.318 SIT
USD (31 December)	202.430 SIT	176.243 SIT
EUR (average)	239.636 SIT	238.885 SIT
EUR (31 December)	239.576 SIT	239.743 SIT

Share Information (Krka Group)	**2005**	**2004**
Total shares outstanding	3,542,611	3,542,612
Earnings per share in SIT*	6,890	4,627
Dividend per share in SIT	1,400	1,200
Share price end of period in SIT	102,342	84,482
Share price/earnings per share (P/E)	14.9	18.3
Book value per share in SIT**	33,994	28,736
Market capitalisation end of period SIT millions	**362,558**	**299,289**

* Profit attributable to majority owners of the Krka Group / number of shares issued less trasury shares
** Equity / number of shares issued less treasury shares
Note: Ratios are calculated based on the accounts prepared under International Financial Reporting Standards.

Significant Achievements

- In 2005 the Krka company generated an operating profit of SIT 28.8 billion, which is 60% greater than the previous year, while the Krka Group generated SIT 28.5 billion (59% growth).
- The net profit was SIT 22.5 billion (47% growth) for the Krka company, and SIT 23.3 billion (49% growth) for the Krka Group.
- The Krka company recorded sales of products and services worth SIT 116.6 billion, while the Krka Group's sold products and services worth SIT 132.8 billion.
- Double-digit growth was recorded for the last year by both the company and the group: the Krka company recorded 19% growth and the Krka Group 17%.
- The highest growth in sales and the highest proportion of overall sales for both the Krka Group and Krka company was recorded in the East Europe and Central Europe regions.
- The proportion of sales on foreign markets was 82% for the Krka Group, and 84% for the Krka company. The production of solid pharmaceutical forms increased by 28%.
- The company has successfully implemented the new SAP information system.
- Production started in the new production and distribution centre in Jastrebarsko in Croatia.
- Last year Krka acquired market authorisations for 272 products in 552 forms on its traditional markets, eight of which were first authorisations for new products. In western European countries, it acquired 113 marketing authorisations for 12 products in 41 forms.
- The Krka Group allocated SIT 21.5 billion to investments, SIT 18 billion of which by the Krka company and SIT 3.5 billion by subsidiaries.
- The number of employees in the Krka Group passed the 5000 mark. The new jobs created were primarily abroad. Now over 30% of all Krka employees are employed abroad.
- Based on the resolution adopted by the 10th general meeting, held on 17 July 2005, Krka paid a dividend of SIT 1 400 (gross) per share.
- On 31 December 2005 the price for Krka shares listed on the Ljubljana Stock Exchange was SIT 102,342 per share, a growth of 22% compared to end of 2005.

Significant Events

- The new President of the Management Board and Chief Executive, Jože Colarič, started his five-year term on 1 January 2005.
- The Krka Supervisory Board appointed Zvezdana Bajc as a member of the Management Board on 1 April 2005. She continues in her post of Director of Economics and Information Processing. Her term will expire at the end of 2009.
- The Ljubljana District Court rejected the claim filed by the US company Merck&Co. Inc. (Rahway, New Jersey) against the Krka company concerning an alleged infringement of a patent protecting the medicament simvastatin. This brought the simvastatin dispute to its legal conclusion.
- The Pfizer company filed an action against Krka alleging patent violation, relating to patent protection for the atorvastatin medicine (Atoris®). The action is still ongoing.
- On 10 November 2005 the Krka share price passed SIT 100,000 for the first time in the company's history, year high for 2005 was at SIT 107,502.60 on 15 November.
- Krka acquired the foodstuff safety system certification (HACPP) and certification for the occupational health and safety system (OHSAS 18001).

Significant Events after the Accounting Period

- Krka successfully implemented its sales plans during the first quarter of 2006.

- On 28 February 2006, the Pfizer company withdrew the action it filed against Krka in 2002, alleging Krka was guilty of unfair competition in relation to a acquisition of market authorisation for the Yasnal® product.

Report by the Supervisory Board

Report on the process and the result of the verification of the 2005 Annual Report for Krka d.d. Novo Mesto and the Krka Group and the proposal for the accumulated profit appropriation

I.

According to Article 274 of the Companies Act, a company's Supervisory Board must verify the prepared Annual Report of the company and the proposal for the accumulated profit appropriation, which are submitted to the Supervisory Board by the Management Board. The result of the verification is to be presented as a written report at the company's Annual Meeting. The Supervisory Board must indicate in its report in what way and to what extent, it verified the Company's management during the year and must also state its position on the independent Auditor's Report. At the end of its report it must state any comments it has on the Annual Report and whether it approves the Annual Report. If a supervisory board approves the company's annual report, the report is adopted.

II.

The Management Board of Krka d.d. Novo Mesto (the Krka company) submitted the 2005 Annual Report for the Krka Company and the Krka Group together with the Auditor's Report, to the Supervisory Board on 10 April 2006, and also submitted its proposal on the use of the accumulated profit to the Supervisory Board within the time limit set by the Supervisory Board.

In accordance with the law the Supervisory Board of the Krka company performed the legally defined examination and prepared a report for the Annual Meeting on:

- the verification and approval of the 2005 Annual Report for the Krka company and the Krka Group and the result of this verification
- the verification of the proposal for use of the accumulated profit
- the Supervisory Board's position on the independent Auditor's Report
- the process and extent of the verification of the Company's management during the year
- an evaluation of the company's operations and development.

III.

Verification and approval of the 2005 Annual Report for the Krka Company and the Krka Group

In accordance with the law the Supervisory Board of the Krka Company examined the form and content of the Company's 2005 Annual Report. The examination started before the formal submission of the Annual Report to the Supervisory Board and depended on the preparation process in terms of content and timing, as well as on the actions required following submission of the Annual Report to the Supervisory Board.

In January 2006 the Supervisory Board had already started discussions on the unaudited financial statements. At the end of March 2006 the Supervisory Board, in the presence of an auditor at a meeting of both the Supervisory Board and its Auditing Committee, then discussed the audited financial statements of the Krka Company and the Krka Group and the draft of the 2005 Annual Report for the Krka Company and the Krka Group.

On 10 April 2006 the Management Board submitted all three documents to the Supervisory Board. The Supervisory Board by law then had one month in which to submit its report to the Company's Management Board.

During the process of discussing and verifying the 2005 Annual Report for the Krka Company and the Krka Group, the Supervisory Board found that the Annual Report met all the mandatory legal requirements in terms of form and content for company annual reports. The Annual Report was prepared well, with a full and clearly presented content and provides both owners and the public with an appropriate overview of the conditions and operational results in 2005 and Krka's planned development and operations in the following years.

The 2005 Annual Report of the Krka Company and the Krka Group was approved by the Supervisory Board at its regular session of 24 April 2006, and subsequently adopted.

IV.

Verification and submission of the proposal for use of the accumulated profit

The Company's Management Board submitted a calculation of the accumulated profit and a proposal for its use, to the Supervisory Board together with the Annual Report. The Management Board allocated SIT 800,000,000 to reserves under the articles of association, and a further SIT 6,500,000,000 after statutory profit allocation to the other revenue reserves from profit. The accumulated profit of SIT 20,255,287,402 comprises the remaining net profit of SIT 14,280,823,149 and the retained profit of SIT 5,974,464,253.

The Supervisory Board agreed with the Management Board that the proposal of a dividend of SIT 1,650 gross per share is in line with the dividend growth policy and the policy on the allocation of the net profit to shareholder payments. The Supervisory Board also approved the proposal to allocate accumulated profit of SIT 7,312,000,711 to other reserves, to carry SIT 7,312,000,711 forward to the following year, and SIT 54,368,480 for other purposes (Supervisory Board’s participation in profit).

After the verification, in accordance with the law, and on the basis of prior coordination with the Management Board, the Supervisory Board concluded that there were no legal impediments to submitting the proposal for use of the accumulated profit to the General Meeting of the Krka Company, together with the Annual Report and in compliance with the fourth paragraph of Article 282 of the Companies Act.

V.

The Supervisory Board's position on the independent auditor's report

In accordance with the second paragraph of Article 274a of the Companies Act, the Supervisory Board reviewed the auditor's report, which includes statements on the financial reports of the Krka Company and the Krka Group and the statement on the compliance of the business report with the audited financial statements. In 2005 the Company prepared financial statements for the controlling company in accordance with the Slovenian Accounting Standards (SAS), and in accordance with the International Financial Reporting Standards (IFRS), while the financial statements for the Krka Group were prepared in accordance with the IFRS.

The auditing company KPMG Slovenija d.o.o. was appointed by the Annual Meeting to audit the 2005 financial statements. The majority of the subsidiaries in the Krka Group also had their financial statements audited by local subsidiaries of the KPMG auditing company.

Before the end of the business year, the auditor informed the members of the Supervisory Board’s Auditing Committee of its findings from the preliminary auditing process, the aim of which is to check the functioning of internal control procedures. The members of the Auditing Committee proposed which areas of operation the auditor should pay particular attention to before concluding the audit. The auditor submitted its report on the result of its review to the Auditing Committee in the first half of April before approval of the Annual Report.

Krka shares are quoted on the Ljubljana Stock Exchange’s A list, so financial statements of the Krka Company and Krka Group prepared in accordance with the IFRS have been included in the Annual Report for the first time. The auditor reported on this to the members of the Auditing Committee and members of the Supervisory Board, informing the members of the method and effects of the transfer to the IFRS.

The auditor prepared three reports: one on the audit of the Krka Company's financial statements prepared according to the SAS, and two reports on the audits of the Krka Company and Krka Group financial statements prepared according to the IFRS. The Supervisory Board did not have any comments on the auditor’s report, and agreed with the findings in the report that the financial statements that are part of this Annual Report and prepared in accordance with the SAS give a true and fair view of the financial position of the Krka Company, the results of operations, its cash flows and changes in equity. The Supervisory Board also agreed with the findings in the reports stating that the financial statements that are part of this Annual Report and prepared in accordance with the IFRS give a true and fair view of the financial position of the Krka Company and the Krka Group, the results of operations, its cash flows and changes in equity.

VI.

Extent and manner of the verification of the company's management during the year

From 1 January to 20 June 2005 the Supervisory Board comprised the following members: shareholder representatives: Bojan Dejak, Borut Jamnik, Janko Kastelic (Deputy President), Mojca Osolnik Videmšek, Janez Prijatelj (President) and Stanislav Valant; worker representatives: Sonja Kermc, Mihaela Korent, Miroslav Kramarič, Darinka Kure, Boris Petančič and Božena Šuštar. The Supervisory Board met six times over this period.

In relation to the 2004 report it agreed with the Management Board's resolution on long-term provisions, and studied the preliminary unaudited and audited statements of the Krka Company and the Krka Group. It first studied a draft of the annual report, then the proposed version before issuing its approval. It also decided on a position on the auditor's report. Together with the Management Board it proposed that the General Meeting adopt the resolution on the use of the accumulated profit and the formal approval of the Management Board (discharge). It agreed with the Management Board’s proposal for the Agenda of the General Meeting and prepared a proposed list of candidates for shareholder representatives, and a proposal on the appointment of an authorised auditor for 2005. It also accepted the Supervisory Board’s report on the process and results of the verification of the Annual Report.

On the proposal of the Remuneration and Nominations Committee, the Supervisory Board adopted the Rules on Remuneration for the Management Board and Provisions on Management Board Bonuses for 2004. They also discussed information comparing Krka operations with those of select pharmaceutical companies in 2004, and studied Krka's operating plan for 2005 and the Krka Company and Krka Group business report for the first quarter of 2005. Every quarter the Supervisory Board also studies information on treasury shares in accordance with the Rules on Treasury Shares.

During the year Supervisory Board followed the realisation of the fixed targets through exhaustive regular quarterly reports from the Management Board on the Company and the Group's operational results and conditions, and thus regularly examines Krka's performance and the Management Board's management of the company, comparing them with the adopted corporate strategy and annual plan.

Over the same period the Auditing Committee met twice, chaired by Janko Kastelic. The Committee agreed with the acts of the Internal Audit Service and the 2004 report, with the medium-term work programme for 2005 to 2008, and the work programme for 2005. On the Auditing Committee’s recommendation the authorised auditor KPMG prepared a special report for the Committee on a detailed review of individual areas of operation. The Auditing Committee agreed with the report’s findings and additional clarifications given by the authorised auditor at a meeting of the Committee. The Auditing Committee also considered the content of a letter to the management, and approved the bases for preparation of the Supervisory Board’s report.

The Remuneration and Nominations Committee met twice, and was chaired by Borut Jamnik. It studied the report on Management Board earnings, and on the basis of the Rules on Management Board Remuneration, proposed the amount of the bonuses for the Management Board for 2004.

For the period from 21 June 2005 until year-end the Supervisory Board comprised the following members: Shareholder representatives: Dr Gregor Gomišček (President), Mateja Božič, Dr Marko Kranjec (Deputy President), Anton Rous, Dr Draško Veselinovič and Alojz Zupančič; worker representatives: Sonja Kermc, Tomaž Sever and Dr Mateja Vrečer.

The Supervisory Board met three times over this period. The first meeting addressed the constitution of the new Supervisory Board and its two working bodies (the Auditing Committee and Remuneration and Nomitanions Committee) and the amendment to the Rules of Procedure of the Supervisory Board and the Rules of Procedure of the Auditing Committee. The reduction in the number of Supervisory Board members led to the Auditing Committee being reduced from six to five members.

At this meeting the President of the Management Board informed the Supervisory Board’s members of important data and information on the Krka Company and the Krka Group.

At its following meeting the Supervisory Board studied the Krka Company and Krka Group’s half-year business report for the first half of 2005, and on the proposal of the Remuneration and Nominations Committee defined the pre-payment of Management Board members’ bonuses for the first half of 2005. It also studied offers submitted to perform the 2006 auditing and information on the treasury shares.

The third meeting of the Supervisory Board was the most extensive and most complex. After deliberating on the Krka Company and Krka Group business report for the period from January to September 2005, it assessed operations as very successful. It studied the 2006 business plan, gave its consent to the Krka Group Strategy 2006-2010 and information comparing Krka operating results with those of a selection of other pharmaceutical companies for the first half-year in 2005. Based on the Auditing Committee's opinion, the Supervisory Board decided to propose that the General Meeting appoint the auditing company KPMG as auditors for the 2006 business year. It also adopted a timetable of its meetings throughout 2006 and studied information on the treasury shares. It also agreed with the Management Board’s proposal to arrange liability insurance for Company bodies to the Company’s benefit.

Draško Veselinovič chairs the five-member Auditing Committee for the new term-in-office. At its November session the Committee discussed the report by the authorised auditor on the preliminary audit performed for 2005 and set out guidelines for the authorised auditor to follow in performing a detail review of specific operational areas in 2005. It prepared a proposal for the Supervisory Board for the appointment of the authorised auditor for 2006, which will be decided on by the General Meeting. It also adopted a report on the work of the Internal Audit Service for the first year of 2005.

For the new term-in-office, the three-member Remuneration and Nominations Committee is chaired by Alojz Zupančič. At its first regular meeting the Committee drew up a proposal for the Supervisory Board to set the prepayment of Management Board member bonuses for the first half-year of 2005.

On the grounds of detailed and timely reports from the Management Board, its answers and explanations, materials, analyses, produced also on the Supervisory Board's request, and other data on the Company, the Supervisory Board was provided with a thorough overview of the policies and performance indicators, changes in sales by activity, region and product group, and the Company's financial statements. The Supervisory Board is aware of the Company's stable position as a generic company in the global pharmaceutical industry, earned by developing new generic products, investing and successful adjusting its product portfolio to the demands of the global market. On the basis of reports prepared by the Management Board, the Supervisory Board is also periodically informed on the operations of other similar producers of generic pharmaceuticals in the global market and subsequent comparisons with Krka operations.

The Management and Supervisory Boards cooperate successfully, and the presidents of the two boards communicate frequently, including during the periods between Supervisory Board meetings.

VII.

Evaluation of operations and development

The Supervisory Board monitors the operations of the Krka Company and Krka Group throughout the year. Together with the Management Board it paid additional careful attention to divergences from plans and concluded that realising Krka's long-term objectives requires rapid and flexible adaptation to changes in the generic pharmaceutical industry. Intense competition will require additional efforts in cost management, risk management, and investment in production, development, employees, knowledge and sales and marketing activities.

In 2005 Krka operated in accordance with its annual plans and strategic objectives. Its sales results were well above average, with the Company recording a 19 per cent growth in sales revenue. The Krka Group also recorded an impressive 17 per cent growth. This growth came largely from sales in the East Europe and Central Europe regions, which were significantly up on the 2004 figures. Proof that Krka's long-term policy of strengthening its chemical and pharmaceutical production is correct is the 21 per cent growth in prescription pharmaceutical sales. The Company's total profit under the Slovenian Accounting Standards (SAS), was 61% higher than the previous year, while its pre-tax profit under the International Financial Reporting Standards (IFRS) increased by 58% on the previous year. The pre-tax profit of the Group under the IFRS was 61% up on the previous year. The increased pre-tax profit and the reduced investment relief and the net provisioning (release and formation of provisions) led to the Group's corporate income tax almost doubling. Nevertheless, there was a significant growth in the net profit: 53 per cent (under the SAS), and 47 per cent (under the IFRS) for the Company, and 49 per cent for the Group (undero the IFRS). All Krka's performance indicators, which are regularly monitored during the year by the Supervisory Board, exceeded last year's figures and the planned levels.

In 2005 the intense investment continued, with the Supervisory Board informed on an ongoing basis. The new Sinteza 4 plant for active pharmaceutical ingredient production, which will start production in autumn 2006, will further strengthen Krka's vertical integration, a vital company strategic orientation. Other investments in pharmaceutical production that are planned or underway can also be expected to produce very positive results in the future. In 2005 Krka's investment in its own plant in the Russia Federation in 2005 proved to be a sound business move, already contributing to increasing Krka Group's sales.

Krka has also met other planned objectives. It has a modern portfolio of quality products that it uses to generate almost half its sales, it manages its regulatory procedures very proficiently, which is expressed in the number of forms of new products granted market authorisations, as well as patent and legal requirements relating to legal actions. It makes planned investments in employees, strengthening its marketing and sales networks, and internationalising individual business functions. Krka's share price on the Ljubljana Stock Exchange grew by 22 per cent in a year, and at the end of 2005 was 190 per cent higher than its book value.

The Krka Company and Krka Group's results have been achieved despite growing price pressures, unfavourable legislative changes, and every greater competition in pharmaceuticals development and despite a global economic slowdown. The Supervisory Board therefore evaluates Krka's operations and achievements as very successful and recognises the work of all those have contributed.

The achievements set out above, particularly the Krka Group's ambitious strategy for the period up to 2010, give the Supervisory Board a real basis for its assessment that Krka will continue to be a successful independent company in the future. This assessment is not only based on past achievements, but above all on future plans, analyses and growth forecasts for the generic market, SWOT analysis and key future expectations.

The Supervisory Board assesses that Krka adequately meets its owners' expectations. Krka provides a suitable dividend yield and information disclosure for its shareholders, and given its strategy and objective assessments from a number of analysts, it will continue to be a sound investment in the future.

In 2006 the Supervisory Board will continue to pay particular attention to how Krka performs compared to its competitors in the generic pharmaceutical industry, particular in terms of sales and costs, but also for investment profitability and other performance indicators. It will continue to expect the Management Board to provide regular checks on the realisation of its strategic objectives and policies, and to make any amendments of objectives to market changes that may be necessary. The Supervisory Board also found that Krka's successful operations had continued in the first three months of this year.

VIII.

Changes in the Management and Supervisory Boards

The following important changes occurred in the management of the Krka company in 2005:

- On 1 January 2005 Jože Colarič assumed office for his five-year term as President of the Management Board.
- On 1 April 2005 Zvezdana Bajc, Director of the Economics and Information Processing Division was appointed as a member of the Management Board. She was appointed by the Supervisory Board because on 31 December 2004 Miloš Kovačič, the previous President of the Board, ended his term-in-office, which reduced the number of board members to four. Zvezdana Bajc's term-in-office will conclude at the same time as the President of the Board's. Since 1 April 2005 the Management Board has therefore again been operating in its full complement of five members, as defined by the articles of association.
- At the General Meeting, held on 17 June 2005, a new Supervisory Board was elected, which started its four-year term-in-office on 21 June 2005. The General Meeting and Works Council both elected new members of the Supervisory Board, except for one member, the workers' representative. In accordance with an amendment to the Company's articles of association approved by the General Meeting held on 4 July 2003, the number of Supervisory Board members was reduced from 12 to nine. The Supervisory Board now comprises six shareholder representatives and three workers' representatives.

IX.

Resignations by Supervisory Board members

Supervisory Board members Tomaž Sever and Dr Gregor Gomišček purchased Krka shares during a period in which other public had not yet been informed of the operating results. The former purchased 50 shares on 23 August, the latter purchased 12 shares on 24 and 25 August. They were cited in the media for using insider information to their own benefit, and on 14 September 2005 Dr Gregor Gomišček tendered his resignation to the President of the Management Board, stating he would resign as a Supervisory Board on the Annual General Meeting. He tendered his resignation for the reasons given above, although he did not personally feel responsible for the use of insider information.

Tomaž Sever also submitted a letter of resignation, to Sonja Kermc, president of the Works Council. On 21 September 2005 the Works Council declined to accept the resignation, as it found there were no grounds for his dismissal. Tomaž Sever agreed with the decision of the Works Council.

The Supervisory Board was officially informed of Supervisory Board member Dr Gregor Gomišček's resignation and the resolution by the works council in relation to the resignation of Supervisory Board member Tomaž Sever at its 3rd regular meeting on 23 November 2005. No Supervisory Board member expressed any reservations about Dr Gregor Gomišček continuing to fulfil his function as President of the Supervisory Board.

Based on the request of the Dr Gregor Gomišček, the Securities Market Agency sent its findings in the supervisory procedure no N-PP-nelic-79/05 concerning the purchase of 12 Krka's shares in august 2005 by Dr Gomišček as a Supervisory Board member of the securities issuer Krka d.d., Novo mesto.

The Securities Market Agency "established that after examination of complete documentation the suspicion for insider trading is unfounded. Based on collected documentation and explanations it has been established that this action does not represent a violation and hence the violation decision will not be issued."

Based on this finding Dr Gregor Gomišček recalled his resignation.

X.

Conflicts of interest for Supervisory Board members

The Supervisory Board assures that there has not been any conflict of interest during the Supervisory Board decision making and Supervisory Board agenda discussions. According to the Corporate Governance Code effective from 14 December 2005, the Supervisory Board will determine the assessment of conflicts of interest existence and the appropriate measures in this respect within changes and supplements of the Supervisory Board's Rules of Procedure. These changes to the rules will be presumably implemented already in 2006 or in 2007 at the latest, when the rules are supposed to be changed or supplemented due to the adoption of the amended Companies Act.

XI.

Resolution and summary of the Supervisory Board's report, positions and proposals to the General Meeting

- The Supervisory Board verified the 2004 Annual Report of the Krka Company and the Krka Group within the legally prescribed time limit, i.e. within a month of the Management Board submitting the report.

  After the verification the Supervisory Board had no comments or reservations regarding the Annual Report, and at its meeting of 24 April 2006, the Supervisory Board unanimously approved the 2005 Annual Report of the Krka Company and the Krka Group. The Supervisory Board recognised the excellent work of the Management Board for the results achieved.

  After approval at the Supervisory Board on 24 April 2006, the 2005 Annual Report of the Krka Company and the Krka Group was officially adopted.

- In accordance with the law, the Supervisory Board also discussed the Auditor's Report and the work of the authorised Auditor.

  The authorised auditor issued an unqualified opinion on the financial statements and the Financial Report of the Krka Company and the Krka Group. The Supervisory Board had no comments on the auditor's work and the Auditor's Report.

- The Supervisory Board reviewed the Management Board's proposal to use the accumulated profit of SIT 20,255,287,402 and after some coordination, endorsed it.

- Based on the verification and coordination referred to in the preceding point and pursuant to the fourth paragraph of Article 282 of the Companies Act, which states that the Annual Meeting decides on the use of the accumulated profit on the proposal of the Management Board, the Supervisory Board and Management Board propose that the Annual Meeting adopt the resolution on the use of the accumulated profit submitted in writing to the Annual Meeting together with this Report.

- Based on the data from the 2005 Annual Report of the Krka Company and the Krka Group, as well as the Auditor's Report and this report, the Supervisory Board proposes that the General Meeting give its formal approval (discharge) to the Management Board and the Supervisory Board of the Krka Company, in accordance with the provisions of Article 282a of the Companies Act.

- The Supervisory Board endorsed this report unanimously at the session of 24 April 2006.

Dr Gregor Gomišček,
President of the Supervisory Board

Novo Mesto, 24 April 2006

Corporate governance of the Krka Group and Company

Corporate governance of the Krka Group

The Krka Group consists of the controlling company Krka d.d. Novo Mesto, thirteen subsidiaries abroad, and one in Slovenia. This is the majority owner of one subsidiary and has a participating interest in an associated company. In 2006 two companies outside Slovenia will cease operations. All functioning subsidiaries are 100% owned by the Krka company. The operations of these companies take place in accordance with local legislation and mandatory internal rules and instructions for the operation of companies in the Krka Group, which are adopted by the Management Board of the controlling company.

Corporate governance of the Krka Company

The principles of governance for the Krka company are based on valid legal norms in the Republic of Slovenia, the company's internal acts, and established best practice. The Krka company has a two-tier governance system, where the management board manages the company, and the supervisory board supervises its operations. The company's management bodies are: the management board, the supervisory board, and the general meeting, at which shareholders exercise their rights relating to company affairs.

Members of the Supervisory Board

Since 21 June 2005 the Supervisory Board has comprised nine members.

Shareholder Representatives:
- Dr Gregor Gomišček, President
- Dr Marko Kranjec, Deputy President
- Mateja Božič, member
- Anton Rous, member
- Dr Draško Veselinovič, member
- Alojz Zupančič, member.

Worker Representatives:
- Sonja Kermc, member
- Tomaž Sever, member
- Dr Mateja Vrečer, member.

A more detailed presentation is available on the company website: www.krka.si.

Members of the Management Board:

- Jože Colarič, President of the Management Board
- Janez Poljanec, member
- Dr Aleš Rotar, member
- Zvezdana Bajc, member
- Danica Novak Malnar, member.

No member of the Krka Management Board is a member of a supervisory board of any other company outside the Krka Group.

A more detailed presentation is available on the company website: www.krka.si.

Corporate governance code compliance statement

The Management Board of Krka d.d., Novo Mesto hereby states that in 2005 individual members of the Management Board, and the Management Board as a body of a public limited company have acted in compliance with the corporate governance principles and have worked to ensure their application within the company. The conduct of individual members of the Management Board, and the Management Board as a body of the company is in compliance with the provisions of the Code, adopted on 14 December 2005.

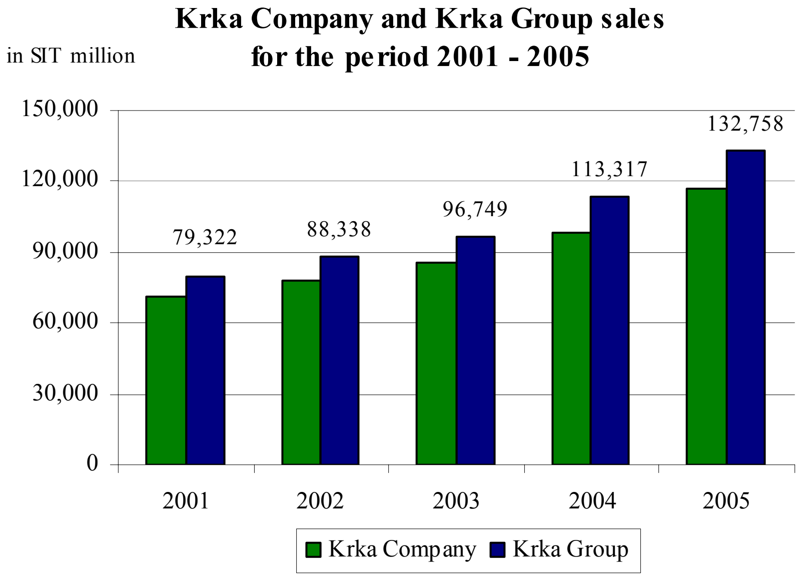
The company objectives as required by Provision 1.1.1. of the Code have not yet been stated within the articles of association. We assess this as a minor divergence from the Code and will be redressed in the next amendment to the company's articles of association in 2006 or 2007 at the latest. This will also be necessary due to the adoption of the newly amended Companies Act.

SUMMARY OF BUSINESS REPORT

Business operations analysis of the Krka company and Krka Group

Given that the financial statements have been prepared according to the IFRS for the first time, there is a special chapter in the summary of the financial statements of the annual report explaining in detail the transition to the IFRS for both the company and the Group.

Revenues



The net sales of the Krka Group increased by 17 % while Krka generated an increase of 19 %. The sales growth considerably exceeded the five-year average (by 13.7% in the Group and 13.2% in the Company) due to the economic situation in some key markets, in particular the Russian Federation, as well as organisational and personnel changes within the marketing-sales network. The highest proportion of net sales for the Krka Group i.e. 80% was generated through the sale of prescription pharmaceuticals growing 21% or SIT 18 billion over 2004. As for the growth rate, East and Central Europe achieved the most outstanding results, East Europe with 48%, followed by Central Europe with 34% growth. In the past financial year the share of sales on the foreign markets increased from 78% to 82%. Krka plans to achieve a 13% increase in sales in 2006 and thus continue the growth of the past years. A detailed analysis of the sales results in terms of individual markets and product groups is described in the Marketing and Sales chapter.

Krka generated SIT 131.7 billion of revenues and the Krka Group SIT 149 billion indicating a 23% increase over 2004. The increase in revenues is higher than the increase in sales which is mostly due to the release of provisions of SIT 11.4 billion formed for the lawsuit relating to cardiovascular drugs. Consequently, other operating revenues increased significantly.

Expenses

The Krka Group’s expenses were SIT 119.4 billion and increased by 16% compared to 2004. Without taking into account the newly formed provisions, the Group's expenses increased by 11 percent, which is six percentage points less than the sale's increase.

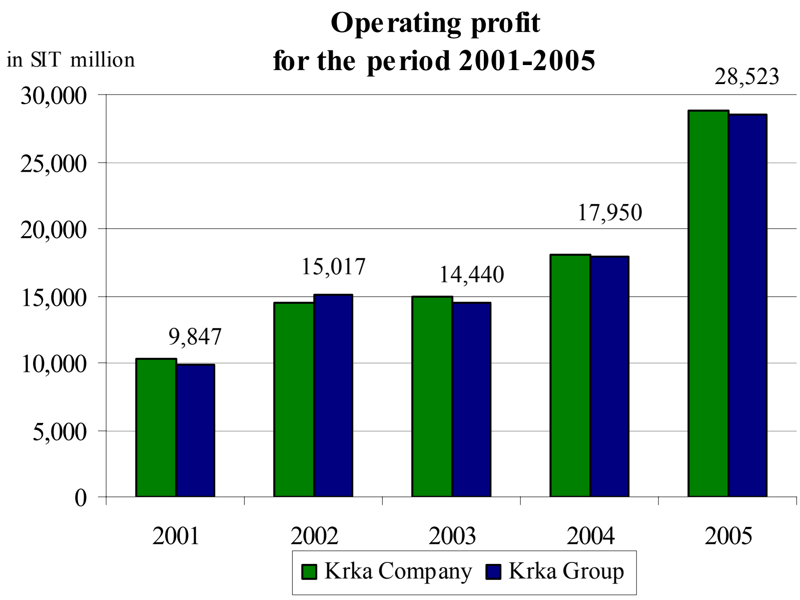
The Krka Group recorded operating expenses in the amount of SIT 116.4 billion, of which SIT 51.8 billion refers to production cost of goods sold, SIT 41.6 billion to marketing and sales, SIT 9.6 billion to R&D costs and SIT 13.4 billion to administrative expenses.

Compared to 2004 the increase in production costs of goods sold by the Krka Group is significantly lower compared to the increase in sales. Its proportion in the net sales has decreased over the past five years from

48% to 39%. This is mostly attributable to the rationalisation of operations as well as the introduction of contemporary technology that ensures greater productivity.

The changes in the marketing and sales and R&D costs were quite different since the increasing demand of the market and the pressing competition require constant and larger investments in these fields. The expansion of Krka's own marketing network on all its significant markets resulted in an increase in marketing and sales costs which amounted to SIT 41.6 billion in the reporting period, representing 36% of all operating expenses. Marketing and sales costs also comprise SIT 12.5 billion of provisions formed by Krka in connection with the court action relating to cardiovascular drug. R&D costs recorded by the Krka Group show an increase of 16% compared to the 2004 figures and come mainly from the controlling company. The R&D costs represent the total amount for the financial year since these costs are not capitalised. Administrative expenses increased by 3%.

Operating result



Note: Data for 2001 - 2003 under SAS, For 2004 and 2005 under IFRS.

The Group's operating profit was SIT 28.5 billion representing an increase of 59% on 2004.

The profit before tax increased by 61% and amounted to SIT 29.5 billion. Corporate income tax amounted to SIT 6.2 billion, with SIT 9.8 billion in levied tax and SIT 3.6 billion in deferred tax (mostly due to newly and reversed provisions for lawsuits involving the controlling company). The effective taxation of the Group has increased from 14.4% in 2004 to 21%, which is mostly attributable to the reduced level of tax relief.

Net profit of the Krka Group was SIT 23.3 billion and increased by 49%, whereas the Krka company recorded a profit of SIT 22.5 billion indicating an increase of SIT 7.1 billion or 47% in comparison to the previous year's figures.

Assets

The Group's assets were worth SIT 188.8 billion at the end of 2005 and grew by 21% in the last year. The proportion of current assets in the assets' structure increased from 31% at the start of the year to 36% at year-end. By the end of the year non-current assets represented 64% of the total assets an increase of 13% on the previous year.

Non-current assets amounted to SIT 120.5 billion of which SIT 108.2 billion is property, plant and equipment that increased by 10 % or SIT 9.6 billion and represent the largest proportion i.e. 57% among total assets. Deferred taxes in the amount of SIT 4.8 billion predominantly comprise taxes on the formation of new provisions.

During the financial year there was 41% increase in current assets, amounting to SIT 68.4 billion at year-end. The respective rise is a result of the increased inventories and receivables. Compared to the previous year, inventories increased by 45% or SIT 8.9 billion to SIT 29 billion which is largely due to the larger volume of production and sales, preparation of inventories for sales and production allocated for the first quarter of

2005 as well as due to the formation of safety stocks, especially for the most significant products. Operating receivables amounted to SIT 33 billion, an increase of 38%, which was a result of a higher sale in the last months of the year. Most of the receivables are not yet due.

Equity and liabilities

The Group's equity increased by 18% and represents 61% of total equity and liabilities. The respective increase is mostly attributable to the Group's net profit for 2005, which was SIT 23.3 billion. The decrease is due to the dividend payout of SIT 4.8 billion.

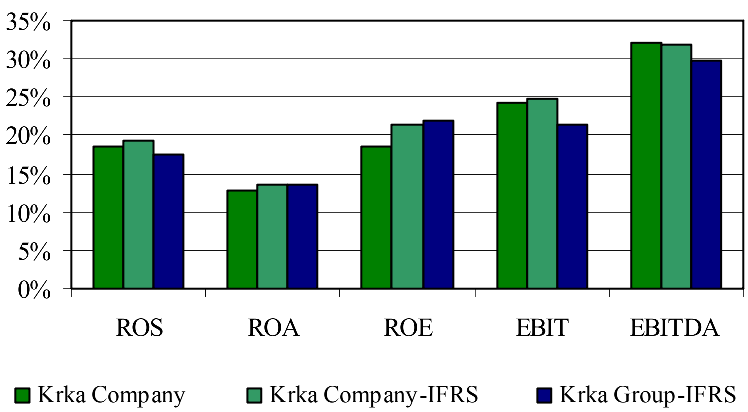
Non-current provisions increased by 5.5% and include provisions of SIT 10.7 billion for payables to employees and provisions of SIT 12.8 billion for court actions. Krka formed provisions in the amount of SIT 12.5 billion for the new lawsuit relating to the cardiovascular drug that is still in process and also reversed provisions that were formed for the court action relating to the simvastatin drug in the amount of SIT 11.4 billion as the court decided in Krka's favour. The balance sheets prepared in compliance with the IFRS, include provisions for both the Krka company and the Krka Group for retirement and long-service bonuses.

At year-end long-term borrowings amounted to SIT 11.7 billion, a decrease of 20 %. The Krka company did not arrange any additional loans and the decrease was almost entirely due to the repayment of existing loans. The subsidiaries Krka Zdravilišča and Krka Farma Zagreb did however arrange additional loans but in a smaller amount.

Current liabilities in the amount of SIT 37.9 billion represented 20% of balance sheet total. This amount includes trade payables in the amount of SIT 14 billion at year-end, an increase of SIT 5 billion or 55% on the previous year. This increase was due to higher trade payables, a larger volume of supplies in the last quarter of the year, as well as agreed extended payment terms. Due to the considerable increase of the corporate income tax levied, corporate income tax liabilities rose to SIT 6.7 billion. Current borrowings recorded at SIT 9.1 billion show an increase of 73 %, while non-current and current loans together increased by 5%. Half of the provisions and other current liabilities recorded at SIT 8.1 billion (a 56% increase) refers to current provisions for contractually based discounts on products sold in 2005.

Performance

Performance Ratios for 2005



The performance indicators for the company Krka and the Krka Group are in compliance with strategic guidelines and objectives and improved compared to 2004. The Krka company's net profit margin was 17.6% (Krka Group 19.3%), return on assets 13.5% (13.5%), return on equity 22.0% (21.3%), operating profit margin 21.5% (24.7%) and EBITDA margin 29.7 % (31.9 %).

In 2005 both the Krka company and the Krka Group operated in line with annual plans and strategic objectives.

Risk management

The long-term stability of the Group's operations is managed by an active risk management policy. The international focus of Krka's imports and exports exposes us to risks relating to foreign exchange movements and interest rates, and credit risk. Derivative financial instruments are used to hedge against interest rate and currency risks.

Credit risk

We manage credit risk by means of credit assessment of customers and an active receivables recovery process. Receivables write-offs had no material impact on our financial position in 2005.

Interest rate risk

We hedged three long-term loans in 2004 by entering pay-fixed, receive variable interest rate swaps, two denominated in USD and the other in EUR. We did not arrange additional hedging in 2005.

Foreign exchange risk

The key exchange rates in 2005 were EUR/SIT and EUR/USD. Other major currencies PLN, MKD, and RUB, were used by our main subsidiaries aboard. As net positions related to these currencies were relatively low in 2005, so the main focus was on managing the net long positions in EUR and USD. We use foreign currency options (range forwards) and regular forward contracts to hedge against foreign exchange risk.

Liquidity risk

Liquidity risk was very low in 2005, due to appropriate cash flow planning and pre-arranged credit lines.

Sensitivity analysis

The ever smaller imbalance in our currency positions due to the structure of our import and export transactions, an increasing proportion of transaction in EUR, and hedging arrangements has reduced the impact of foreign exchange movements on the Group’s operating result. We assess that potential large foreign exchange rate movements in future will not have a significant impact on the Group’s operating result. Due to the relatively low indebtedness and past hedging arrangements, the same also applies for any major movements in interest rates.

Marketing and sales

In 2005 the Krka Group sold SIT 132.8 billion worth of products and services, which is a 17% increase on 2004. The Krka company sold SIT 116.6 billion worth of products, achieving a 19% increase in sales compared to 2004. Krka Group's sales were 14% greater than sales by the controlling company alone. Significant performances by subsidiaries include sales by Krka Polska of SIT 18.2 billion, sales by Farma Zagreb of SIT 8.5 billion, and sales by Krka Zdravilišča of SIT 5.9 billion. The proportion of exports in overall Krka Group sales continued to increase. Product exports were worth SIT 108.6 billion in 2005, or 82% of overall sales.

Sales by Region

Krka Group and Krka company sales by Region in 2005 (SIT million)

	Krka Group	Proportion (%)	Krka company	Proportion (%)
Slovenia	24 185	18	18 337	16
South-East Europe	22 629	17	20 027	17
East Europe	32 763	25	31 501	27
Central Europe	33 425	25	26 708	23
West Europe and Overseas Markets	19 756	15	19 997	17
Total	**132 758**	**100**	**116 570**	**100**

In 2005 the Krka Group achieved its highest sales growth in its Region East Europe and Region Central Europe, somewhat ahead of Region South-East Europe, where it nevertheless managed to achieve double-digit growth. Sales in Region Slovenia remained at the same level as in 2004, while sales in Region West Europe fell somewhat after high growth in 2004.

Slovenia

Sales by the Krka company in Slovenia were one per cent down on sales in 2004 but still reached SIT 18.3 billion. The highest sales were for prescription pharmaceuticals for human consumption and self-medication products, together representing 93% of all sales. Sales of veterinary products and cosmetics in particularly were much lower due to the rationalisation of the product range and Krka's strategic decision to focus on its most promising cosmetics brands.

The Krka Group, including the Krka Zdravilišča health resorts, generated SIT 24.2 billion from sales of products and services, which is one per cent down on 2004.

South-East Europe

On the markets of Region South-East Europe, the Krka Group sold products worth SIT 22.6 billion, an 11% increase on 2004. The Krka company recorded sales of SIT 20 billion, which was a 19% increase on the previous year. The Krka Group achieved its highest sales growth in Romania (index 132) and Bulgaria (index 131), as well as 9% growth in Albania and Croatia.

Sales of prescription pharmaceuticals and self-medication products, which together represent 90% of sales, were both up by over 10%. Sales of veterinary products were up over 30%, while sales of cosmetics fell as a result of consolidating the cosmetic product range.

In **Croatia**, the largest individual market in Region South-East Europe, representing 40% of the entire region and one of the Krka's five key markets, the Krka Group achieved sales of SIT 9 billion, which is 9% more than in 2004. The Krka company recorded sales of SIT 7 billion in Croatia, an increase of 25% on the previous year. Krka is therefore the third ranking pharmaceutical producer in Croatia, right behind the two largest domestic producers. Three newly launched prescription pharmaceuticals – Atoris®, Tenox® and Zyllt® – contributed most to the increased growth. Krka will further consolidate its position in Croatia with its new production and distribution centre in Jastrebarsko, near Zagreb, where production of Tenox® and Zyllt® for the Croatian market took place in 2005. The plan in 2006 is to produce additional products in this plant for the Croatian and other markets.

In **Romania**, the second most important market in the region with sales of just under SIT 5 billion, prescription pharmaceuticals representing the largest proportion of sales, growing by 34% compared to 2004, followed by self-medication products with 23% growth. The excellent sales results were primarily attributable to Enap®, Vasilip® and Fromilid®, well supported by Nolicin®, Tramadol and Bilobil®. In contrast with the previous year, animal health product sales were also good, increasing by over 60%.

Sales growth in Bulgaria was among the highest in the region in 2005, due largely to the successful launch of new products. While sales in Serbia and in Bosnia & Herzegovina remained at 2004 levels, sales were down in Macedonia and Montenegro, due mainly to the specific economic conditions on those markets.

East Europe

In Region East Europe, the Krka Group sold SIT 32.8 billion worth of products, 48% more than the year before, and recorded the highest growth of any Krka Region. The Krka company achieved sales of SIT 31.5 billion on the markets of this region in 2005, an increase of 42 % on the previous year. The Krka Group achieved growth of over 30% on six markets, the highest growth being achieved in Ukraine (index 167), Uzbekistan (index 149), and the Russian Federation (index 147).

Sales growth was achieved in every product group, the highest being for prescription pharmaceuticals (index 158), which represent 75% of overall sales, and veterinary products (index 153).

The most important market in this region is the **Russian Federation**, which is also one of Krka’s key markets. Sales increased by 47% compared to 2004. The highest growth was in prescription pharmaceuticals which represent 80% of overall sales. Their sales increased by 60%, compared to 2004. Krka's successful performance – with sales growth higher than the growth of overall market sales – Krka advanced by two positions in the company rankings in the Russian Federation. Krka also advanced one place in the rankings for a key pharmaceutical market segment – pharmacy prescription pharmaceuticals – moving up to third place. The growth of sales can be attributed to new products, previous organisational changes that improved efficiency and making best use of new market conditions. This includes the introduction of new lists of pharmaceuticals covered by health insurance for specific patient groups. At the same time we almost doubled our marketing team. The Krka Rus company, where production started in 2004, supplies the market with two key products: Vasilip® and Nolicin®. Preparations are also underway for the manufacture of additional products.

Ukraine is the second largest market in the region. Sales were very successful there in 2005, with sales of prescription pharmaceuticals rising by 64%, sales of self-medication products by 69%, and sales of animal health products doubled. All the main prescription pharmaceutical products sold well. Two recently launched self-medication products contributed to the positive sales for that product group: Duovit® for men and Duovit® for women.

On other markets in the region, sales of over SIT 1 billion were achieved for the first time in Belarus and Kazakhstan. Double-digit sales growth on the previous year was recorded on both these markets.

Central Europe

In 2005 the Krka Group achieved sales on the markets of Central Europe worth SIT 33.4 billion, which is 34% more than in 2004. Even greater growth was achieved in sales of prescription pharmaceuticals (index 140), which represent 89% of overall sales, while sales of self-medication products were also up 5%. In 2005 the Krka company recorded sales of SIT 26.7 billion, 38 % more than in 2004.

In **Poland**, one of Krka's key markets, where 56% of overall sales in Region Central Europe are recorded, Krka achieved sales worth SIT 18.8 billion, which is 32% more than in 2004. These excellent growth figures boosted Krka's share of the Polish pharmaceutical market by 14%, making Krka the third ranking generic pharmaceutical company in Poland. Atoris® is one of the most important prescription pharmaceuticals in Poland. The highest growth by product group was for medicines for diseases of the central nervous system, including Zalasta® which has already become one of Krka's leading products on this market in the first year since its launch, supported by sales of Yasnal®, Asentra® and others. The changes concerning the prescription of sartans to reduce high blood pressure led to Krka relaunching Lorista® on the Polish market at the end of the year. In the field of self-medication products, Krka's most successful products were Bilobil® and products under the umbrella brand Pikovit®. Sales of animal health products were somewhat higher than in 2004.

In the **Czech Republic,** Krka's second most important market in the region, it increased its sales by 30%, making it the third ranked generic pharmaceutical company in the Czech Republic. Sales of products that have been marketed in past years were very good. Sales of the newly launched products Atoris® and Ampril® (marketed as Amprilan in the Czech Republic) contributed significantly to that growth.

After 2004's poor sales figures in **Slovakia**, Krka reversed the trend, selling over 40% more than in 2004, and increasing its market share by 15%.

The highest growth in Region Central Europe was achieved in **Hungary** where sales more than doubled the 2004 figures. The results are thanks to the successful marketing of new products such as Atoris® and Tenox®, as well as good sales of Fromilid®. The marketing team in Hungary was significantly strengthened to achieve the more ambitious targets made feasible by the new products.

Krka operated successfully on the markets of the **Baltic States,** particularly in Latvia. Results in Lithuania were a little less encouraging but sales did remain the same as in 2004. The plan to offer new products promises even better results in the coming year.

West Europe and overseas markets

In Region West Europe and Overseas Markets, we sold products worth over SIT 19.8 billion, eight percentage points behind the 2004 sales figures.

Sales on the markets of **western Europe,** another key Krka market, represented 90% of sales in this Region. The most important markets are Germany, Great Britain, the Nordic countries and the Netherlands. Most of the sales were of prescription pharmaceuticals, which in cooperation with our partners, are now sold in almost all western European countries. In 2005 we started direct sales of Krka prescription pharmaceuticals in the Nordic countries, via Krka Sverige AB, Krka's Swedish subsidiary, which strengthened Krka's presence on those markets. We also successfully introduced sertralin tablets and lansoprazole capsules. With large volume market shares on the western European markets, Krka is the leading supplier of generic amlodipine, lansoprazole, carvedilol and norfloxacin and one of the leading suppliers of generic enalapril, simvastatin and mirtazapine. The Region recorded its highest growth in sales compared to 2004 in Africa, southern EU member states, and parts of Asia.

New products making key contributions to sales growth

Krka continually offers new products to its markets in accordance with our business strategy and the opportunities offered through its consistent respect for the intellectual property of others. In 2005 Krka's new prescription pharmaceuticals included the following: the diuretic Rawel® SR (indapamide), the antiepileptic Triginet® (lamotrigine), the platelet aggregation inhibitor Zyllt® (clopidogrel) and at the end of the year, the antihypertensive Prenessa® (perindopril). At the same time we expanded our range of products under existing trademarks with the products Kamiren® XL (a doxazosin in a new and innovative prolonged-release formulation) and the Atifan® cream (terbinafine), while other existing products were supplemented by versions with new active ingredient strengths. The proportion of new products sales (products launched in the last five years) in overall sales was 46.3% in 2005.

Sales by product group

Prescription pharmaceuticals are Krka's most important product group, constituting 80% of the Group's overall sales. They are followed by self-medication products, health resort services, animal health products and cosmetics. Krka recorded a growth in sales in comparison with 2004 in every product group except cosmetics, due to the decision to reduce the range of cosmetic products and focus on a select number of key brands.

Krka Group and Krka company sales by product group in 2005 (SIT million)

	Krka Group	Proportion (%)	Krka company	Proportion (%)
Human health products	121 884	92	111 762	96
Prescription pharmaceuticals	105 743	80	95 974	82
Self-medication products	14 108	11	13 826	12
Cosmetic products	2 033	2	1 962	2
Animal health products	4 796	4	4 603	4
Health resorts	5 848	4		
Other	229		205	
Total	**132 758**	**100**	**116 570**	**100**

*Sales of cosmetic products were recorded as consumer health products in 2005 due to organisational changes.

Krka produces a wide range of products for the treatment of human diseases, for the most important indication groups. The leading products are for treating cardiovascular diseases and represent almost 50% of sales. Compared to 2004, the proportion of medicines for the treatment of the central nervous system sold increased again.

In 2005 the Krka Group sold prescription pharmaceuticals worth SIT 105.7 billion, 21% more than in 2004. The Krka company sold SIT 96 billion of these products, 20% more than in 2004. In 2005 the Krka Group sold SIT 14.1 billion worth of self-medication products, 13 % more than in 2004. Of this, the Krka company sold products worth SIT 13.8 billion, 22% more than during the previous year. In 2005 the Krka Group sold cosmetics worth SIT 2 billion, around 30% less than in 2004. In May we completed the reorganisation of our cosmetics operations. The future development will be to offer 'cosmocevtical' products to consumers trough direct points-of-sale where Krka already has a presence with other products. In 2005 the Krka Group sold SIT 4.8 billion worth of animal health products, 16% more than in 2004. Of this, the Krka company sold products worth SIT 4.6 billion, 18% more than the previous year.

The Krka Zdravilišča health tourism group generated net sales of SIT 5.8 billion in 2005. The Krka Zdravilišča group recorded 316,969 overnight stays, of which 104,164 were sold to foreign guests. The average occupancy of accommodation capacity was 68%, while the average occupancy of our health resort capacity was 81%.

Research and development

The registration of the lansoprazole capsules confirmed Krka's development abilities and commandment of specialist know-how required for API synthesis and pelleting technology. Lansoprazole was launched on the market in capsule form in western European countries the very next day after the original patent expired. Vertical integration and overall product management from the active ingredient and formulation phases to the documentation and market authorisation management processes, once again proved to be the key to achieving set objectives. Total product management was also a major advantage in Krka's success with the tablet Prenessa® (perindopril), for which it acquired market authorisation Hungary, the Russian Federation, and for the Krka partners in the Czech Republic and Slovenia. Krka was the first generic supplier to successfully launch this product in Hungary. Another of Krka's vertically integrated products is Zyllt® (clopidogrel) tablets, registered in Croatia at the end of 2004. In 2005 we entered the market in Croatia as the first generic supplier of clopidogrel.

We further developed the continuous acquisition of registrations by concluding 13 MRPs (Mutual Recognition Procedures). The high quality of our work on market authorisation processes, and the continual strengthening of partnerships and trust with regulating agencies in countries throughout Central, East and South-East Europe have enabled Krka to become the first pharmaceutical company from a new EU member state (Czech Republic in this case) to successfully manage and conclude an MRP for Losartan tablets in a number of countries in the West and Central Europe regions. Krka was also the first company from Slovenia to successfully manage and conclude an MRP for market authorisation in the other new EU member states.

Another successful registration in western European countries came in 2005 with the first registration of a veterinary product there. In Ireland and the United Kingdom we acquired a market authorisation for enrofloxacin, in an orally administered solution.

The Krka subsidiaries continue to successfully acquire registrations, which represents a significant time saving in getting products onto the market. In 2005 the Krka-Rus company registered Rawel® SR (indapamide) tablets, Prenessa® (perindopril) tablets and Zyllt® (clopidogrel) tablets, while Krka-Farma in Zagreb registered Laaven® (lisinopril) and Laaven® HCTZ tablets (lisinopril and hydro-chlorotiazide) tablets.

In 2005 Krka registered 272 products in 552 forms on its traditional markets. On behalf of the Krka company and its partners, Krke Sverige, we acquired 113 registrations for 12 products in 41 forms in the countries of western Europe.

In 2005 the company submitted patent applications for 14 new products, and 17 international patent applications on the basis of prioritised applications from 2004.

The company markets its products under its own brands, which further enhances the added value of Krka products. In 2005 Krka registered 42 trademarks in Slovenia and submitted 54 applications for international trademark registration.

Investments

In 2005 the Krka Group allocated SIT 21.5 billion to investment, 16.2% of net sales The most important investment project was the construction of the new chemical synthesis plant (Sinteza 4) for the production of active pharmaceutical ingredients, which should be completed in autumn of this year. A new liquid raw material storage facility was constructed at the controlling company's central Novo Mesto site, while production capacity was increased in one of the existing plants (Specifika), and the capacity of the finished product warehouse was almost doubled. The co-investment in the town water treatment plant in Ljutomer was completed, while the technology at the water treatment plant in Novo Mesto was upgraded. The construction of a production and distribution centre in Croatia was completed, and all the permits required to produce pharmaceutical in solid dosage form were obtained. The Krka Zdravilišča subsidiary primarily invested in increasing and improving health and tourism complex at the Zdravilišče Šmarješke Toplice health resort, and increasing and improving capacity at the Balnea wellness centre in Dolenjske Toplice.

Employees

Implementing our demanding business plans has required additional staff. In Slovenia, numbers have mainly increased in the fields of R&D and marketing, while there have been large increases in the number of people employed in marketing departments in Krka's representative offices and companies abroad.

At year end, the Krka Group employed 5224 people, 2954 of those in the Krka company in Slovenia, 1024 in representative offices abroad, 620 in companies abroad and 626 in the Krka Zdravilišča company. This was an increase of 443 or 8.4% in the number of employees on the previous year. A total of 1644 employees worked in companies outside Slovenia, representing 31% of all employees in the Group.

The influx of new employees has increased the proportion of university-educated staff in the Krka Group, which now stands at 39 per cent of all Group employees. At the end of 2005 there were 2222 employees with university level education, including 51 people with doctorates and 153 people with a master's degree. The international orientation of our company is confirmed by the fact that 65% of our employees with university degrees work in representative offices abroad.

In 2005, 360 of our employees were engaged in part-time studies, 137 of these at postgraduate level for MSc or PhD degrees. Education was continued by 58 employees, who entered the new form of certificate-based education in order to achieve a national vocational qualification.

Last year each Krka employee spent on average 28 hours updating their knowledge; 92% of that time was spent at internal seminars, 6% in Slovenia and 2% abroad. The Group has encouraged the influx of new talent through 62 scholarships; a special incentive for the most creative people is the Krka prize for young researchers and scientists, which has been awarded on 35 occasions.

Recognising the importance of a healthy environment and positive atmosphere among employees has led Krka to set up an integrated system of employee health care and well being for the workplace and outside the workplace too. Since the Reciprocal Relations and Sick Leave project started there has been a significant decrease in sick leave, which has been just above 5% in recent years.

One of the basic conditions for assigning an employee to a certain position is that they are trained in correct and safe work procedures. Accident data is monitored continually. Real accidents that are directly related to working conditions, inadequate equipment and inappropriate qualifications of employees, are decreasing year by year. The LITR indicator (indicates the number of accidents in the workplace requiring three or more days of sick leave per million hours of work) was down to 6.7 in 2005.

Receipts of Groups of Persons

At year-end the members of the Krka company's management board held 5173 shares in the Krka company, which represents 0.15% of total equity, while directors of subsidiaries held 1207 shares, equivalent to 0.03% of total equity.

As at 31 December 2005 members of the management board and supervisory board together held 0.17 per cent of Krka shares. Members of the management board held the following number of shares: Jože Colarič 1700 shares (0.048% of total equity), Janez Poljanec 2206 shares (0.062%), Aleš Rotar 1157 shares (0.033%) and Zvezdana Bajc 110 shares (0.003%). Members of the supervisory board held the following number of shares: Gregor Gomišček 12 shares (0.0003%), Marko Kranjec 101 shares (0.003%), Alojz Zupančič 514 shares (0.015%), Sonja Kermc 211 shares (0.006%) and Tomaž Sever 50 shares (0.001%).

Total amount of receipts that groups of persons received in the financial year for performing their functions or duties in conformity with Article 253 of the Companies Act

SIT Thousands

Groups of persons as per Companies Act	Total gross receipts	Hereof participation in profit according to the AGM resolution
Members of the Management Board	365,145	0
Members of the Supervisory Board	63,066	51,291
- the Board up to 21 June 2005 (12 members)	59,899	51,291
- the Board from 22 June 2005 (9 members)	3,167	0
Persons employed under individual employment contracts	3,812,416	0
Total	**4,240,627**	**51,291**

Receipts received by individual Management Board members for 2005

SIT Thousands

	Gross salary– fixed part	Gross salary– variable part	Fringe benefits and other receipts	Refund of expenses	Total receipts
Jože Colarič	57,209	45,356	3,068	1,919	107,552
Janez Poljanec	47,449	37,545	2,219	2,067	89,280
Aleš Rotar	44,749	35,395	3,220	2,331	85,695
Zvezdana Bajc	31,667	23,628	1,948	429	57,672
Danica Novak Malnar	23,841	0	879	226	24,946
Total	**204,915**	**141,924**	**11,334**	**6,972**	**365,145**

The fixed salary for Management Board members is defined in individual contracts agreed between them and the Supervisory Board. The variable part of a Management Board member's salary is calculated according to the provisions of the Rules on Management Board Remuneration, adopted by the company's Supervisory Board, and represents part of the gross salary. The Management Board does not receive a participation in profit. The receipts of Management Board member Zvezdana Bajc includes receipts for the period after 1 April 2005 onwards, after she became a board member.

The receipts of the Supervisory Board members include remuneration for the tasks performed within the Supervisory Board. Receipts of persons employed under individual employment contracts not governed by collective contract tariffs, include salary, fringe benefits, holiday allowance, any other consideration (e.g. long-service bonuses), and refund of expenses.

Share and ownership structure

Since October 2005 Krka shares, which have been listed on the Ljubljana Stock Exchange since 1997, have been includeed in the Ljubljana Stock Exchange’s prime market, and are one of the most liquid securities on the market. On 30 December 2005 the share price was SIT 102,342, which is 190% higher than its book value (SIT 35,298). In 2005 the company’s share price increased by 22%.

In 2005 the growth of the Krka share price outperformed most of the selected share indices. Krka’s share performance was significantly better than the Slovenian Stock Exchange Index (SBI 20) and Standard & Poor's Pharmaceuticals Industry Index. In the final quarter of the year the growth in the share performance caught up with the value of the FTSE All Share Pharmaceuticals & Biotechnology Index.

In 2005 the trading turnover in Krka shares was SIT 43 billion (2004: SIT 40.7 billion), which is an increase of 6% on 2004. Average daily trading in 2005 was SIT 172 million (2004: SIT 160 million). Compared with 2004, the average daily turnover increased by 7.5%. The annual trading turnover in Krka shares in 2005 represented 10% of the total annual turnover of the Ljubljana Stock Exchange (2004: 10%) and 14% of Krka's average market capitalisation over the same period (2004: 16%).

At the end of 2005, Krka’s total market capitalisation was SIT 362.6 billion (2004: SIT 299.3 billion), which is the largest market capitalisation of any company listed on the Ljubljana Stock Exchange. In fact, Krka’s market capitalisation at the end of 2005 represented 11% of the stock exchange’s total market capitalisation (2004: 10%).

Krka is pursuing a policy of moderate increase of dividends. The dividends are paid once per year, within 60 days of the Annual General Meeting. On the meeting shareholders decide on the dividend for the past business year.

The earnings per share is calculated as the ratio of profit to total number of shares, excluding 162,662 treasury shares. Krka’s earnings per share (according to the SAS) in 2005 was SIT 6,385 (2004: SIT 4,172).

The book value per share is calculated as the ratio of total equity (minus the value of reserves for treasury shares) to the number of shares issued (minus the number of treasury shares). On 31 December 2005 it was SIT 35,615 (31 Dec 2004: SIT 30,190) for the Krka company(according to the SAS).

On 31 December 2005 Krka had 162,662 treasury shares with a nominal value on that day of SIT 650,648 thousand, which is 4.6% of the share capital. The value of treasury shares in the balance sheet as on 31 December 2005 was SIT 4,670,280 thousand. That is a value of SIT 28,711.56 per treasury share according to the market value on 29 December 2001. On 30 December 2005 the share price on the Ljubljana Stock Exchange was SIT 102,342.30. The fair value of treasury shares was therefore SIT 16,647,203 thousand.

At the end of 2005, Krka had 53,635 shareholders (2004: 54,911), meaning the ownership of the company became slightly more concentrated. This reversed the trend towards dispersion of previous years. In 2005 the proportion of international investors rose to 6.2 % (2004: 2.8%), largely due to a reduction in the ownership stake of Slovenian investment companies and funds, which represented 15.2 % (2004: 17.6%) at the end of the year. The ownership share of Slovenian state financial companies (SOD, and KAD with PPS) did not change significantly in 2005 and stood at 24.6% (24.5% in 2004). The proportions held by other shareholder groups also remained more or less constant in 2005.

On 31 December 2005 the ten largest shareholders together held slightly less than 37 per cent of all Krka shares:

	Shareholder domicile	No of shares	Proportion (%)
SLOVENSKA ODŠKODNINSKA DRUŽBA, D.D.	SLOVENIA	513 963	14.51
KAPITALSKA DRUŽBA, D. D.	SLOVENIA	343 710	9.70
NFD 1 DELNIŠKI INVESTICIJSKI SKLAD D. D.	SLOVENIA	132 703	3.75
VS TRIGLAV STEBER I	SLOVENIA	61 089	1.72
BANK AUSTRIA CREDITANSTALT AG	AUSTRIA	49 057	1.38
KD GALILEO, VZAJEMNI SKLAD	SLOVENIA	49 006	1.38
NEW WORLD FUND INC	USA	46 000	1.30
ZAVAROVALNICA TRIGLAV, D. D.	SLOVENIA	38 830	1.10
LUKA KOPER, D. D.	SLOVENIA	34 670	0.98
MARIBORSKE LEKARNE MARIBOR	SLOVENIA	30 000	0.85
T O T A L		**1 299 028**	**36.67**

AUDITED FINANCIAL STATEMENTS

Financial Statements of Krka pursuant to SAS

KPMG

Auditor's Report

To the Supervisory Board of KRKA, d.d., Novo mesto

We have audited the accompanying balance sheet of the company KRKA, d.d., Novo mesto, as of 31 December 2005, and the related income statement, the cash flow statement, the statement of changes in equity, and the notes thereto for the year then ended. We also read the Management Report. These financial statements, prepared in accordance with the Slovenian Accounting Standards, and the notes thereto are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing issued by International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above give a true and fair view of the financial position of the Company as of 31 December 2005, the results of its operations, its cash flows and the changes in equity for the year then ended in conformity with Slovenian Accounting Standards issued by Slovenian Institute of Auditors.

The Management Report is in conformity with the audited financial statements.

KPMG SLOVENIJA,

podjetje za revidiranje, d.o.o.

Marjan Mahnič, B.Sc.Ec.
Managing Partner and Certified Audit

Andrej Korinšek, B.Sc.Ec.
Managing Partner and Certified Audit

Ljubljana, March 23, 2006

KPMG Slovenija, d.o.o.
4

Balance Sheet of Krka (SAS)

in TSIT

	31 Dec 2005	31 Dec 2004
ASSETS	**182,826,120**	**151,080,787**
FIXED ASSETS	**114,012,826**	**103,768,324**
Intangible fixed assets	5,240,167	4,337,508
Tangible fixed assets	73,440,344	67,607,520
Long-term investments	35,332,315	31,823,296
CURRENT ASSETS	**68,731,246**	**47,176,096**
Inventories	26,926,295	18,538,074
Operating receivables	37,182,590	25,617,311
Short-term investments	3,863,593	1,919,757
Cash in bank, cheques and cash in hand	758,768	1,100,954
DEFERRED COSTS (EXPENSES) AND ACCRUED REVENUES	**82,048**	**136,367**
OFF BALANCE SHEET ASSETS	19,352,546	18,599,067
LIABILITIES	**182,826,120**	**151,080,787**
CAPITAL	**125,045,773**	**106,711,173**
Called-up capital	14,170,448	14,170,448
Capital reserves	2,598,736	2,598,736
Revenue reserves	64,542,300	55,230,357
Net profit from previous periods	5,974,464	3,583,658
Net profit for the financial year	14,280,823	9,101,384
Capital revaluation adjustment	23,479,002	22,026,590
PROVISIONS	**13,027,768**	**12,025,182**
FINANCIAL AND OPERATING LIABILITIES	**40,918,261**	**30,972,198**
Long-term financial and operating liabilities	10,011,560	13,786,543
Short-term financial and operating liabilities	30,906,701	17,185,655
ACCRUED COSTS (EXPENSES) AND DEFERRED REVENUES	**3,834,318**	**1,372,234**
OFF BALANCE SHEET LIABILITIES	19,352,546	18,599,067

Income Statement of Krka (SAS)

in TSIT

	2005	2004
Net sales	116,570,332	97,977,511
- on domestic market	18,336,745	18,474,969
- on foreign market	98,233,587	79,502,542
Change in inventories	4,794,880	-1,074,999
Capitalised own products and services	19,143	44,949
Other operating revenues	11,796,305	4,098,175
Cost of goods, materials and services	-52,173,899	-43,518,841
Labour cost	-28,657,196	-26,359,527
Amortisation/depreciation expense	-10,252,992	-9,750,662
- amortisation/depreciation expense, and operating expenses from revaluation of intangible and tangible fixed assets	-9,327,315	-8,604,262
- Operating expenses from revaluation of current assets	-925,677	-1,146,400
Other operating expenses	-13,908,010	-3,832,049
Financial revenues from shares	1,019,272	1,545,028
Financial revenues from long-term receivables	146,652	404,541
Financial revenues from short-term receivables	1,996,463	1,599,680
Financial expenses for long- and short-term investment write-offs	-2,095,761	-1,816,727
Interest expenses and financial expenses for other liabilities	-1,879,116	-2,353,173
PROFIT FROM ORDINARY ACTIVITIES	**27,376,073**	**16,963,906**
Extraordinary revenues	64,723	112,051
Extraordinary expenses	-25,220	-10,799
PROFIT FROM EXTRAORDINARY ACTIVITIES	**39,503**	**101,252**
PROFIT BEFORE TAX	**27,415,576**	**17,065,158**
Income tax	-5,834,753	-2,963,774
NET PROFIT FOR THE FINANCIAL YEAR	**21,580,823**	**14,101,384**

Cash Flow Statements of Krka (SAS)

in TSIT

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Inflows	**114,887,674**	**100,953,333**
Operating revenues	122,930,717	98,307,948
Extraordinary revenues associated with operations	64,723	112,051
Opening less closing operating receivables	-8,162,086	2,610,502
Opening less closing deferred costs (expenses) and accrued revenues	54,320	-77,168
Outflows	**90,962,569**	**72,022,595**
Operating expenses excluding amortisation (depreciation) expense and long-term provisions	82,675,482	72,032,895
Extraordinary expenses associated with operations	25,220	10,799
Income tax and other taxes not included in operating expenses	4,085,332	1,459,866
Closing less opening inventories	8,925,893	-1,610,308
Opening less closing operating liabilities	-2,287,273	95,246
Opening less closing accrued costs (expenses) and deferred revenues	-2,462,085	34,097
Net cash from operating activities	**23,925,105**	**28,930,738**
CASH FLOWS FROM INVESTING ACTIVITIES		
Inflows	**252,506**	**303,878**
Financial revenues associated with investing activities (excluding revaluation)	252,506	303,878
Outflows	**16,475,164**	**20,894,133**
Financial expenses associated with investing activities (excluding revaluation)	1,150,399	0
Offset increase in intangible fixed assets (excluding revaluation)	1,861,732	2,670,036
Offset increase in tangible fixed assets (excluding revaluation and contributions in kind)	11,856,076	17,113,317
Offset increase in long-term investments (excluding revaluation)	1,228,739	755,915
Offset increase in short-term investments (excluding revaluation)	378,218	354,865
Net cash used in investing activities	**-16,222,658**	**-20,590,255**
CASH FLOWS FROM FINANCING ACTIVITIES		
Inflows	**4,042,482**	**9,752,356**
Financial revenues associated with financing activities (excluding revaluation)	70,253	260,034
Offset increase in long-term financial liabilities (excluding revaluation)	0	9,492,322
Offset increase in short-term financial liabilities (excluding revaluation)	3,972,229	0
Outflows	**10,217,973**	**17,305,957**
Financial expenses associated with financing activities (excluding revaluation)	1,237,572	1,359,046
Offset decrease in long-term financial liabilities (excluding revaluation)	4,171,324	0
Offset decrease in short-term financial liabilities (excluding revaluation)	0	11,854,143
Dividends paid	4,809,077	4,092,768
Net cash used in financing activities	**-6,175,491**	**-7,553,601**
CLOSING BALANCE OF CASH AND CASH EQUIVALENTS*	**3,800,901**	**2,263,745**
Net cash flow for the financial year	1,526,956	786,882
Effect of the exchange rate fluctuations on cash and cash equivalents	10,200	-52,252
Opening balance of cash and cash equivalents	2,263,745	1,529,115

* Balance of 2005 encompasses also cash equivalents i.e. securities and options in the amount of 3,042,133 TSIT. As at 31 December 2004 cash equivalents were recorded in the amount of 1,162,791 TSIT.

Statement of Changes in Equity of Krka as at 31 December 2005 (SAS)

in TSIT

	Called-up capital	Capital reserves	Legal reserves	Reserves for own shares	Statutory reserves	Other revenue reserves	Net profit or loss from previous periods	Net profit or loss for the financial year	General capital revaluation adjustment	Specific capital revaluation adjustment	Total capital
Balance as at 31 Dec 2004	**14,170,448**	**2,598,736**	**3,592,196**	**4,670,280**	**1,500,000**	**45,467,881**	**3,583,658**	**9,101,384**	**21,724,113**	**302,477**	**106,711,173**
Transfer to capital	**0**	**0**	**0**	**0**	**0**	**0**	**87,663**	**21,580,823**	**0**	**1,509,832**	**23,178,318**
Entry of net profit for the financial year	0	0	0	0	0	0	0	21,580,823	0	0	21,580,823
Entry of specific capital revaluation adjustment	0	0	0	0	0	0	0	0	0	0	0
Other increases in capital components	0	0	0	0	0	0	87,663	0	0	1,509,832	1,597,495
Transfer within capital	**0**	**0**	**0**	**0**	**800,000**	**12,386,801**	**3,214,583**	**-16,401,384**	**0**	**0**	**0**
Distribution of net profit for the financial year based on the decision of Management and	0	0	0	0	800,000	6,500,000	0	-7,300,000	0	0	0
Allocation of net profit to additional reserves based on the decision of the annual meeting	0	0	0	0	0	5,886,801	-5,886,801	0	0	0	0
Other reclassifications of capital components	0	0	0	0	0	0	9,101,384	-9,101,384	0	0	0
Transfer from capital	**0**	**0**	**0**	**0**	**0**	**3,874,858**	**911,440**	**0**	**0**	**57,420**	**4,843,718**
Dividends paid	0	0	0	0	0	3,874,858	911,440	0	0	0	4,786,298
Other eliminated capital components	0	0	0	0	0	0	0	0	0	57,420	57,420
Balance as at 31 Dec 2005	**14,170,448**	**2,598,736**	**3,592,196**	**4,670,280**	**2,300,000**	**53,979,824**	**5,974,464**	**14,280,823**	**21,724,113**	**1,754,889**	**125,045,773**

Statement of Changes in Equity of Krka as at 31 December 2004 (SAS)

in TSIT

	Called-up capital	Capital reserves	Legal reserves	Reserves for own shares	Statutory reserves	Other revenue reserves	Net profit or loss from previous periods	Net profit or loss for the financial year	General capital revaluation adjustment	Specific capital revaluation adjustment	Total capital
Balance as at 31 Dec 2003	**14,170,448**	**2,598,736**	**3,592,196**	**4,670,280**	**1,000,000**	**38,558,331**	**5,014,357**	**5,011,206**	**21,724,113**	**164,369**	**96,504,036**
Transfer to capital	**0**	**0**	**0**	**0**	**0**	**0**	**73,925**	**14,101,384**	**0**	**138,109**	**14,313,418**
Entry of net profit for the financial year	0	0	0	0	0	0	0	14,101,384	0	0	14,101,384
Other increases in capital components	0	0	0	0	0	0	73,925	0	0	138,109	212,034
Transfer within capital	**0**	**0**	**0**	**0**	**500,000**	**9,459,641**	**51,565**	**-10,011,206**	**0**	**0**	**0**
Distribution of net profit for the financial year based on the decision of Management and Supervisory Boards	0	0	0	0	500,000	4,500,000	0	-5,000,000	0	0	0
Allocation of net profit to additional reserves based on the decision of the annual meeting	0	0	0	0	0	4,959,641	-4,959,641	0	0	0	0
Other reclassifications of capital components	0	0	0	0	0	0	5,011,206	-5,011,206	0	0	0
Transfer from capital	**0**	**0**	**0**	**0**	**0**	**2,550,091**	**1,556,189**	**0**	**0**	**0**	**4,106,280**
Dividends paid	0	0	0	0	0	2,550,091	1,556,189	0	0	0	4,106,280
Balance as at 31 Dec 2004	**14,170,448**	**2,598,736**	**3,592,196**	**4,670,280**	**1,500,000**	**45,467,881**	**3,583,658**	**9,101,384**	**21,724,113**	**302,477**	**106,711,173**

Financial Statements of the Krka Group pursuant to IFRS

Financial statements for the year ended 31 December 2005 have been audited, with the exception of companies in Hungary, the Czech Republic and Germany, where no operations are carried out. Most of the Group companies have been audited by the local subsidiaries of KPMG. Financial statements of the company Krka Polska have been audited by PricewaterhouseCoopers Sp. z o. o., whereas those of Krka Pharma Dublin Limited by the company Doggett & Co.

Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC). These are the Group's first consolidated financial statements prepared in compliance with the IFRS 1.
Clarification on the transition to IFRS and its impact on the Group's financial position, financial performance and the financial result is presented in a separate section.

When preparing the consolidated financial statements for 2005 following new standards, amendments and interpretations have not been complied with:

- IFRS 6 Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)
- IFRS 7 Financial Instruments: Disclosures (effective from 1 January 2007)
- Amendment to IFRS 1 First-time Adoption of International Financial Reporting Standards and IFRS 6 Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)
- Amendment to IAS 1 Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007)
- Amendment to IAS 19 Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures (effective from 1 January 2006)
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006)
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement – The Fair Value Option (effective from 1 January 2006)
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts – Financial Guarantee Contracts (effective from 1 January 2006)
- Amendment to IAS 21 The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation (effective from 1 January 2006)
- IFRIC 4 Determining whether an Arrangement contains a Lease (effective from 1 January 2006)
- IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006)
- IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective from 1 December 2005)
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006)
- IFRIC 8 Scope of IFRS 2 (effective from 1 May 2006)
- IFRIC 9 Reassessment of Embedded Derivatives (effective from 1 June 2006)

KPMG

Auditor's Report

To the Supervisory Board of KRKA, d.d., Novo mesto

We have audited the accompanying consolidated balance sheet of the KRKA Group as of 31 December 2005, the related consolidated income statement, the consolidated cash flow statement, the consolidated statement of changes in equity, and the notes thereto for the year then ended. These consolidated financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, and the notes thereto are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing issued by International Federation of Accountants and other auditing regulations issued by Slovenian Institute of Auditors. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above give a true and fair view of the financial position of the Group as of 31 December 2005, the results of its operations, its cash flows and the changes in equity for the year then ended in conformity with International Financial Reporting Standards as adopted by the EU.

KPMG SLOVENIJA,

podjetje za revidiranje, d.o.o.

Marjan Mahnič, B.Sc.Ec.
Managing Partner and Certified Audit

Andrej Korinšek, B.Sc.Ec.
Managing Partner and Certified Audit

KPMG Slovenija, d.o.o.
4

Ljubljana, March 23, 2006

Consolidated Balance Sheet of the Krka Group (IFRS)

in TSIT

	31 Dec 2005	31 Dec 2004
Assets		
Property, plant and equipment	108,165,231	98,539,914
Intangible assets	5,058,450	4,151,803
Investments in associates	270,761	119,871
Deferred tax assets	4,778,324	1,913,542
Other non-current assets	2,182,301	2,207,730
Non-current assets	**120,455,067**	**106,932,860**
Inventories	28,966,629	20,035,072
Trade and other receivables	33,008,703	23,910,769
Current investments	3,391,005	1,875,683
Cash and cash equivalents	3,027,752	2,841,099
Current assets	**68,394,089**	**48,662,623**
Total assets	**188,849,156**	**155,595,483**
Off balance sheet items	20,201,775	19,271,908
Equity		
Share capital	14,170,448	14,170,448
Own shares	-4,670,280	-4,670,280
Reserves	34,885,325	34,085,325
Retained earnings	68,131,642	51,140,710
Reserves for fair value	561,602	519,987
Translation reserves	4,648	59,959
Equity holders of the parent	**113,083,385**	**95,306,149**
Minority interest	1,813,556	1,819,476
Total equity	**114,896,941**	**97,125,625**
Liabilities		
Borrowings	11,669,435	14,596,143
Provisions	23,647,648	22,416,952
Grants received	445,849	209,898
Deferred tax liabilities	285,236	248,948
Total non-current liabilities	**36,048,168**	**37,471,941**
Trade liabilities	14,043,571	9,073,437
Borrowings	9,120,664	5,282,943
Income tax liabilities	6,689,431	1,490,963
Provisions and other liabilities	8,050,381	5,150,574
Total current liabilities	**37,904,047**	**20,997,917**
Total liabilities	**73,952,215**	**58,469,858**
Total equity and liabilities	**188,849,156**	**155,595,483**
Off balance sheet items	20,201,775	19,271,908

Consolidated Income Statement of the Krka Group (IFRS)

in TSIT

	2005	**2004**
Net sales	132,757,626	113,317,141
Production cost of goods sold	51,847,673	51,676,455
Gross operating yield	**80,909,953**	**61,640,686**
Sales and marketing	41,609,639	26,869,490
R&D costs	9,611,856	8,313,591
Administrative expenses	13,386,461	13,031,883
Other operating expenses	12,221,261	4,524,293
Operating profit	**28,523,258**	**17,950,015**
Financial income	3,989,327	3,545,539
Financial expenses	2,982,607	3,195,485
Net financial expenses	**1,006,720**	**350,054**
Profit before tax	**29,529,978**	**18,300,069**
Income tax expense	6,210,850	2,639,051
Profit for the period	**23,319,128**	**15,661,018**
Equity holders of the parent	**23,288,582**	**15,637,826**
Minority interest	**30,546**	**23,192**
Earnings per share	6,890	4,627

Consolidated Cash Flow Statement of the Krka Group (IFRS)

in TSIT

	2005	2004
Cash flows from operating activities		
Profit for the period	**23,319,128**	**15,661,018**
Adjustments for:	**18,432,818**	**14,201,263**
- amortisation /Depreciation	10,970,573	10,354,434
- foreign exchange gain	-572,441	-685,066
-foreign exchange loss	836,799	1,026,136
- investment income	-9,694	36,470
- financial income	-70,253	-253,034
- financial expenses	1,012,153	1,106,463
- income taxes and other taxes not included in operating expenses	6,210,850	2,639,052
- other	54,831	-23,192
Operating profit before changes in net operating current assets and	**41,751,946**	**29,862,281**
Change in trade receivables	-8,954,104	1,511,716
Change in inventories	-8,931,557	2,853,588
Change in operating debts (liabilities)	3,254,225	1,158,966
Change in other trade payables and provisions	3,662,565	-1,125,278
Income taxes paid	-4,528,103	-1,824,489
Cash generated from operations	**26,254,972**	**32,436,784**
Cash flows from investing activities		
Interest received	116,262	171,402
Proceeds from sale of investments	64,744	71,004
Dividends received	40,496	19,812
Proceeds from property, plant and equipment	365,498	124,074
Purchase of intangible assets	-1,847,877	-2,670,483
Purchase of property, plant and equipment	-18,018,146	-20,405,420
Acquisition of long-term investments	84,621	428,823
Acquisition of short-term investments	-1,820,853	-1,119,762
Acquisition of derivative financial instruments	-334,251	27,673
Net cash used in investing activities	**-21,349,506**	**-23,352,877**
Cash flows from financing activities		
Proceeds from an increase in long-term financial liabilities	0	8,854,051
Proceeds from an increase in short-term financial liabilities	3,965,392	0
Payment of interest in respect of financing	-547,754	-1,093,274
Payment of long-term financial liabilities	-3,337,574	0
Payment of short-term financial liabilities	0	-11,813,907
Dividends paid	-4,809,077	-4,092,768
Net cash used in financing activities	**-4,729,013**	**-8,145,898**
Net increase in cash and cash equivalents	176,453	938,009
Cash and cash equivalents at beginning of period	2,841,099	1,955,342
Effect of exchange rate fluctuations on cash held	10,200	-52,252
Net cash and cash equivalents at end of period	**3,027,752**	**2,841,099**

Consolidated Statement of Changes in Equity of the Krka Group (IFRS)

in TSIT

	Share Capital	Reserves	Own shares	Retained earnings	Fair value reserve	Translation reserves	Minority share capital	Total Equity
Balance at 1 January 2004	**14,170,448**	**33,585,325**	**-4,670,280**	**40,226,095**	**29,605**	**17,938**	**1,813,103**	**85,172,234**
Entry of profit for the period	0	0	0	15,637,826	0	0	23,192	15,661,018
Formation of statutory reserves	0	500	0	-500	0	0	0	0
Dividends paid	0	0	0	-4,106,280	0	0	-22,176	-4,128,456
Recognised income and expense	0	0	0	-116,931	490,381	42,021	5,357	420,828
Balance at 31 December 2004	**14,170,448**	**34,085,325**	**-4,670,280**	**51,140,710**	**519,987**	**59,959**	**1,819,476**	**97,125,625**
Entry of profit for the period	0	0	0	23,288,582	0	0	30,546	23,319,128
Formation of statutory reserves	0	800	0	-800	0	0	0	0
Dividends paid	0	0	0	-4,786,297	0	0	-31,85	-4,818,147
Recognised income and expense	0	0	0	-711,352	41,615	-55,311	-4,616	-729,663
Balance at 31 December 2005	**14,170,448**	**34,885,325**	**-4,670,280**	**68,131,642**	**561,602**	**4,648**	**1,813,556**	**114,896,941**

Clarification on the Transition to the IFRS Reporting – Krka Group

Reconciliation of Equity

in TSIT

		Balance at 1 Jan 2004			Balance at 31 Dec 2004		
	Note	Balance Sheet under SAS	Effects of transition to IFRS	Balance sheet under IFRS	Balance sheet under SAS	Effect of transition to IFRS	Balance sheet under IFRS
Assets							
Property, plant and equipment	a	85,268,878	3,669,055	88,937,933	93,800,670	4,739,244	98,539,914
Intangible assets	b	2,575,488	-322,433	2,253,055	4,674,953	-523,150	4,151,803
Investments in Group companies		120,256	0	120,256	123,295	-3,424	119,871
Deferred tax assets	c	324,016	1,078,826	1,402,842	743,298	1,170,244	1,913,542
Other non-current assets	d	6,252,198	-4,584,383	1,667,815	6,143,344	-3,935,614	2,207,730
Total non-current assets		**94,540,836**	**-158,935**	**94,381,901**	**105,485,560**	**1,447,300**	**106,932,860**
Inventories	e	22,938,944	-50,284	22,888,660	20,162,766	-127,694	20,035,072
Trade receivables	f	25,649,298	195,027	25,844,325	23,651,141	259,628	23,910,769
Short-term investments	g	1,070,295	15,289	1,085,584	1,813,800	61,883	1,875,683
Cash and cash equivalents		1,955,340	2	1,955,342	2,841,097	2	2,841,099
Other current assets	f	195,027	-195,027	0	259,630	-259,630	0
Total current assets		**51,808,904**	**-34,993**	**51,773,911**	**48,728,434**	**-65,811**	**48,662,623**
Total assets		**146,349,740**	**-193,928**	**146,155,812**	**154,213,994**	**1,381,489**	**155,595,483**
Equity							
Share capital		14,170,448	0	14,170,448	14,170,448	0	14,170,448
Own shares		0	-4,670,280	-4,670,280	0	-4,670,280	-4,670,280
Reserves	h	11,861,212	21,724,114	33,585,326	12,361,212	21,724,113	34,085,325
Retained earnings		45,684,561	-5,458,465	40,226,096	55,782,868	-4,642,158	51,140,710
Reserves for fair value	h	21,888,482	-21,858,877	29,605	22,029,250	-21,509,263	519,987
Translation reserve	i	37,445	-19,507	17,938	78,808	-18,849	59,959
Equity holders of the parent		**93,642,148**	**-10,283,015**	**83,359,133**	**104,422,586**	**-9,116,437**	**95,306,149**
Minority interest	j	1,980,140	-167,037	1,813,103	1,993,014	-173,538	1,819,476
Total equity		**95,622,288**	**-10,450,052**	**85,172,236**	**106,415,600**	**-9,289,975**	**97,125,625**
Liabilities							
Borrowings		5,821,295	0	5,821,295	14,596,143	0	14,596,143
Provisions	k	13,290,074	10,205,172	23,495,246	11,994,437	10,422,515	22,416,952
Grants received		222,785	0	222,785	209,898	0	209,898
Deferred tax liabilities	c	0	50,960	50,960	0	248,948	248,948
Total non-current liabilities		**19,334,154**	**10,256,132**	**29,590,286**	**26,800,478**	**10,671,463**	**37,471,941**
Trade payables	l	10,115,932	555,682	10,671,614	9,053,894	19,543	9,073,437
Borrowings		17,472,880	0	17,472,880	5,282,943	0	5,282,943
Income tax liabilities		0	0	0	1,490,963	0	1,490,963
Provisions for other liabilities	l	3,804,486	-555,690	3,248,796	5,170,116	-19,542	5,150,574
Total current liabilities		**31,393,298**	**-8**	**31,393,290**	**20,997,916**	**1**	**20,997,917**
Total liabilities		**50,727,452**	**10,256,124**	**60,983,576**	**47,798,394**	**10,671,464**	**58,469,858**
Total equity and liabilities		**146,349,740**	**-193,928**	**146,155,812**	**154,213,994**	**1,381,489**	**155,595,483**

Notes to individual items

a) As for the transition to IFRS individual parts of an item of property, plant and equipment which differ in their expected useful lives were accounted for as individual assets, for which depreciation is accounted for individually. The adjustments were made for the entire period since their bringing into use. Lower depreciation amounts result in higher carrying amounts of the items of buildings and equipment by 3,566,637 TSIT as at 1 January 2004 and by 4,389,908 TSIT as at 31 December 2004. The effect is recorded under retained earnings. The transfer of the amounts of 'intangible assets' in the value of 102,418 TSIT as at 1 January 2004 and 349,336 TSIT as at 31 December 2004 resulted in an additional increase in the value of buildings and equipment.

b) Intangible assets as at 1 January 2004 recorded a decrease due to the transfer of the amounts of 'investments in assets not owned by the Group' to the item of 'property, plant and equipment' and the transfer of the amounts recorded in 'long-term operating lease' to 'long-term receivables'. The decrease is recorded at 322,433 TSIT as at 1 January 2004 and at 523,150 TSIT as at 31 December 2004.

c) Some of the companies in the Krka Group accounted for the deferred tax already prior to the Group's transition to the IFRS. As at 1 January 2004 the deferred tax assets amounted to 324,016 TSIT and to 743,298 TSIT as at 31 December 2004. The transition to IFRS resulted in an increase of deferred tax assets by 1,078,826 TSIT as at 1 January 2004 and by 1,170,244 TSIT as at 31 December 2004.

d) Other non-current are decreased as at 1 January 2004 and 31 December 2004 by the amount of own shares i.e. 4,670,280 TSIT, which are recorded as a deductible item within equity in the balance sheet prepared under IFRS. Other changes refer mostly to value adjustments of investments in securities that are allocated to available for sale, to the market value, as well as to the transfer from intangible assets to other non-current assets. Effects of the adjustment to the market value are disclosed in the reserve for fair value within the item of equity.

e) The valuation of inventories according to IFRS remained unchanged if compared to the valuation carried out in compliance with SAS provisions. Due to lower depreciation the value of inventories of finished products and work in progress was lower by 50,284 TSIT as at 1 January 2004 and by 127,694 TSIT as at 31 December 2004.

f) As at 1 January 2004 trade receivables record an increase of 195,027 TSIT and as at 31 December 2004 an increase of 259,628 TSIT i.e. amounts that were recorded under deferred costs and accrued revenues pursuant to SAS.

g) Investments in shares are valued at fair value, whereas the effects are recorded under retained earnings in the income statement.

h) During the transition to IFRS the general equity revaluation adjustment was eliminated from the reserve for fair value as at 1 January 2004 in the amount of 21,724,114 TSIT, which was accounted for according to SAS and included in reserves. Revaluation of derivative financial instruments in the amount of 164,368 TSIT is under IFRS included in the item of retained earnings. In addition, the reserve for fair value has increased by 29,605 TSIT based on the adjustment of the value of non-current investments to the fair value. As at 31 December 2004 reserves for fair value amount to 519,987 TSIT and result from the increase in non-current investments by the fair value adjustment i.e. 653,843 TSIT and the decrease of the deferred tax i.e. 163,461 TSIT.

i) The transition to IFRS resulted also in a decrease of exchange differences. They occur during the translation of items of financial statements of subsidiaries abroad and decreased by 19,507 TSIT as at 1 January 2004 and by 18,849 TSIT as at 31 December 2004.

j) The reconciliation of items within equity required by the transition to IFRS resulted also in a decrease of minority interest.

k) Non-current provisions have increased by the amount of provisions formed for termination pays and anniversary bonuses. The relevant provisions lower the amount of retained earnings. Other non-current provisions referring mostly to intellectual property lawsuits remained unchanged.

l) Trade payables increased due to the transfer of accrued costs from the item of provisions and other liabilities.

Reconciliation of Profit for 2004

in TSIT

	Note	2004 Income statement under SAS	2004 Effects of transition to IFRS	2004 Income statement under SAS
Net sales		113,317,141	0	113,317,141
Production cost of goods sold	a, b	51,698,079	-21,624	51,676,455
Gross operating yield		**61,619,062**	**21,624**	**61,640,686**
Sales and marketing	a, b	27,006,114	-136,624	26,869,490
R& D costs	a, b	8,372,923	-59,332	8,313,591
Administrative expenses	a, b	13,213,618	-181,735	13,031,883
Other operating revenues	c	4,364,063	160,230	4,524,293
Operating profit		**17,390,470**	**559,545**	**17,950,015**
Financial income	d	3,355,646	189,893	3,545,539
Financial expenses	e	3,323,750	-128,265	3,195,485
Net financial expenses		**31,896**	**318,158**	**350,054**
Extraordinary income/expenses		116,172	-116,172	0
Profit before tax		**17,538,538**	**761,531**	**18,300,069**
Income tax	f	2,878,183	-239,132	2,639,051
Net profit for the period		**14,660,355**	**1,000,663**	**15,661,018**
Equity holders of the parent		14,630,663	1,007,163	15,637,826
Minority interest		29,692	-6,500	23,192
Net profit for the period		**14,660,355**	**1,000,663**	**15,661,018**

Notes to individual items

a) The lower amount of depreciation according to IFRS resulted in lower production cost of goods sold by 158,800 TSIT, sales and marketing by 154,834 TSIT, R&D costs by 81,672 TSIT and administrative expenses by 251,415 TSIT.

b) The income statement for 2004 records an actuary loss (increase in provisions for employees) in the amount of 217,342 TSIT, resulting in an increase of operating expenses for 2004 namely production cost of goods sold by 137,176 TSIT, sales and marketing by 18,210 TSIT, R&D costs by 22,340 TSIT and administrative expenses by 39,616 TSIT.

c) Financial revenues increased by the amount of the derivative financial instruments adjusted to the market value i.e. 138,108 TSIT that was pursuant to SAS recorded under the reserve for fair value, as well as by the amount of short-term securities adjusted to the market value (46,593 TSIT). Pursuant to SAS, no strengthening of assets was carried out by the Group.

d) In accordance with IFRS financial expenses are lower due to exchange differences that result from subsidiary's changing of operations due to transition to IFRS.

e) Other operating expenses record an increase due to revenues that are recorded in the income statement pursuant to SAS as extraordinary revenues.

f) Reconciliation of balance sheet items during the transition to IFRS had an impact of the calculation of the deferred tax that in the amount of 239,132 TSIT decreases the Group's income tax liability for 2004.

Financial Statements of Krka pursuant to IFRS

Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC). These are the Company’s first consolidated financial statements prepared in compliance with the IFRS 1.

Clarification on the transition to IFRS and its impact on the Company's financial position, financial performance and the financial result is presented in a separate section.
When preparing the financial statements for 2005 following new standards, amendments and interpretations have not been complied with:

- IFRS 6 Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)
- IFRS 7 Financial Instruments: Disclosures (effective from 1 January 2007)
- Amendment to IFRS 1 First-time Adoption of International Financial Reporting Standards and IFRS 6 Exploration for and Evaluation of Mineral Resources (effective from 1 January 2006)
- Amendment to IAS 1 Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007)
- Amendment to IAS 19 Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures (effective from 1 January 2006)
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions (effective from 1 January 2006)
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement – The Fair Value Option (effective from 1 January 2006)
- Amendment to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts – Financial Guarantee Contracts (effective from 1 January 2006)
- Amendment to IAS 21 The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation (effective from 1 January 2006)
- IFRIC 4 Determining whether an Arrangement contains a Lease (effective from 1 January 2006)
- IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds (effective from 1 January 2006)
- IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment (effective from 1 December 2005)
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies (effective from 1 March 2006)
- IFRIC 8 Scope of IFRS 2 (effective from 1 May 2006)
- IFRIC 9 Reassessment of Embedded Derivatives (effective from 1 June 2006)

KPMG

Auditor's Report

To the Supervisory Board of KRKA, d.d., Novo mesto

We have audited the accompanying balance sheet of the KRKA d.d as of 31 December 2005, the related income statement, the cash flow statement, the statement of changes in equity, and the notes thereto for the year then ended. These financial statements, prepared in accordance with International Financial Reporting Standards as adopted by the EU, and the notes thereto are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing issued by International Federation of Accountants and other auditing regulations issued by Slovenian Institute of Auditors. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. It also includes an assessment of the compliance of the Management's Report on operation with the financial statements, which form a constituent part of the annual report. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above give a true and fair view of the financial position of the Company as of 31 December 2005, the results of its operations, its cash flows and the changes in equity for the year then ended in conformity with International Financial Reporting Standards as adopted by the EU.

KPMG SLOVENIJA,

podjetje za revidiranje, d.o.o.

Marjan Mahnič, B.Sc.Ec.

Managing Partner and Certified Audit

Andrej Korinšek, B.Sc.Ec.

Managing Partner and Certified Audit

Ljubljana, March 23, 2006

KPMG Slovenija, d.o.o.
4

Balance Sheet of Krka (IFRS)

in TSIT

	31 Dec 2005	31 Dec 2004
Assets		
Property, plant and equipment	78,103,851	71,527,763
Intangible assets	4,897,744	3,947,586
Investments in subsidiaries	27,756,710	25,307,556
Deferred tax assets	3,732,861	1,103,451
Other non-current assets	2,097,824	2,120,726
Non-current assets	**116,588,990**	**104,007,082**
Inventories	26,883,175	18,483,216
Trade and other receivables	33,774,998	25,745,309
Current investments	3,933,668	1,981,639
Cash and cash equivalents	758,768	1,100,954
Current assets	**65,350,609**	**47,311,118**
Total assets	**181,939,599**	**151,318,200**
Off balance sheet items	19,352,546	18,599,067
Equity		
Share capital	14,170,448	14,170,448
Own shares	-4,670,280	-4,670,280
Reserves	34,885,325	34,085,325
Retained earnings	69,193,532	53,031,991
Reserves for fair value	561,602	519,986
Total equity	**114,140,627**	**97,137,470**
Liabilities		
Borrowings	10,011,560	13,786,543
Provisions	22,692,910	21,488,397
Grants received	87,605	100,492
Deferred tax liabilities	265,879	248,949
Total non-current liabilities	**33,057,954**	**35,624,381**
Trade payables	12,713,863	8,312,672
Borrowings	8,495,030	4,628,896
Income tax liabilities	6,598,933	1,347,211
Provisions and other liabilities	6,933,192	4,267,570
Total current liabilities	**34,741,018**	**18,556,349**
Total liabilities	**67,798,972**	**54,180,730**
Total equity and liabilities	**181,939,599**	**151,318,200**
Off balance sheet items	19,352,546	18,599,067

Income Statement of Krka (IFRS)

in TSIT

	2005	2004
Net sales	116,570,332	97,977,511
Production cost of goods sold	45,055,228	43,918,709
Gross operating yield	**71,515,104**	**54,058,802**
Sales and marketing	35,056,183	22,022,101
R&D costs	9,487,512	8,313,591
Administrative expenses	10,050,639	9,961,612
Other operating revenues	11,880,171	4,255,175
Operating profit	**28,800,941**	**18,016,673**
Financial income	3,283,180	3,043,936
Financial expenses	3,734,629	3,066,041
Net financial expenses	**-451,449**	**-22,105**
Profit before tax	**28,349,492**	**17,994,568**
Income tax expense	5,890,302	2,684,951
Profit for the period	**22,459,190**	**15,309,617**
Earnings per share	6,645	4,530

Cash Flow Statement of Krka (IFRS)

in TSIT

	2005	2004
Cash flows from operating activities		
Profit for the period	**22,459,190**	**15,309,617**
Adjustments for:	**15,927,547**	**10,853,166**
- amortisation /Depreciation	8,378,685	7,739,468
- foreign exchange gain	-1,523,964	-1,384,488
- foreign exchange loss	842,959	1,274,430
- investment income	-6,219	-195,228
- investment expense - subsidiaries	1,150,399	0
- financial income	-70,253	-260,034
- financial expense	1,180,260	994,067
- income taxes and other taxes not included in operating expenses	5,890,302	2,684,951
- other	85,378	0
Operating loss before changes in net operating current assets and provisions	**38,386,737**	**26,162,783**
Change in trade receivables	-7,785,501	2,790,362
Change in inventories	-8,399,959	2,555,573
Change in operating debts (liabilities)	2,504,351	-47,238
Change in other current liabilities and provisions	3,387,544	-1,221,832
Income taxes paid	-4,085,332	-1,459,866
Cash generated from operations	**24,007,840**	**28,779,782**
Cash flows from investing activities		
Interest received	92,450	171,402
Proceeds from sale of investments	64,744	71,004
Dividends received	25,886	219,812
Proceeds from property, plant and equipment	150,165	124,074
Sale of subsidiary	0	31,698
Purchase of intangible assets	-1,853,563	-2,670,036
Purchase of property, plant and equipment	-12,164,575	-17,237,391
Acquisition of long-term investments	-2,378,695	-1,111,968
Acquisition of short-term investments	-2,257,560	-816,991
Acquisition of derivative financial instruments	-334,251	27,673
Net cash used in investing activities	**-18,655,399**	**-21,190,723**
Cash flows from financing activities		
Proceeds from an increase in long-term financial liabilities	0	9,407,773
Proceeds from an increase in short-term financial liabilities	3,993,805	0
Payment of interest in respect of financing	-625,317	-980,878
Payment of long-term financial liabilities	-4,264,238	0
Payment of short-term financial liabilities	0	-11,598,430
Dividends paid	-4,809,077	-4,092,768
Net cash used in financing activities	**-5,704,827**	**-7,264,303**
Net increase in cash and cash equivalents	-352,386	324,756
Cash and cash equivalents at beginning of period	1,100,954	828,450
Effect of exchange rate fluctuations on cash held	10,200	-52,252
Net cash and cash equivalents at end of period	**758,768**	**1,100,954**

Statement of Changes of Equity of Krka (IFRS)

In TSIT

	Share capital	Reserves	Own shares	Retained earnings	Fair value reserve	Total equity
Balance at 1 January 2004	**14,170,448**	**33,585,325**	**-4,670,280**	**42,445,585**	**29,605**	**85,560,683**
Entry of profit for the period	0	0	0	15,309,617	0	15,309,617
Formation of statutory reserves	0	500,000	0	-500,000	0	0
Dividends paid	0	0	0	-4,106,280	0	-4,106,280
Recognised income and expense	0	0	0	-116,931	490,381	373,450
Balance at 31 December 2004	**14,170,448**	**34,085,325**	**-4,670,280**	**53,031,991**	**519,986**	**97,137,470**
Entry of profit for the period	0	0	0	22,459,190	0	22,459,190
Formation of statutory reserves	0	800,000	0	-800,000	0	0
Dividends paid	0	0	0	-4,786,297	0	-4,786,297
Recognised income and expense	0	0	0	-711,352	41,616	-669,736
Balance at 31 December 2005	**14,170,448**	**34,885,325**	**-4,670,280**	**69,193,532**	**561,602**	**114,140,627**

Clarification on the Transition to the IFRS Reporting - Krka

Reconciliation of Equity

in TSIT

	Note	Balance at 1 Jan 2004			Balance at 31 Dec 2004		
		Balance Sheet under SAS	**Effects of transition to IFRS**	**Balance sheet under IFRS**	**Balance sheet under SAS**	**Effect of transition to IFRS**	**Balance sheet under IFRS**
Assets							
Property, plant and equipment	a	59,322,654	3,156,191	62,478,845	67,607,520	3,920,243	71,527,763
Intangible assets	b	2,198,129	-148,844	2,049,285	4,337,508	-389,922	3,947,586
Investments in Group companies	c	24,605,734	-879,310	23,726,424	25,773,021	-465,465	25,307,556
Deferred tax assets	d	0	980,958	980,958	0	1,103,451	1,103,451
Other non-current assets	e	5,857,026	-4,584,381	1,272,645	6,057,104	-3,936,378	2,120,726
Total non-current assets		**91,983,543**	**-1,475,386**	**90,508,157**	**103,775,153**	**231,929**	**104,007,082**
Inventories	f	21,038,789	0	21,038,789	18,538,074	-54,858	18,483,216
Trade receivables	g	28,925,297	51,868	28,977,165	25,610,482	134,827	25,745,309
Short-term investments	h	1,472,022	15,289	1,487,311	1,919,757	61,882	1,981,639
Cash and cash equivalents		828,450	0	828,450	1,100,954		1,100,954
Other current assets		59,199	-59,199	0	136,367	-136,367	0
Total current assets		**52,323,757**	**7,958**	**52,331,715**	**47,305,634**	**5,484**	**47,311,118**
Total assets		**144,307,300**	**-1,467,428**	**142,839,872**	**151,080,787**	**237,413**	**151,318,200**
Equity							
Share capital		14,170,448	0	14,170,448	14,170,448	0	14,170,448
Own shares	e	0	-4,670,280	-4,670,280	0	-4,670,280	-4,670,280
Reserves	i	11,861,212	21,724,114	33,585,326	12,361,212	21,724,113	34,085,325
Retained earnings		48,583,894	-6,138,309	42,445,585	58,152,923	-5,120,932	53,031,991
Reserves for fair value	i	21,888,482	-21,858,877	29,605	22,026,590	-21,506,603	519,987
Total equity		**96,504,036**	**-10,943,352**	**85,560,684**	**106,711,173**	**-9,573,702**	**97,137,471**
Liabilities							
Borrowings		4,509,155	0	4,509,155	13,786,543	0	13,786,543
Provisions	j	13,230,950	9,432,295	22,663,245	11,924,690	9,563,707	21,488,397
Grants received		113,379	0	113,379	100,492	0	100,492
Deferred tax liabilities	d	0	50,960	50,960	0	248,948	248,948
Total non-current liabilities		**17,853,484**	**9,483,255**	**27,336,739**	**25,811,725**	**9,812,655**	**35,624,380**
Trade payables	k	9,824,549	442,712	10,267,261	8,312,672	0	8,312,672
Borrowings		16,610,590	0	16,610,590	4,628,896	0	4,628,896
Income tax liabilities		0	0	0	1,347,211	0	1,347,211
Provisions and other liabilities	k	3,514,641	-450,043	3,064,598	4,269,110	-1,540	4,267,570
Total current liabilities		**29,949,780**	**-7,331**	**29,942,449**	**18,557,889**	**-1,540**	**18,556,349**
Total liabilities		**47,803,264**	**9,475,924**	**57,279,188**	**44,369,614**	**9,811,115**	**54,180,729**
Total equity and liabilities		**144,307,300**	**-1,467,428**	**142,839,872**	**151,080,787**	**237,413**	**151,318,200**

Notes to individual items

a) As for the transition to IFRS individual parts of an item of property, plant and equipment which differ in their expected useful lives were accounted for as individual assets, for which depreciation is accounted for individually. The adjustments were made for the entire period since their bringing into use. Lower depreciation amounts result in higher carrying amounts of the items of buildings and equipment by 3,053,773 TSIT as at 1 January 2004 and by 3,570,907 TSIT as at 31 December 2004. The effect is recorded under retained earnings. The transfer of the amounts of ‘intangible assets’ to the item of ‘investments in assets not owned by the Company’ resulted in an additional increase in the value of buildings and equipment.

b) Intangible assets as at 1 January 2004 recorded a decrease due to the transfer of the amounts of ‘investments in assets not owned by the Company’ to the item of ‘property, plant and equipment’ and the transfer of the amounts recorded in ‘long-term operating lease’ to ‘long-term receivables’. The decrease is recorded at 148,844 TSIT as at 1 January 2004 and at 389,922 TSIT as at 31 December 2004.

c) In accordance with SAS investments in subsidiaries were accounted for by using the equity method and were higher by profits or lower by losses that resulted in the Company's increase of financial revenues or financial expenses respectfully. In the opening balance as at 1 January 2004 and 31 December 2004 prepared pursuant to IFRS, the value of investments in subsidiaries is decreased by attributable profits or losses as IFRS requires the Company to value investments in subsidiaries by using the cost method.

d) The Company for the first time accounted for the deferred tax in the opening balance sheet prepared under IFRS. Accordingly the Company records deferred tax assets as at 1 January 2004 and 31 December 2004. Most of the deferred tax assets refers to the formation of non-current provisions and increase the item of retained earnings.

e) Other non-current are decreased as at 1 January 2004 and 31 December 2004 by the amount of own shares i.e. 4,670,280 TSIT, which are recorded as a deductible item within equity in the balance sheet prepared under IFRS. Other changes refer mostly to value adjustments of investments in securities that are allocated to available for sale, to the market value, as well as to the transfer from intangible assets to other non-current assets. Effects of the adjustment to the market value are disclosed in the reserve for fair value within the item of equity.

f) The valuation of inventories according to IFRS remained unchanged if compared to the valuation carried out in compliance with SAS provisions. Due to lower depreciation the balance of inventories of finished products and work in progress as at 31 December 2004 is lower by 54,858 TSIT.

g) As at 1 January 2004 and 31 December 2004 trade receivables record an increase by amounts that were recorded under deferred costs and accrued revenues pursuant to SAS.

h) Investments in shares are valued at fair value, whereas the effects are recorded under retained earnings in the income statement.

i) During the transition to IFRS the general equity revaluation adjustment was eliminated from the reserve for fair value as at 1 January 2004 in the amount of 21,724,114 TSIT, which was accounted for according to SAS and included among reserves. Revaluation of derivative financial instruments in the amount of 164,368 TSIT is under IFRS included in the item of retained earnings. In addition, the reserve for fair value has increased by 29,605 TSIT based on the adjustment of the value of non-current investments to the fair value. As at 31 December 2004 reserves for fair value amount to 519,987 TSIT and result from the increase in non-current investments by the fair value adjustment i.e. 653,843 TSIT and the decrease of the deferred tax i.e. 163,461 TSIT.

j) Non-current provisions are higher by the amount of provisions for termination pays and anniversary bonuses, which were however not formed and recorded in financial statements prepared according to SAS. Provisions formed lower the amount of retained earnings. Other non-current provisions referring mostly to intellectual property lawsuits remained unchanged.

k) As at 1 January 2004 trade payables are higher by the amount that is recorded within accrued costs and deferred revenues in the balance sheet prepared according to SAS.

Reconciliation of Profit for 2004

in TSIT

	Note	2004 Income statement under SAS	2004 Effects of transition to IFRS	2004 Income statement under SAS
Net sales		97,977,511	0	97,977,511
Production cost of goods sold	a, b	44,047,215	-128,506	43,918,709
Gross operating yield		**53,930,296**	**128,506**	**54,058,802**
Sales and marketing	a, b	22,067,586	-45,485	22,022,101
R& D costs	a, b	8,372,923	-59,332	8,313,591
Administrative expenses	a, b	10,048,354	-86,742	9,961,612
Other operating revenues	c	4,143,124	112,051	4,255,175
Operating profit		**17,584,557**	**432,116**	**18,016,673**
Financial income	d	3,549,249	-505,313	3,043,936
Financial expenses	e	4,169,900	-1,103,859	3,066,041
Net financial expenses		**-620,651**	**598,546**	**-22,105**
Extraordinary income/expenses		101,252	-101,252	0
Profit before tax		**17,065,158**	**929,410**	**17,994,568**
Income tax	f	2,963,774	-278,823	2,684,951
Net profit for the period		**14,101,384**	**1,208,233**	**15,309,617**

Notes to individual items

a) The lower amount of depreciation according to IFRS resulted in lower production cost of goods sold by 196,841 TSIT, sales and marketing by 61,254 TSIT, R&D costs by 81,672 TSIT and administrative expenses by 122,509 TSIT.

b) The income statement for 2004 records an actuary loss (increase in provisions for employees) in the amount of 131,412 TSIT, resulting in an increase of production cost of goods sold by 68,334 TSIT, sales and marketing by 15,769 TSIT, R&D costs by 22,340 TSIT and administrative expenses by 24,968 TSIT.

c) Other financial revenues are increased by the amount of revenues that are recorded as extraordinary revenues in the income statement prepared pursuant to SAS.

d) Financial revenues are lower by profits of subsidiaries in the amount of 690,014 TSIT. They are, however higher by the amount of the derivative financial instruments adjusted to the market value i.e. 138,108 TSIT that was pursuant to SAS recorded under the reserve for fair value, as well as by the amount of short-term securities adjusted to the market value (46,593 TSIT). Pursuant to SAS, no strengthening of assets was carried out by the Company.

e) In accordance with IFRS financial expenses are lower due to elimination of subsidiary' losses in the amount of 1,103,859 TSIT.

f) Reconciliation of balance sheet items during the transition to IFRS had an impact of the calculation of the deferred tax that in the amount of 278,823 TSIT decreases the Company's income tax liability for 2004.

Strategic objectives of the Krka Group until 2010

- Over 10 per cent average annual growth in sales.
- Launching new products onto the market.
- Strengthening our marketing and sales network.
- Vertical integration.
- Maintaining our independence.
- Continuing to operate to the benefit of the company, employees, shareholders and the wider community.

The Krka Group's business objectives for 2006

- A 13% sales growth generating total sales of SIT 150 billion.
- Generating over 80% of sales revenues on foreign markets.
- We forecast the Russian Federation will be the largest single market for sales.
- The highest sales growth is forecast for Region Central Europe and Region East Europe.
- Human health products (prescription pharmaceuticals, self-medication products, and cosmetics) will remain by far the most important product group, representing 92 per cent of sales.
- We will increase R&D investment, especially in the company's own vertically-integrated development.
- We will complete construction of the active pharmaceutical ingredient production plant, which will ensure an even higher level of vertical integration, and start construction of the new injection production plant.
- At the end of 2006, the Krka Group will employ an estimated 5700 people, over 2000 of which will be working in companies outside Slovenia.

Novo Mesto, 26 April 2006

Krka d.d. Novo Mesto
Management Board