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## Annual Report 2006



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# Boldness.

JOSEF RESSEL

Invented a boat propeller.

He worked as forestry engineer in Kostanjevica na Krki, where he tested a boat with a hand-run screw in the Krka river back in 1825. He patented the invention in 1827.





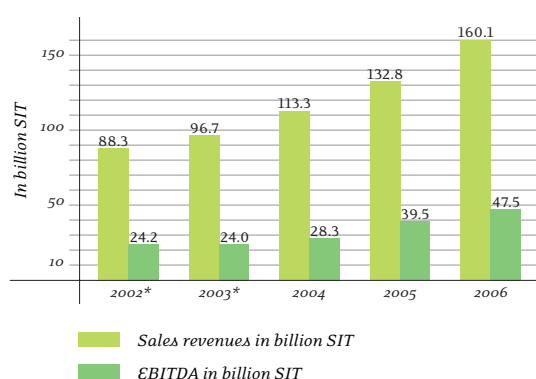
## Introduction

Who says  
a big ship can't sail  
a small river?



## Significant achievements

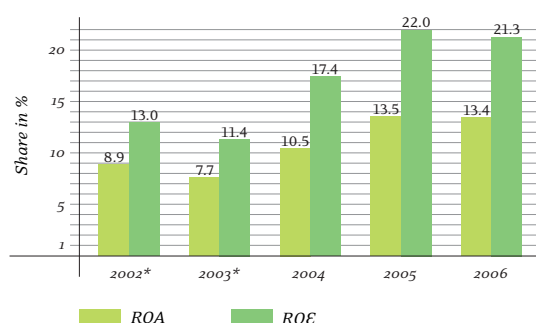
### SALES REVENUES AND EBITDA



In 2006 overall sales revenues grew by 21%, largely due to the successful business performance in the Russian Federation and Poland.

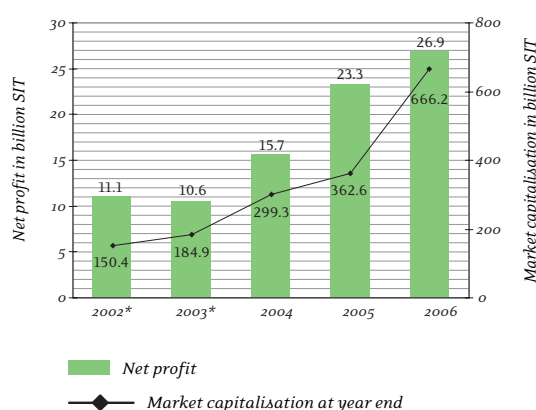
Earnings before interest, taxes, depreciation and amortisation (EBITDA) grew by 20%.

### ROA AND ROE



In 2004 and 2005 we improved both ratios due to an improved product mix and cost efficiency, while in 2006 this growth slowed slightly, with a small drop in ROE recorded in 2006.

### NET PROFIT AND MARKET CAPITALISATION



In 2006, the net profit grew by 15%, and market capitalisation by 84%.

\*Financial statements for 2002 and 2003 prepared in compliance with the Slovenian accounting standards

## The Krka Group financial highlights

	2006		2005		
	in million SIT	in thousand EUR	in million SIT	in thousand EUR	
Sales revenues	160,069	667,955	132,758	554,137	
EBIT	36,065	150,495	28,523	119,057	
EBITDA	47,497	198,200	39,494	164,849	
Net profit	26,860	112,086	23,319	97,335	
Non-current assets	137,756	574,847	120,455	502,785	
Current assets	72,918	304,282	68,394	285,480	
Equity	136,812	570,905	114,897	479,585	
Non-current liabilities	39,287	163,940	36,368	151,803	
Current liabilities	34,576	144,283	37,584	156,877	
R&D costs	12,617	52,650	9,612	40,120	
Investments	25,689	107,200	21,451	89,537	
RATIOS			2006	2005	
ROS			16.8%	17.6%	
EBIT margin			22.5%	21.5%	
EBITDA margin			29.7%	29.7%	
ROE <sup>1</sup>			21.3%	22.0%	
ROA <sup>2</sup>			13.4%	13.5%	
Liabilities/Equity			0.540	0.644	
R&D costs/Sales revenues			7.9%	7.2%	
Number of employees (year end)			5759	5224	
EXCHANGE RATES			2006	2005	
EUR (average)			239.601 SIT	239.636 SIT	
EUR (31 December)			239.640 SIT	239.576 SIT	
USD (average)			190.993 SIT	192.819 SIT	
USD (31 December)			181.931 SIT	202.430 SIT	
SHARE INFORMATION	2006	2005	2004	2003	2002
Total number of shares issued	3,542,612	3,542,612	3,542,612	3,542,612	3,542,612
Earnings per share in SIT <sup>3</sup>	7,918	6,890	4,627	3,113	3,266
Earnings per share in EUR <sup>3</sup>	33.04	28.76	19.30	13.15	14.18
Dividend per share in SIT	1,650	1,400	1,200	1,050	950
Dividend per share in EUR	6.89	5.84	5.01	4.44	4.13
Share price at year end in SIT	188,057	102,342	84,482	52,188	42,458
Share price at year end in EUR	784.75	427.18	352.39	220.49	184.39
Price/earnings ratio (P/E)	23.75	14.85	18.26	16.76	13.00
Market capitalisation in million SIT (31 December)	666,213	362,558	299,289	184,882	150,414
Market capitalisation in thousand EUR SIT (31 December)	2,780,058	1,513,334	1,248,374	781,115	653,216

<sup>1</sup> Net profit/average equity balance in the period

<sup>2</sup> Net profit/average total assets balance in the period

<sup>3</sup> Net profit of the majority owners of Krka Group/average number of shares issued excluding treasury shares



## ID card of the Krka Group

### Data on the controlling company

The controlling company is Krka, tovarna zdravil, d. d., Novo mesto.

<b>Registered office:</b>	Šmarješka cesta 6 8501 Novo mesto Slovenia
<b>Telephone:</b>	+386 7 331 21 11
<b>Fax:</b>	+386 7 332 15 37
<b>E-mail:</b>	info@krka.biz
<b>Web pages:</b>	www.krka.si
<b>Basic activity:</b>	Production of pharmaceutical preparations
<b>Activity code:</b>	DG 24.420
<b>Year established:</b>	1954
<b>Registration entry:</b>	1/00097/00, Novo mesto District Court
<b>VAT number:</b>	82646716
<b>Company ID number:</b>	5043611
<b>Called-up capital:</b>	14,170,448,000 SIT
<b>Shares:</b>	3,542,612 ordinary registered shares at par value of 4,000 SIT. Krka's shares have been listed on the Ljubljana Stock Exchange in 1997 with the trading code KRKG.

The Krka Group consists of the controlling company, Krka d. d., Novo mesto, and a number of subsidiaries in Slovenia and abroad.

The Krka Group is engaged in the development, production, sale and marketing of human health products (prescription and self-medication pharmaceuticals, and cosmetics), animal health products, and health and tourism services. Production takes place at the controlling company and in three production and distribution centres, located in Croatia, Poland and the Russian Federation. The other subsidiaries outside Slovenia are

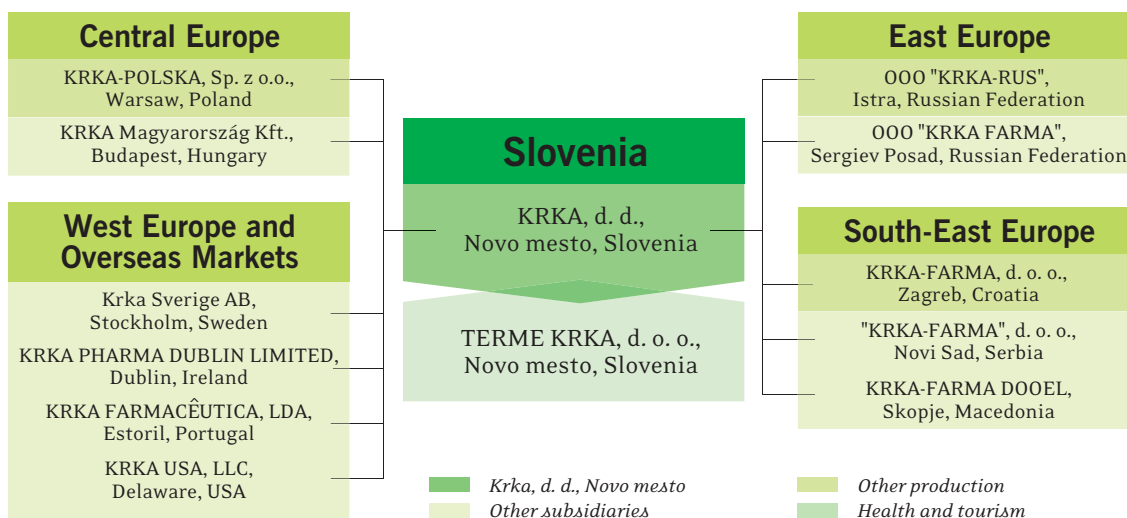
engaged in the marketing and/or the sale of Krka products.

The company Terme Krka, d. o. o., Novo mesto combines the business units of the health resorts (spas) and hotels Terme Dolenjske Toplice, Terme Šmarješke Toplice, Hoteli Otočec and the Hotel Krka in Novo Mesto, and is also the majority owner of Terme Krka – Strunjan, d. o. o.

Abbreviated company names are used in the text below.

## Organisational chart of the Krka Group\*

ORGANISATIONAL CHART OF THE KRKA GROUP\*



\* The organisational chart shows the acting companies.

## Significant events and awards

- The President of the Management Board and CEO Jože Colarič won the Manager of the Year award from the Managers' Association. At the Kapital 2006 finance conference, he was awarded the Director of the Year award, voted for by business journalists, while at the 18th Forum of Excellence and Craftsmanship organised by the Dolenjska and Bela Krajina Association of Economists he was awarded the grand prize for excellence and craftsmanship.
- According to the 2006 Corporate Reputation Survey by PR agency Kline & Partner, Krka is a company with the highest reputation in Slovenia according to the business and general community opinion.
- In the Russian Federation, Krka was made the third most influential pharmaceutical producer, following a survey by the trade review, Farmaceutski Vestnik. Krka's Enap® was the third-ranked pharmaceutical product.
- For the third time, Krka won the IR Magazine's first prize in the category for best investor relations in Slovenia.
- After being granted official authorisation from the Croatian and Slovenian GMP inspectorates, regular production of products started at the Jastrebarsko plant intended for local market and export markets, among others also for EU markets.
- Pfizer Inc, New York, USA withdrew its action against Krka relating to the Yasnal® (donepezil) product, and an out-of-court settlement was reached with the French company Servier on Prenessa® (perindopril).
- The 11th Krka Annual General Meeting, with shareholders present representing 37.18% of equity, passed a resolution that from 1 January 2006 onwards the Annual Report will only be prepared in accordance with the International Financial Reporting Standards (IFRS).
- After a successful GMP verification, the Agency for Medicinal Products and Medical Devices of the Republic of Slovenia issued Krka with a manufacturing licence for the new Sinteza 4 plant for the production of active pharmaceutical ingredients (APIs). The first OHSAS assessment was also successfully carried out.
- In Poland Krka received two awards for self-medication products, Bilobil® and Septolete®.
- The traditional Krka Prizes for young researchers were bestowed for the 36th year in succession.
- The Slovenian Science Foundation made Krka its 2006 Sponsor of the Year.
- In the 2005 Best Annual Report Awards organised by the Slovenian business daily Finance, Krka received first prize for its financial report, and third prize in the overall best annual report of 2005 category.
- Terme Krka Company officially opened public Hotel Vitarium, featuring a relaxation centre, at Terme Šmarješke Toplice and the golf course at Otočec.
- The Tourist Association of Slovenia's award for the best spa resorts, part of its My Country - Beautiful and Welcoming promotional campaign, went to the Krka spa resorts in Strunjan and Šmarješke Toplice.

## Events after the accounting period

In 2007 the controlling company, Krka, d. d., Novo mesto paid the founding capital for two new subsidiaries, which were registered as KRKA

FARMACÊUTICA, LDA, Estoril, Portugal and KRKA USA, LLC, Delaware, United States, in which it has 100% ownership.

## Statement by the President of the Management Board



Dear Shareholders and Business Partners,

Krka's performance in 2006 has confirmed the wisdom of our planned strategies. Once more, we have completed a successful year, one in which our rapid response to changes on different markets and to our customers' needs produced results that we can all be most proud of. Increasing competition, pressure to lower prices, and stricter health legislation are, on the one hand, obstacles to even better results, and on the other hand, offer a constant trial and challenge to acquire knowledge and skills and to increase the creativity of all our employees.

Sales worth 668 million euros were achieved in the Krka Group, with growth at 21%. In recent years we have achieved our highest growth in Region East Europe and Region Central Europe, where two Krka production and distribution companies are successfully operating. Sales have grown by over one third on Krka's largest single market, the Russian Federation. Significant sales potential and our lengthy presence in the region have made it easier for us to decide on expanding our production capacity in the Russian Federation, where a tenth of overall Krka sales now come from. On another key market, Poland, growth reached 21%, which is much higher than growth for the Polish pharmaceutical market overall. We have also grown more quickly than our competitors in Croatia, another key market where Krka has its own production capacity. In the EU-15 (the 15 countries already member states before May 2004), our sales grew by 22% on the previous year. We remain the number one pharmaceutical company on the Slovenian market, and are also successful in the health tourism sector. In addition to these key markets, I must also focus on the positive sales results achieved in Romania - where growth reached 47% - and in Ukraine and Hungary. I believe that the positive macroeconomic circumstances forecast on our

key markets will, in addition to the high quality of our work, contribute to the realisation of our strategic sales objectives for this year. Our plan is that in 2007 the Russian Federation will remain Krka's largest market, where in past months we have recorded delays in payment within the federal health programme. At the same time we are working intensely to market products outside that sales sector. The major markets this year will still be Poland, Slovenia, western Europe, Romania and Ukraine, but our smaller markets will also contribute to meeting this year's sales target for the Group of 750 million euros.

Our commitment to pharmaceutical-chemical operations and the continued focus on sales results remain essential policies for the coming strategic period. Prescription and self-medication pharmaceuticals represent over 90% of overall sales, and are the fastest growing product group. Sales of animal health products and health resort and tourism services are also growing. Following the strategic decision to reduce our range of cosmetic products over a number of years, in 2006 we recorded a growth in sales. In 2007 sales will continue to grow in all products and service categories.

Our wide marketing and sales network of representative offices and companies, and excellent range of high quality, effective and safe products are the key to our positive sales performance. The share of products launched in the past five years in overall Krka sales is constantly increasing, as is the share of products from our vertically integrated business model. Vertical integration, which involves managing the entire process from raw materials to the finished product, reduces risk in the fields of intellectual property rights, which are a constant factor in the pharmaceutical industry. As prudent management requires, we have formed the necessary provisions for all as yet unsettled lawsuits, in line with our

analyses of all the relevant facts. To counter the constant changes in the business environment, which sometimes prove difficult to predict, we have a systematic approach to managing other operating and financial risks, which is a vital element in ensuring stability for the Group.

The success of the Krka Group's operations is confirmed by the high growth in sales, and also by the 26% growth in operating profit and 21% growth in our pre-tax profit. The Group's net profit was 112 million euros.

It is now ten years since Krka became a public limited company. To date, the Group's sales have increased by almost four times, the net profit by nine times, and the share price by seven times. Krka's market capitalisation, which totalled 2.8 billion euros at the end of 2006, increased by 84% in one year, and is the highest for any company listed on the Ljubljana stock exchange. The growth in the Krka share price and its liquidity can be ascribed to a sound business performance and a number of well organised presentations and meetings with investors, as well as the change in Slovenia's currency at the start of 2007. International investors have also demonstrated their trust in Krka shares as individual shareholders, and as a group they now represent 8% of all shareholders, the number of which is once more over 54,000. At Krka we assess the stock split will further increase share liquidity.

In the interests of sustainable development, we have allocated significant resources to grants and sponsorships, offering assistance to institutions in the fields of health, education, culture, sport and to charities. This is also part of the Krka mission.

Krka's international, global orientation is reflected in the fact that not only are 84% of our products sold abroad – in over 70 countries around the

world, that we have own production capacity in our major markets, and that we establish subsidiaries abroad, but also in the fact that more than one third of all Krka employees are employed outside Slovenia. We employ higher educated and highly motivated specialists. People are the key to our success, so we have a range of incentives to encourage staff to work creatively and effectively, which increases overall satisfaction on all sides.

The dynamism of the pharmaceutical industry and the overall business environment means we continually review and update our development strategy. We are currently working on a five-year development strategy for the Krka Group for 2007-2012. Our vision is to consolidate our position as a leading generic pharmaceutical company on the European market and the markets of Central Asia, and we will realise that vision by maintaining our independence, and strengthening our long-term business networks and part-

nerships. At the same time we will take advantage of any opportunities in the consolidation of the pharmaceutical industry, and will strengthen the professional and cost synergy within the Group. Our objective is to achieve excellence in all areas of operation.

I have every confidence in the knowledge and skills of the Krka staff, and would like to take this opportunity to thank them for their contribution to the results that Krka has achieved. I would also like to thank the Supervisory Board for their excellent and committed work, and particularly their support for the Krka Group's development strategy, and indeed all those who have helped to build the excellent reputation that Krka enjoys today. I am sure that together we will achieve the planned objectives, that you, as shareholders, will continue to place your trust in Krka and its shares, and that customers will continue to put their trust in Krka's high quality products.



Jože Colarič  
President of the Management Board and CEO



## Report of the Supervisory Board

The composition of the Supervisory Board remained unchanged throughout 2006: the shareholder representatives are Mateja Božič, MSc, Gregor Gomišček, PhD (President), Marko Kranjec, PhD (Deputy President), Anton Rous, Draško Veselinovič, PhD, and Alojz Zupančič; the employee representatives are: Sonja Kermc, Tomaž Sever, MSc, and Mateja Vrečer, PhD.



### The functioning of the Supervisory Board

In 2006 the Supervisory Board held five regular meetings, where the main focus was on the realisation of the business objectives defined in the Krka Group's 2006-2010 development strategy, and the annual business plan. Below is a detailed description of the Supervisory Board's functioning and the issues it has addressed at its meetings.

- The Supervisory Board adopted 2005 annual report of the Krka Company and Krka Group.
- Discussed the quarterly and half-year business reports for the Krka Group and Krka Company and assessed the operations of the Krka Group and Krka Company and the work of the Management Board as for each period.
- Studied comparisons between the periodic operating results for Krka and a selection of other pharmaceutical companies.
- Approved some draft amendments to the company's Articles of Association, which will be put to the shareholders at their 2007 Annual General Meeting.
- The President of the Management Board gave a detailed presentation, at the Supervisory Board's request, of human resource management within the Krka Group, with an emphasis on key elements of human resource strategy, organisational climate, provisions for employee development, motivational methods, health and safety at work, relations with the Works Council and trade unions, etc.
- Discussed the 2007 business plan for the Krka Group and Krka Company and studied the planned sales figures, planned scale of investment, including R&D investment, new employments, and the planned performance indicators.
- In line with the Rules on Treasury Shares, the Management Board reported the state of treasury shares and current ownership structure to the Supervisory Board each quarter.
- The Management Board reports at least once a year to the Supervisory Board on the state

- of legal claims against Krka, d. d., Novo mesto and other companies within the Krka Group.
- As the term-in-office will expire in 2007 for two members of the Management Board, in accordance with the Companies Act, and the recommendations of the Corporate Governance Code, around one year before the expiry of these terms, the Supervisory Board reappointed Janez Poljanec and Aleš Rotar, PhD, as Management Board members until 31 December 2009, so that the term-in-office will be the same for all Management Board members, except the worker director.
  - In line with the Rules on Management Board Remuneration, the Supervisory Board decided on the bonuses for management board members for 2005 and the first half of 2006, taking into account the Recommendations of the Association of Supervisory Board Members on the Appointment, Dismissal and Earnings of Management Board Members and the Recommendations of the Managers' Association on Concluding Individual Senior Management Contracts in Companies.
  - Taking into account the recommendations of the Association of Supervisory Board Members, the Supervisory Board proposed to the General Meeting that the method of remunerating supervisory board members be amended to ensure that payments are more closely linked to the tasks and duties of individual supervisory board members. The General Meeting accepted the proposal.
  - The Supervisory Board adopted new Rules of Procedure in response to amendments to the Companies Act and the Corporate Governance Code.

The Supervisory Board found that the diverse and specialist composition of the Supervisory Board's shareholder representatives and its employee representatives contributed to its successful work.

The Supervisory Board includes four people holding doctorates (two in economics, and two in natural sciences), two people with MBAs and two specialists with university level education. Their areas of expertise cover economics, law and finance, as well as construction, pharmacy,

physics, chemistry and engineering. They all have considerable experience in business and in research and development. They also offer a wide range of international experience. Draško Veselinovič, PhD, holds a B-licence for supervisory board membership, while the other members all received statements of qualification to serve as supervisory board and management board members in 2006.

The members work independently, but with a great deal of sensitivity for their shared work and responsibilities. No conflict of interests arose in relation to discussions on the items from the agenda or when making Supervisory Board decisions. In its amended Rules of Procedure, the Supervisory Board clearly states how individual members and the Board should act in case of a conflict of interests.

The Supervisory Board assessed that it had available sufficient reports, information and data, which Management Board members had been able to additionally clarify as required at individual Supervisory Board meetings. This means that the Supervisory Board can monitor and supervise the company's operations and the work of the Management Board as the year proceeds. Cooperation between the Supervisory Board and Management Board was optimal, direct communication between the presidents of the two Boards also took place between individual meetings of the Supervisory Board. The annual report provides an overall picture of the Group and the Company's operations, and was deliberated in detail by the Supervisory Board and approved unanimously. The Supervisory Board also assessed the work of the Management Board as very good.

### The work of the Supervisory Board committees

The five-member Audit Committee met four times. It drew up positions on the 2005 annual report for the Krka Group and Krka Company, the auditor's report, and the report of the Supervisory Board on its verification of the Group and Company's operations. Before that, in the presence of the authorised auditor, it discussed a special report prepared by the auditing company

KPMG on the auditing committee's request. The report covered an assessment of IT systems risk, interest rate risk and credit risk, and the transfer pricing issue. The auditor informed the audit committee members of the preliminary audit findings for 2006, the main purpose of which was to check the functioning of internal controls. The audit committee members took the opportunity to propose that, before concluding the audit, the auditor should review the calculation of corporate income tax, and any potential tax optimisation at the Group level, as well as reviewing current financial investments, and producing reports on these two matters. The audit committee received both reports before the discussion of the 2006 annual report. The audit committee gave its approval to the report on the work of the Internal Audit Department in 2005, the medium-term work programme for the period 2006 to 2009 and the work programme for 2006. It also discussed the report on the work of the Internal Audit Department for the first half year of 2006.

The three-member Human Resource Committee met three times. It produced a proposal on the amount of the Supervisory Board's participation in the accumulated profit for 2005, a proposal on the level of session fees and monthly salary for Supervisory Board members for work on the Supervisory Board and its committees, a proposal on work bonuses for Management Board members for 2005 and the first half of 2006, and a proposal that the Supervisory Board reappoint Janez Poljanec and Aleš Rotar, PhD, as Management Board members until 31 December 2009, before their current terms-in-office expire.

Both committees adopted the new Rules of Procedures for their work and changes in their name in Slovene (from odbor to komisija).

#### **Approval of the annual report and submission of the proposal regarding appropriation of the accumulated profit**

The Supervisory Board examined the 2006 annual report of the Krka Company and Krka Group within the legal deadline. It also discussed the auditor's report, in which the auditing company

KPMG Slovenija, d. o. o. stated that the financial statements that are part of this Annual Report 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 and that the business report is in compliance with the financial statements. The Supervisory Board did not make any comments on the auditor's report. After the verification, the Supervisory Board also had no comments regarding the Annual Report and unanimously approved it at its meeting of 3 April 2007. With this, the Annual Report was formally adopted in accordance with Article 282 of the Companies Act and Krka's Articles of Association.

At the same time as approving the Annual Report, the Supervisory Board approved the proposal for the use of the accumulated profit. In 2006 the Company achieved a net profit of 27,085,839,664 SIT, of which 500,000,000 SIT was appropriated to statutory reserves and 4,800,000,000 SIT to other revenue reserves. The remaining net profit of 21,785,839,664 SIT and the retained net profit of 2,978,037,410 SIT comprise the accumulated profit, which stood at 24,763,877,074 SIT on 31 December 2006. The Management Board and Supervisory Board propose that the General Meeting uses the accumulated profit for the following purposes:

- 6,479,769,744 SIT for dividends (1,917.12 SIT or 8.00 EUR gross per share)
- 9,142,053,665 SIT for other revenue reserves, and
- 9,142,053,665 SIT to be carried forward to next year.

The Supervisory Board accepted this report unanimously at its meeting of 3 April 2007.



Gregor Gomišček, PhD  
President of the Supervisory Board





# Vision.

HERMAN POTOČNIK

Author of the book *The Problem of Space Travel - the Rocket Engine* (1928), a pioneering work in astronautics. He was the first to realistically conceive of a geostationary telecommunication satellite.

## Business report

Those that pursue their goals will reach for the stars again and again.





## Corporate governance

Krka's principles of corporate governance are based on valid legal norms in the Republic of Slovenia, the company's internal acts, and established best practice. The governance system operates with a two-tier system, where the Management Board manages the company, and the Supervisory Board supervises the work of the Management Board.

The company's governance bodies comprise:

- the Management Board
- the Supervisory Board
- the General Meeting.

Krka responsibly exercises its rights and fulfils its obligations in relation to a range of stakeholders or interest groups (shareholders, employees, creditors, customers, suppliers, the natural and business environment, and the state). The communication strategy for relations with the various interest groups is described in the chapter Communications.

## General Meeting

In accordance with the Companies Act, the General Meeting is the highest body of the company, where the company's shareholders can participate directly and make fundamental and statutory decisions. Each share represents one vote at the general meeting. Krka does not have shares with restricted voting rights. Treasury shares do not offer any voting rights at the general meeting.

The Management Board normally convenes a regular general meeting once a year. Shareholders recorded in the shareholder register on the record date published in the general meeting notice have the right to attend the general meeting and exercise voting rights, and their representatives and proxies have the same rights, if they file the appropriate power of attorney when registering for a general meeting.

The Management Board provides the General Meeting with the necessary data, information and clarifications to assess the content of the general meeting agenda, taking into account any legal or other restrictions on the disclosure of information.

The Eleventh Annual General Meeting of the Krka company was held on 6 June 2006 and:

- discussed information on the Annual Report and the Supervisory Board's report for 2005
- decided on the use of the accumulated profit and the dividend pay out

- appointed the auditor for 2006
- defined the use of the International Financial Reporting Standards for the preparation of the Annual Report, and
- defined the directors' fees and payments for Supervisory Board members.

The resolutions of the 11th Annual General Meeting were published in Delo newspaper, on the SEOnet electronic information system, and the Krka website ([www.krka.si/en/finance/info/skupscine/](http://www.krka.si/en/finance/info/skupscine/)).

The full material was available from the General Meeting notice until the day of the meeting at the company's registered office.

In 2007 the Annual General Meeting (12th AGM) is planned for the beginning of July. The notice convening the General Meeting with the proposed resolutions and location of the meeting will be published on the Ljubljana Stock Exchange's SEOnet information system and in Delo newspaper, and the entire text of the proposed resolutions, conditions for participation and material will be available on the Company's website.





On photo from left: Tomaž Sever, MSc, Alojz Zupančič, Mateja Božič, MSc, Gregor Gomišček, PhD, Marko Kranjec, PhD, Mateja Vrečer, PhD, Draško Veselinovič, PhD, Sonja Kermc, Anton Rous.

## Supervisory Board

The **primary function** of the Supervisory Board is to supervise the company operations and the management of company operations. The Supervisory Board also selects and appoints the members of the Management Board.

The **composition** of the Supervisory Board is defined by the company's articles of association. The members of the Supervisory Board are elected for a four-year term-in-office, and can be reappointed.

The **payment, reimbursement and other benefits** for Supervisory Board members are not directly dependent on the company's performance and are set out in the financial report in Note 32, entitled Transactions with Related Parties. Krka does not have a remuneration system for Supervisory Board members in place that includes options schemes.

The same chapter covers the **ownership of shares** in the company by Supervisory Board members. Members of the Supervisory Board inform the company and competent institutions of any acquisition or disposal of company shares. Krka makes this information public.

The conduct of Supervisory Board members in the case of **conflicts of interest** is defined in the amended Rules of Procedure for the Supervisory

Board, which is available on the company website. Members of the Supervisory Board primarily take into account the Company objectives, and must subordinate any personal interests or interests of any third parties to those objectives. Each Supervisory Board member must inform the Supervisory Board of membership in the supervisory board of any other company.

The composition and function of the Supervisory Board and its committees in 2006 are presented in the Report of the Supervisory Board.

### Shareholder representatives

#### Gregor Gomišček, PhD, 50 years

##### *President of the Supervisory Board*

Gregor Gomišček completed his natural sciences studies at the University of Ljubljana, and attained a doctoral degree from the Vienna University of Technology. He enrolled in the management school (General Management Programme) at the IEDC Bled School of Management. He worked at the Institute of Medicinal Physics at Vienna University for almost 10 years, and is now employed at the Institute of Biophysics at the Faculty of Medicine in Ljubljana as a researcher and assistant professor. He also lectures at the Faculty of Social Sciences on Technological Policy in the United States.

**Marko Kranjec, PhD, 67 years**

*Deputy President of the Supervisory Board*

Marko Kranjec passed his degree and his doctorate at the Faculty of Economics of the University of Ljubljana. He has worked as a macro-economist at the OECD in Paris, in the World Bank in Washington DC. Between 1990 and 1991 he was the Minister of Finance in the Slovenian Government, and from 1991 to 1997 he was Vice-Governor and Member of the Governing Board of the Bank of Slovenia. Until 2002 he was the Slovenian Ambassador to the European Union in Brussels. From 2002 to 2006 he was a professor of public finance at the Faculty of Administration at the University of Ljubljana, and since 2007 is an outside collaborator with the Institute of Economic Research in Ljubljana.

**Mateja Božič, MSc, 40 years**

Mateja Božič's master's degree is in management and organisation. She was employed at the Petrol company, where she was actively involved in the restructuring process and the company's strategic development. Since 2003 she has worked as a consultant to the member of the Management Board for finance and energy management, being involved in controlling and the implementation of activity-based costing (ABC). She is currently a member of the management board of Kapitalska Družba.

**Draško Veselinovič, PhD, 48 years**

*President of the Supervisory Board's audit committee*

Draško Veselinovič attained his doctorate at the Faculty of Economics in Ljubljana. He did his specialisation studies in global finances, international marketing and international banking abroad. From 1991 to 2004 he was president and CEO of the Ljubljana Stock Exchange. He is now the President of the Management Board of the Deželna Banka Slovenije, d. d., Ljubljana and associate professor for international finance and capital markets at the Faculty of Economics in Ljubljana and for several postgraduate programmes at the Faculty of Economics and Business in Maribor, IEDC Bled, Vienna University, etc.

**Anton Rous, 67 years**

Anton Rous graduated from Faculty of Law in Ljubljana. In 1970 he began his 11-year service as managing director of Avtoradgona, before taking the post of CEO of SOZD Integral and then director of group services at Hidromontaža Maribor. After four and half years as president of the ex-

ecutive council of the City of Maribor he took early retirement. He is now a state secretary in the Office of the Prime Minister of the Republic of Slovenia.

**Alojz Zupančič, 68 years**

*President of the Supervisory Board's human resource committee*

Alojz Zupančič is a university graduate engineer in chemical technology and master's degree candidate in organisational and management studies at the Faculty of Economics of the University of Ljubljana. After working in Novo mesto, first at the INIS glass factory and then at IMV Motor Engineering he worked for Krka from 1969 to his retirement in 1998, his final position being consultant to the director of animal health products.

**Employee representatives**

**Sonja Kermc, 55 years**

Sonja Kermc started her employment in Krka in 1976 as a graduate chemical engineer. She is currently head of the Applied Water Services and in charge of applied media systems and cooperation with the technological and technical engineering in the developing of new systems. She is currently serving her third term-in-office as member of the Works Council, and in the current 2004 to 2008 mandate is the council president.

**Mateja Vrečer, PhD, 40 years**

Mateja Vrečer started working for Krka in 1990 as a university graduate in pharmacy, and later gained a master's degree, doctorate and specialist examination in pharmaceutical engineering. She was first employed in the Research and Development Division, and is now Deputy Director of Quality Management. She is an internal quality auditor of Krka's quality systems and of contractual partners.

**Tomaž Sever, MSc, 39 years**

Tomaž Sever attained a master's degree in organisational and management studies, following his first degree in mechanical engineering. From 1992 to 1995 he worked for IBM Slovenija d.o.o. in the field of information systems. He has been employed at Krka since 1995 and is currently Deputy Director of Sales and Director of Region Central Europe, primarily entrusted with Krka's strategy for individual markets and building up sales networks abroad.



On photo from left: Danica Novak Malnar, Janez Poljanec, Jože Colarič, Zvezdana Bajc, Aleš Rotar, PhD.

## Management Board

The Management Board has the following **tasks**:

- to manage the Company and makes business decisions directly and independently
- to adopt a business strategy for the Company
- to ensure appropriate risk management, and
- to act with the care of a conscientious and honest businessman and preserve the business secrets of the company.

The Management Board **comprises** five members:

- the President of the Management Board
- three members, and
- the worker director.

The Worker Director represents the interests of the employees in relation to human resource and social issues, but is not authorised to represent the company.

The **term-in-office** for members of the Management Board is five years, with the possibility of re-appointment.

The Rules of Procedure of the Management Board regulate the **management board's work** and the duties of individual members. It operates by coordinating opinions, and making decisions by consensus rather than on the basis of votes. In line with the Rules of Organisation and the Rules of Procedure of the Management Board, Management Board members also have executive tasks, as may be seen from the presentation of their responsibilities. Each member is also responsible for a number of organisational units, which fa-

cilitates direct cooperation between the Management Board and the executive directors.

The Management Board also has the following working bodies:

- committee of directors
- development committee
- quality committee
- investment committee
- human resource committee
- information technology committee
- sales committee
- economics and finance committee, and
- the corporate identity committee.

The committees bring together specialists from individual areas of the Krka organisation. They prepare detailed policies and strategies for individual areas and also have some decision-making responsibilities relating to implementing annual plans.

**The payment, reimbursement and other benefits** for management board members are defined in contracts drawn up between the Supervisory Board and individual Management Board members. The Rules on Management Board Remuneration, adopted by the Supervisory Board, defines the remuneration available to individual members. Krka does not have a remuneration system for Management Board members in place that includes options schemes. All payment, reimbursement and other benefits paid to Management Board members in 2006 are presented in the financial report, in Notes 32, headed Transactions with Related Parties.

**The ownership** of company shares by Management Board members is presented in the financial report, in Note 32, headed Transactions with Related Parties. Members of the Management Board and persons related to them inform the company and competent institutions of any acquisition or disposal of shares in the company or associated companies. Krka makes this information public.

Management Board members must disclose the existence of any **conflicts of interest** to the Supervisory Board and also inform other members of the Management Board. Members of the Management Board are not at the same time members of the managing or supervisory bodies of unrelated companies.

### Members of the Management Board

#### **Jože Colarič, 51 years**

*President of the Management Board and Chief Executive*

Jože Colarič graduated from the Faculty of Economics in Ljubljana. He has worked for Krka since 1982, and began work in the Financial Sector. In 1989 he took charge of the Exports Service within the Export-Import sector. In 1993 he was appointed as deputy to the CEO for marketing and finance, and in September of the same year took over as the Director of Marketing and Sales. In 1997 he was appointed to the Management Board. The following year the Supervisory Board appointed him as Deputy President of the Board, and in 2002 acknowledged him as future President of the Management Board, placing him in charge of the proposal for the new Management Board team. At its meeting of 12 July 2004, the Supervisory Board appointed him as President of the Management Board and CEO, with a five-year term-in-office starting on 1 January 2005.

#### **Janez Poljanec, 60 years**

*Member of the Management Board and Director of Product Supply*

Janez Poljanec is a graduate from the Faculty of Natural Sciences and Technology in Ljubljana and has worked for Krka since 1974. In 1979 he was made Director of the Division for Overseas Countries within the Export-Import Sector, and later became director of the entire sector. From 1985 to 1989, he worked for Krka through Generalexport in Combick, Frankfurt, and in 1990, he again took over management of the Export-Import Sector. In 1993 he became director of the

Procurement and Logistics Division, and four years later the Supervisory Board appointed him to the Management Board. He was re-appointed on 31 July 2002, and since 2002 has been Director of Product Supply.

#### **Aleš Rotar, PhD, 47 years**

*Member of the Management Board and Director of Research and Development*

Aleš Rotar attained his doctorate from the Faculty of Natural Science and Technology in Ljubljana, and completed the international MBA at the IEDC centre in Brdo. He started work for Krka in 1984 in the Stability Testing Department. In 1991 he was made head of the Pharmaceutical Technology Division, and two years later became Head of Pharmaceutical Development in the Research and Development Sector. In 1998 he was appointed as deputy director of R&D and in 1999 was made Director. He was appointed to the Management Board in 2001, and re-appointed on 31 July 2002, and has remained Director of Research and Development.

#### **Zvezdana Bajc, 54 years**

*Member of the Management Board and Director of Economics and Information Processing*

Zvezdana Bajc is a graduate of the Faculty of Economics in Ljubljana and has worked for Krka since 1977. She started work in the Economics Division, and in 1979 moved to the Investment Service. In 1986 she took over as director of the Economic Planning Division. Since 1999 she has been the Director of Economics and Information Processing. Her term-in-office as Management Board member started on 1 April 2005, and she remains director of Economics and Information Processing.

#### **Danica Novak Malnar, 50 years**

*Member of the Management Board - Worker Director and Head of Pharmaceutical Production*

Danica Novak Malnar is a graduate of the Faculty of Natural Sciences and Technology in Ljubljana and has worked for Krka since 1982. In 1986 she became Head of the Pharmaceutical Division in Ljutomer, and for two years led the Division for Operative Production Planning. In 1994 she was placed in charge of the Production Planning Department. In 1998 she was appointed to the Management Board as the worker director, and was reappointed by the Works Council and approved by the Supervisory Board for a new term-in-office beginning on 1 January 2003. Since 1999 she has been in charge of pharmaceutical production.



## Governance of the Krka Group

The Krka Group consists of the controlling company Krka d. d. Novo mesto, a number of subsidiaries abroad, and one in Slovenia. 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.

To improve the cohesion of the Group and offer the best possible supervision of subsidiaries'

operations, the Krka Company's Management Board functions as the General Meeting for the subsidiaries. The members of the Management Board, depending on the provisions of the legislation of the country in which the subsidiary operates, also function as members of the supervisory boards, supervisory committees or management boards of the subsidiaries, but do not receive any separate payment for that work.

Krka also manages the companies within the Group at the functional level, particularly in the field of marketing, development, supply chain management, financing, human resources and IT support.

## Internal auditing

The Internal Audit Department carries out its mission within the Krka Group on the basis of the medium-term work plan for 2006 to 2009 and the 2006 annual work programme. Eight regular and one extraordinary internal audits were carried out. The work plans and reports on the work of the Internal Audit Department are adopted and approved by the Management Board and the Supervisory Board's Audit Committee.

The objectives of internal auditing relate primarily to gaining assurances that internal control systems are in place and functioning and to assess their effectiveness. The main focus was on verifying the realisation of set objectives and the performance of individual organisational units within the Krka Group.

Internal audits were carried out in the fields of research and development, sales, production planning, warehousing and transport. The internal auditors were able to give an assurance that the internal controls for these processes were in place and functioning effectively, and sup-

ported risk management. Two subsidiaries and a number of representative offices abroad were also subject to internal audits.

In some areas the internal audits found that there were possibilities for improving processes. Internal auditors set out 141 recommendations in that regard, and later carried out checks to verify whether they had been implemented. The audited units had implemented the recommendations in 80% of cases, which means that there are still areas that could be improved.

The Internal Audit Department also performed consultancy work and was involved in the company's project-based work. It also works with external auditors, certified information system auditors (CISA) and the Supervisory Board's Audit Committee.

In future the Internal Audit Department anticipates an independent external assessment to acquire an opinion on the compliance of its work with the Internal Audit Standards.

## External auditing

The certified auditing company KPMG carries out the audit of the financial statements of the controlling company and most of the subsidiaries. In line with the Corporate Governance Code recommendation, the company changes its auditing partner every five years.

As part of the financial statement audit, the external auditor reports its findings to the Management Board and the Auditing Committee of the Supervisory Board.

Cooperation between Krka and the auditing company KPMG Slovenija, d. o. o. is presented in the financial report, in the notes to the financial statements of the Company (Note 33), while relations between companies in the Group and individual auditing houses are addressed in the notes to the financial statements of the Group (Note 33).

## Corporate governance code compliance statement

The Management Board and Supervisory Board of Krka, d. d., Novo mesto hereby state:

That in 2006 individual members of the Management and Supervisory Board, and the Management and Supervisory Boards as bodies of a public limited company, have acted in compliance with the principles of the governance for public limited companies and have worked to ensure their implementation within the company. In 2006 the Rules of Procedure for the Supervisory Board, the Auditing Committee, the Human Resource Committee, and the Management Board were all updated. All these documents are in full compliance with the provisions of the Companies Act and the Corporate Governance Code. Particularly emphasis was placed on potential conflicts of interest of individual members of the boards,

with statements being made on when they occur and the conduct of individual members or of the boards, if any conflict of interest arises. The Rules of Procedure for the Supervisory Board was also published on the company website.

The company's objectives - as required by provision 1.1.1. of the Code - have been incorporated into the draft of the amended articles of association, which will go before the company's general meeting for approval in 2007. We assess this to be a minor deviation from the Code.

Except for the minor divergences mentioned above, Krka complies with all the provisions of the Corporate Governance Code, which has been valid since 5 February 2007, and is published in Slovene and English on the website [www.ljse.si](http://www.ljse.si).



Jože Colarič  
*President of the Management Board*

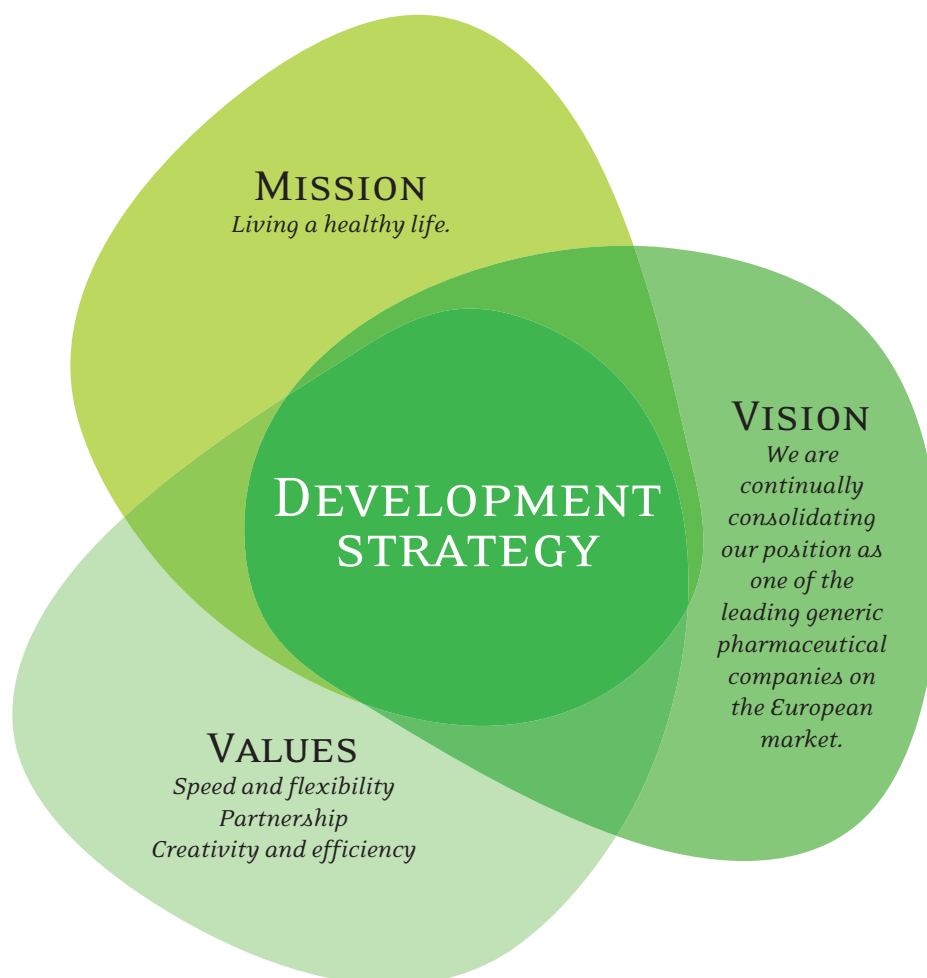


Gregor Gomišček, PhD  
*President of the Supervisory Board*

Novo mesto, 7 March 2007



## The Krka Group development strategy



## Key strategies and objectives – to 2010

- Achieving average annual growth in sales of over 10%.
- Maintaining independence and making use of opportunities in the consolidation of the pharmaceutical industry.
- Expanding the range of prescription pharmaceuticals in key therapeutic areas: medicines for cardiovascular diseases, for diseases of the alimentary tract and metabolism, for the treatment of infections and the central nervous system, and the launch of new therapeutic areas.
- Focusing on European and Central Asian markets and pharmaceutical-chemical operations with objective of achieving a leading position on selected key markets.
- Continued organic growth and growth on the basis of launching new product lines and acquiring market shares and companies.
- Increasing the proportion of products that result from the vertically-integrated business model.
- Strengthening expertise and cost synergies within the Krka Group.
- Expanding own marketing and sales network and establishing own companies abroad.

- Promoting creativity and innovation, motivation, and an entrepreneurial and target-oriented approach.
- Upholding our economic, social and ecological responsibilities to the environment in which we operate.

Performance criteria are used to assess the implementation of strategic objectives. There are 90 strategic criteria, financial and non-financial, at the corporate level, at the level of individual product groups and individual business functions. The guiding principle in establishing the criteria system is increasing the competitive position of individual companies and the entire Group. The criteria are monitored by individual committees and the Management Board.

Because of the very dynamic nature of the pharmaceutical industry and the business environment in general, the Group reviews and updates its strategy every two years. The Krka Group strategy for 2008-2012 is currently in preparation, and is set for adoption by the end of 2007.

## The Krka Group's business objectives for 2007

- 12% growth, generating products and services sales of 750 million euros.
- Highest sales growth is planned on the markets of East, Central and West Europe; the Russian Federation remains the most important individual market.
- The proportion of sales on markets outside Slovenia is anticipated at over 85%.
- Prescription pharmaceuticals will remain the most important product group, representing, it

is anticipated, over 85% of overall sales.

- New prescription pharmaceuticals products will be marketed in key indication groups.
- The planned net profit is 130 million euros.
- At the end of 2006 the Group will have 6300 employees, almost 40% of them abroad.
- Investments planned at 130 million euros will primarily be used to increase and modernisation R&D and production capacity and infrastructure.

## Forecasted macroeconomic environment in 2007

The macroeconomic environment, government health policies and the legal environment together represent the most fundamental element affecting business performance in the pharmaceutical industry.

The increased penetration of generic medicines onto individual markets has led pharmaceutical industry experts to forecast quantitative growth in the generics market, and the migration of international investors into the pharmaceutical

industry of countries in Central and Eastern Europe, which will be key areas in the industry's global growth. Experts point to the Russian Federation and Poland as the most important countries.

Below is an overview of the economic circumstances anticipated in 2007 on Krka's key markets. We expect that macroeconomic condition will have favorable effect on achieving our business goals.

### FORECASTED ECONOMIC GROWTH AND INFLATION ON INDIVIDUAL MARKETS

Country (region)	Pharmaceutical markets growth forecast for 2007 (%)	Economic growth forecast for 2007 (%)	Inflation forecast for 2007 (%)
Slovenia	6	4.2	2.5
Russian Federation	15–20	6.5	8.8
Poland	5–6	4.6	2.6
West Europe and Germany	1–2	2.1 (entire eurozone)	2.1 (entire eurozone)
Croatia	4	4.4	3
Czech Republic	5–6	5.5	3.3
Romania	15–20	5.5	5.5
Ukraine	15	5.2	12

Sources: Business Monitor International, European Economy

### Slovenia

Having met the convergence criteria, Slovenia became the first of the ten newest European Union members to adopt the euro. In line with forecasts, real economic growth and low inflation, together with low interest rates, will lead to a stable economic climate. According to 2006 estimates using wholesale prices, the pharmaceutical market will be worth more than 420 million EUR with annual growth estimated at 6%. A similar dynamic is also anticipated in the future.

### Croatia

The extension rationalisation of legal provisions and regulations that has been announced is an extremely positive move for the Croatian economy and should ease the burden on the business environment and remove administrative barriers that block development and the creation of new companies. Croatia is expected to join the European Union in 2010 or 2011, and the country already

meets many of the criteria. In comparison with other countries in transition, its development is strong in terms of GDP per capita. Forecasts suggest that the high economic growth will continue in 2007, while inflation forecasts are also positive. Croatia's internal and external borrowing does represent a certain level of risk relating to operating in the country. The estimated value of the pharmaceuticals market in 2006 is 600 million EUR, with growth of 6%. Annual growth of 4% is expected in the coming years.

### Russian Federation

Forecasts indicate that exports will exceed 330 billion USD, and the trade surplus will reach almost 140 billion USD. The Russian Federation therefore remains a very important market, with a great potential and high liquidity levels. Mention should be made of the fact that at the end of 2006 and the start of this year, there were delays in payment within the government's medicines reimbursement programme (DLO). We expect cir-

cumstances to normalise by mid-2007. The central government is also reducing a number of products financed under this programme, with several Krka products being cancelled, which represented somewhat over 20% of sales within the federal programme. Planned government spending on healthcare for 2007 is 107.7 billion roubles, which is 72% higher than the previous year, including more funds to purchase pharmaceuticals. Positive economic conditions and record export figures will support continued growth in public spending. Changes are possible due to the parliamentary and presidential elections set for 2007 and 2008. The rouble is expected to continue to strengthen and to reach a dollar exchange rate of 25.5 RUB/USD, while the Russian Federation is expected to join the World Trade Organisation (WTO) soon, with the bilateral trade agreement signed with the United States in November 2006 expected to have a positive impact there. The growth forecasts for the pharmaceuticals market in 2007, based on an estimated market value in 2006 of 6.7 billion euros, are between 15 and 20%.

## Poland

Largely due to monetary stability and one of the highest growth rates in the European Union, Poland remains one of the region's most attractive countries for foreign investment. The country's rapid development has helped resolve the unemployment problem, with the unemployment rate falling by 3.2 percentage points in 2006. Similar trends are also expected in future. In 2005 and 2006 inflation was even lower than in some countries in the EMU (Economic and Monetary Union), and the forecasts for 2007 and 2008 remain encouraging. The continued strengthening of the PLN should lead to reduced inflationary pressures, with the exchange rate forecast to be below 3.90 PLN/EUR. According to current assessments with growth of 8%, the pharmaceuticals market was worth 3.8 billion EUR in 2006, but growth is expected to calm somewhat in 2007 (5 to 6%).

## West Europe

Economic forecasts for Germany and the European Union remain optimistic overall, and the EU strong economic standing can also be seen in comparison with the United States. On 1 January 2007 Germany raised its basic VAT level from 16% to 19%, but it is too early to judge the mac-

roeconomic impact on consumption, economic growth and inflation. The unemployment rate in Germany is starting to fall, although it remains at a high level. Most of the opinions issued by the European Central Bank also offer optimistic predictions for Germany and the remaining eurozone countries. The value of sales in Germany, our leading western European market, grew by just 1.3% in 2006 and were over 22 billion EUR. The lower growth is due to large-scale initiatives to replace original pharmaceuticals with generics and increased pressure to reduce prices. Low single-digit overall growth is expected on the market in 2007, while sales of generic products will continue to grow more quickly than total pharmaceutical product sales.

## Romania

Romania's entry into the European Union is a key event that will have an enormous impact on the country's economic growth and competitiveness, which remains the government's main priority for the next two years. The European Commission has issued a positive opinion on the growth of labour productivity in Romania, but it will be important to ensure that salary increases do not threaten price stability. High levels of foreign investment will contribute to the ambitious economic objectives and increased competitiveness, as it is expected to reach 10 billion EUR in 2007, which is comparable to the level of foreign investment in the Russian Federation, and represents almost one tenth of Romania's GDP. According to some assessments in 2006 the Romanian pharmaceuticals market recorded growth of 34% and was worth over 1.2 billion EUR. It will be difficult to repeat such high market growth in future, and growth of 15-20% is expected in 2007.

## Ukraine

The calming of the political climate and more moderate prices for natural gas mean that a stable economic situation can be expected in 2007. According to some forecasts, Ukraine may join the WTO this year, as it has significantly speeded up the integration process and has already harmonised most of its legislation with WTO requirements. Analysts consider this will have a significant impact on Ukraine's appeal to foreign investors. Despite the high inflation, the exchange rate remains stable, and the posi-

tions taken by the central bank and the exchange rate stability suggest a similar economic climate can be expected in future. The finance ministry has announced further reforms of the healthcare system, and has also forecast a 19% increase in budget spending on healthcare. According to assessments based on wholesale prices, the pharmaceutical market was worth more than 800 million EUR in 2006 with annual growth of 15%. A similar trend is expected in 2007.

## Czech Republic

Economic results were positive in 2006. The budget deficit did not meet the convergence criteria, but was stable due to increasing public finance revenues. The International Monetary Fund (IMF) gave a positive assessment of the economic prospects while expressing the conviction that the positive economic climate made the time ripe for pension and healthcare reforms. Despite the forecast rise in interest rates, a restrictive monetary policy is not expected, as the country's inflation is relatively stable. Inflationary pressures should be reduced by the expected strengthening of the koruna, as the anticipated exchange rate for 2007 should be around 27.0 CZK/EUR. The estimated value of the Czech pharmaceuticals market in 2006 was 1.5 billion EUR, with growth of 4%. Market growth should be 5-6% in 2007, according to forecasts.

## Risk management

Due to activities and business spread across 70 countries, the Krka Group meets a range of risks, which can basically be divided into operating and financial risk. Operating risk is managed as part of the responsibilities and powers built into individual processes and companies within the Krka Group, and via the development committee, quality committee, sales committee, investment committee and the human resource committee. Financial risks are dealt with systematically by the Financial Division, which routinely monitors and manages key financial risks, in accord-

ance with the strategic guidelines to neutralize individual types of risk, and with respect to the international spread of Krka's import and export operations.

In recent years we have perfected and implemented risk assessment methods with the aim of systematically recognising risk, and we define the exposure level or probability of risk occurring, the size of potential losses and activities to improve the reliability of processes.

### OPERATIONAL RISK

Risk area	Description of risk	Risk management method	Exposure
Intellectual property	Risks relating to patents and patent law disputes.	Monitoring patent processes, forming provisions.	Moderate
Regulatory procedures	Risk of potential changes in legislation.	Consultation with regulatory authorities.	Moderate
Development process	Risk that a product development process will not be successfully concluded.	Vertically integrated business model and introduction of new development processes and methods.	Moderate
Reliability of suppliers and contractual partners	Risk of supplies being uncompetitive or erratic.	Performing risk analyses of contractual partners, suppliers, and pharmaceutical ingredient producers.	Moderate
Availability of production capacity	Risk of interrupted operation of production capacity.	Regular preventive maintenance and measurements.	Low
Environmental protection	Risk of accidents with a negative impact on the environment occurring.	Regular preventive activities.	Low
Information sources	Risk of errors in the field of information sources.	Independent security checks on information infrastructure.	Moderate
Health and safety at work	Risk of injuries and accidents in the workplace.	Risk assessment in the workplace and implementing appropriate measures.	Moderate
Asset protection	Risk of assets being stolen or removed.	Systematic threat assessment and taking measures in line with security plan.	Moderate

### FINANCIAL RISK

Risk area	Description of risk	Risk management method	Exposure
Foreign exchange risk	Possibility of losses due to unfavourable movements in exchange rates.	Hedging with appropriate financial derivatives.	Moderate
Interest rate risk	Risk relating to changing financing and borrowing conditions.	Hedging with appropriate financial derivatives.	Low
Credit risk	Risk of customers defaulting on payment.	Calculating credit ratings and restricting maximum exposure to customers at the Group level.	Moderate
Liquidity risk	Risk that the company cannot settle current liabilities.	Planning and monitoring liquidity and established credit lines.	Low
Risk of damage to property	Risk of fire, explosion, business interruption and civil lawsuits.	Systematic threat assessment and taking measures in line with fire prevention studies and taking out appropriate insurance.	Moderate



## Operational risk

We have a systemic approach to dealing with operational risk, which includes the following areas: research and development, environment management, managing incoming materials (suppliers, contractual partners), managing the production process and production capacity, information resources and computer-managed processes, health and safety at work, foodstuffs safety, and asset protection.

### Research and development

Managing risk in the field of research and development is particularly important, given the nature of the pharmaceutical industry.

- **Intellectual property.** For every product, current situation analysis is used to check exposure to risk of lawsuits relating to violations and lawsuits relating to the intellectual property of third parties. The risk of unsanctioned use of Krka's intellectual property is reduced passively and actively. We are protecting our solutions with patents as early as possible in the development process. With regard to competitors' applications we use appropriate mechanisms to participate in patent granting processes from the competent authorities. In unresolved lawsuits we actively defend our position, and demonstrate the absence of any violation, but as prudent management requires we form the provisions required. To date all major patent law disputes have been settled in Krka's favour.
- **Regulatory risk.** Managing regulatory risks, which are related to changes in legislation and its interpretation, begins in the early stages of developing a new product and lasts throughout the whole product life cycle. We assess our product development solutions together with the regulatory authorities using official advisory mechanisms and plan the content of marketing authorisation documentation. This reduces the risk of problems or even failure occurring during the product registration and extended authorisation procedures. Krka actively participates in the preparation phase of legislative amendments via the working groups of industry associations.

- **Scientific risk.** Research and development work is based on new discoveries. Risks can occur in the field of intellectual property, if the patent situation changes during the development process. On the other hand there are also technological and technical risks, when one of the key properties a product requires cannot be obtained. Risks relating to the properties of products can be reduced by introducing new development processes and methods and with our own and with acquired knowledge in the research and development field. We introduce processes that in the early development phases can reduce risk by predicting finished product properties, which have to be high quality, safe and effective. An important factor in improving the management of this kind of risk is the vertically integrated development and production model, which is used to control the entire process from raw materials to the finished product.

### Reliability of suppliers and contractual partners

Krka has a system of using two to three suppliers for key input materials, to ensure secure and competitive supplies. In 2005 Krka started performing risk analyses of contractual partners, suppliers, and pharmaceutical ingredient producers. The results of the risk analyses are used to define priority assessments, which the Quality Management carries out in partner companies. Based on the findings of these assessments, agreements are reached with partners on measures to be taken, while in unusual cases a decision could be made to change supplier or partner.

### Availability of production capacity

Production takes place in line with good manufacturing practice standards, European and international standards, and the provisions of other technological and technical regulations. Uninterrupted production capacity is provided by means of regular preventive maintenance. Measurements are also taken directly on production lines to rapidly determine the cause of unplanned stoppages, and take action to prevent or

eliminate delays. The system of continuously including operators in line set-up reduces the time taken up by planned stoppages. Internal risks relating to the energy supply have been reduced by modernising energy supply systems and using reliable devices with sufficient capacity.

### Environmental protection

An important step towards realising the objective of maintaining and improving the state of the environment has been reducing the risk of accidents and improvements in response procedures. Krka has an internal procedure Recognising Accidents which sets out all the potential accident and emergency situations possible on site and the actions or responses to take if they occur. People have been appointed to take charge of such measures. We carry out preventive activities on a regular basis. In the past years there has been two to three accident per year (e.g. spillage of hazardous substances). Taking effective action in accordance with internal instructions has meant there has been no case of harmful environment impact.

### Information resources

An established methodology is used to define the criticality of information resources, based on assessments of the criticality of processes and the criticality of an information resource to a process. The major information resources are indi-

vidual information services and applications. The criticality level is summarised for all infrastructural elements on which an information service or application depends. One threat detection method is independent security inspections for information infrastructure. Threats and risks to all critical infrastructure elements were identified, and the Company Management Board approved acceptable risk levels and the measures required to eliminate critical risks.

### Health and safety at work

Using an internal, computer-supported methodology and in accordance with the Safety Declaration, we assess the probability of a specific event occurring and the seriousness of such an event. In addition to assessing risk in the workplace, the risk from individual technological procedures is also assessed. We check all technological procedures, in line with Health and Safety at Work Assessment of Technological Procedures.

### Asset protection

The first systematic threat assessment of individual facilities was carried out in 2004, and then again in 2006 using an updated methodology. In addition to the probability of a specific event occurring, the probability of the timely discovery of an event and possibility of eliminating the consequences are also taken into account. A security plan was produced to manage asset protection and keep it at an acceptable level.

## Financial risk

### Foreign exchange risk

The Krka Group's wide international orientation exposes it to risks relating to foreign exchange movements.

The main foreign exchange risk for the Krka Group comes from changes in the US dollar exchange rate, while the currencies used in the countries in which Krka has its key subsidiaries are also very important. These include the Polish zloty, the Russian rouble, the Croatian kuna and the Macedonian denar.

In 2006 Krka actively managed the US dollar risk. We assessed that the foreign exchange risk for other currencies was relatively low, due to the low exposure levels, so active risk management policies were not used.

A significant element of foreign exchange risk management is the difference between inflows and outflows in a specific foreign currency, which is called an open currency position. Krka has a surplus of inflows over outflows in both euros and US dollars. The Krka Group's open position in US dollars is gradually increasing, as the inflows in this currency are growing faster than outflows.

#### OVERVIEW OF FOREIGN EXCHANGE INFLOWS, OUTFLOWS AND OPEN CURRENCY POSITIONS AT THE CONTROLLING COMPANY

in billion SIT	2006			2005			2004		
	Inflows	Outflows	Open position	Inflows	Outflows	Open position	Inflows	Outflows	Open position
EUR	99	62	37	59	31	28	55	23	33
USD	45	19	26	41	24	17	35	18	17

Part of the planned open position in US dollars for specific periods has been hedged using financial derivatives, in accordance with the foreign exchange risk management policy, while part remained unhedged. Simple financial derivatives were used for hedging, such as forward contracts and currency options.

In 2006 the US dollar lost 10.5% of its value against the euro. The foreign exchange losses from payments that occurred due to the long position in US dollars and the falling exchange rate were largely neutralised by inflows from hedging.

fixing the interest rate in the past using interest rate swaps. The gradual increase in the basic interest rates by the US and European central banks in 2006 did not therefore have an impact on the costs of the company's long-term borrowing.

### Credit risk

The credit control process involves obtaining credit ratings for customers to which the controlling company makes annual product sales of 100,000 EUR and over, and regular, dynamic monitoring of customer payment discipline.

### Interest rate risk

At the end of 2006, Krka had four long-term borrowings linked to the 6-month LIBOR for the US dollar or the 6-month EURIBOR for the euro.

Exposure to interest rate changes related to existing long-term borrowings was eliminated with

Credit control has a positive impact seen in:

- reducing the total value of outstanding receivables
- improving the maturity structure of outstanding and overall receivables
- reducing the average payment period, and
- a better ratio of average trade receivables to sale value.

By the end of 2006 the controlling company had included 286 customers in regular credit control. We also successfully concluded a project to implement credit control in companies in Poland, Croatia, Serbia, the Russian Federation and Macedonia. This led to another 150 customers being included in the credit control system, including some customers with annual sales below 100,000 EUR.

Credit control is dealt with centrally for the entire Krka Group by the Risk Management Department and is organised for customers of subsidiaries and the controlling company according to standard procedures and rules.

Receivables write-offs had no material impact on our financial position in 2006.

## Liquidity risk

Liquidity risk involves two aspects: can the company settle its current operating liabilities and is it possible to settle its financing liabilities using the cashflows it generates. Both aspects are studied using specific ratios.

The ratios make clear that the Krka Group and the Krka Company's liquidity risk was low and stable throughout the past years. According to the ratios, Krka is one of the world's leading pharmaceutical companies and far stronger than the Slovenian average. The liquidity ratios improved in 2006 both in comparison with the preceding year, and the average over the past five years, due to more effective management of inventories, receivables and other liquidity categories.

### LIQUIDITY RATIOS FOR THE KRKA GROUP AND COMPANY AND A COMPARISON WITH SELECTED AVERAGES

		2006	2005	2004	2003*	2002*	Krka average	Average for global pharmaceutical companies**	Average for Slovenian companies***
<i>Liquidity ratios</i>									
Current ratio	Group	2.11	1.80	2.32	1.66	2.32	2.04	2.12	1.18
	Company	2.19	1.88	2.55	1.75	2.30	2.13		
Quick ratio	Group	1.31	1.04	1.36	0.93	1.40	1.21	1.41	0.89
	Company	1.46	1.11	1.55	1.04	1.47	1.33		
Acid test ratio	Group	0.24	0.17	0.22	0.10	0.19	0.18	n/a	n/a
	Company	0.27	0.14	0.17	0.08	0.10	0.15		
Receivables turnover ratio	Group	4.34	4.02	4.74	3.72	3.66	4.10	n/a	4.36
	Company	3.72	3.45	3.81	2.95	2.83	3.37		

Current ratio = current assets / current liabilities

Quick ratio = (current assets - inventories) / current liabilities

Acid test ratio = (financial investments + cash and cash equivalents) / current liabilities

Receivables turnover ratio = net sales revenues / accounts receivable and other receivables

\* For the years 2002 and 2003 Krka's financial statements were prepared according to Slovenian Accounting Standards.

\*\* Reuters

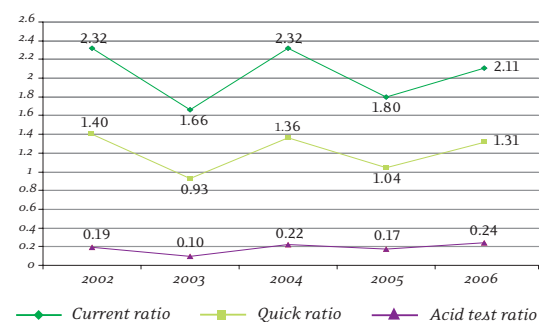
\*\*\* GViN

In addition to the settlement of current liabilities, we also monitor whether the company can service its debts and other financing liabilities using the cash flows it generates. The ratio set out in the table (net debt/EBITDA) indicates that the Krka Group can pay its net debt within a period of 4.4 months, which is a very short period.

When considering liquidity ratios, it is important to examine their dynamics, namely whether

the current, quick and acid test ratio move in accordance to each other. If these ratios move alike, that is an indication of stability between liquid assets and liabilities.

### MOVEMENT IN LIQUIDITY RATIOS FOR THE KRKA GROUP



### FINANCIAL LEVERAGE RATIO FOR THE KRKA GROUP

Leverage ratio	2006	2005	2004	2003	2002	Average
Net debt / EBITDA	0.37	0.45	0.60	1.13	0.46	0.60

Net debt = short-term loans + long-term loans - cash and cash equivalents

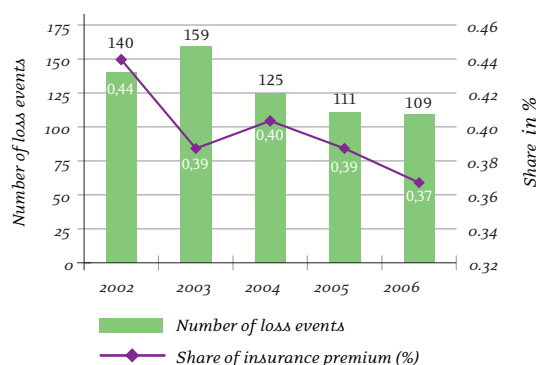
EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization = Operating profit before depr./amort.

## Property, business interruption and liability insurance

Krka Group's insurance provides compensation for damage to property, and loss of earnings due to business interruption, and protects the Group in case of third party claims for bodily injuries and material damages. The procedures for taking our insurance and claims handling are internally standardised for all companies in the Krka Group.

Insurance value for equipment and inventory is based on the current value, and buildings at acquisition price, which means that compensation is not reduced by depreciation due to use. The sum insured by business interruption insurance includes the labour costs, depreciation and other business expenses, and operating profit for a period of one year. The Krka Group has introduced deductibles when insuring losses from minor or frequent risks and closely monitors loss ratios, which significantly reduces the insurance premium and encourages preventive action.

RATIO OF INSURANCE PREMIUM TO SALE REVENUE AND NUMBER OF LOSS EVENTS



The Krka's civil liability for material damage and personal injury to third parties that could be caused by the Group's activities or property, or by placing products on the market is covered by Krka Group's liability insurance. Liability insurance is also managed at contractual partners involved in construction and installation work, investment projects, and transport.

## Investor information

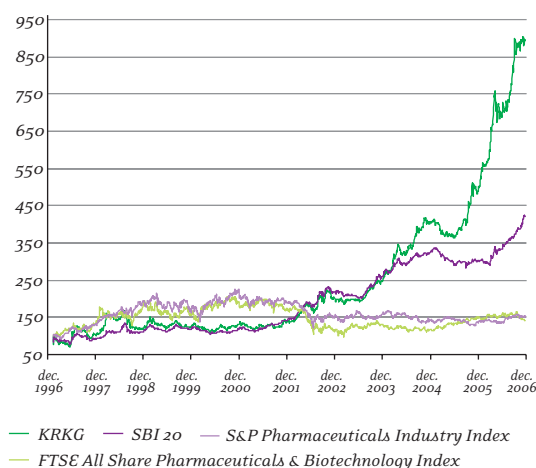
### Shareholder return

#### KRKA SHARE PRICE

in SIT	2006	2005	2004	2003	2002
Year high	189,652	107,503	87,418	52,807	47,156
Year low	102,411	75,912	52,024	38,790	28,462
On 31 December	188,057	102,342	84,482	52,188	42,458
Annual growth	84%	21%	62%	23%	49%

In 2006, the Krka share price increased by 84%, while the Slovenian Stock Exchange Index (SBI 20) grew 38% over the same period.

#### KRKA SHARE PERFORMANCE RELATIVE TO SELECTED SHARE INDICES (INDEX: START OF 1997 = 100)



Source: Reuters

The Krka share price has significantly outperformed all the selected share indices: the Slovenian Stock Exchange Index (SBI 20), the Standard & Poor's Pharmaceuticals Industry Index (S&P) and the FTSE All Share Pharmaceuticals & Biotechnology Index (FTSE).

### Dividend policy

Krka pursues a policy of moderate increase in dividends. The dividends are paid once per year, within 60 days after the Annual General Meeting, where shareholders reach a decision on the proposed dividend for the past business year.

#### DIVIDENDS

	2006	2005	2004	2003	2002
Earnings per share <sup>1</sup> in SIT	7,890	6,890	4,627	3,113	3,266
Gross dividend per share <sup>2</sup> in SIT	1,650	1,400	1,200	1,050	950
Dividend pay out <sup>3</sup> (%)	24	30	39	32	38
Dividend yield <sup>4</sup> (%)	0.9	1.4	1.4	2.0	2.2

<sup>1</sup> Net profit of Krka Group majority shareholders/average number of shares issued in the period excluding own shares

<sup>2</sup> Dividend paid out from net profit from previous period

<sup>3</sup> Gross dividend per share/earnings per share from previous period

<sup>4</sup> Applying share price on 31 December of the year

The 2007 dividend proposal from the Management and Supervisory Board is included in the notice convening the Annual General Meeting.

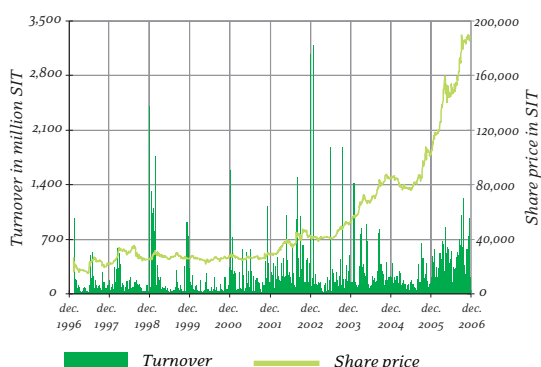


## Share trading and shareholding

Krka shares have been listed on the Ljubljana Stock Exchange since 1997 and are quoted under the trading code KRKG. All issued shares are in the same class (ordinary, transferable without limitations). Each share enables one vote on the general meeting of shareholders. Resident and non-resident investors can trade the share without limitation through brokerage firms and banks that are members of the Ljubljana Stock Exchange.

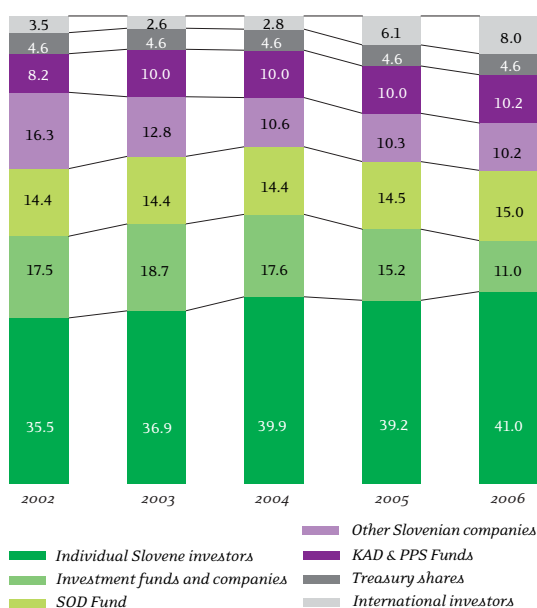
Krka's shares are one of the more liquid securities on the Ljubljana Stock Exchange. In 2006 the trading turnover in Krka shares was 98 billion SIT, an increase of 128% compared to 2005. The average daily turnover in Krka shares was 398 million SIT in 2006, an increase of 131% compared to 2005.

TRADING IN KRKA SHARES



In relation to the possible issue of global depositary receipts (GDRs) on the London Stock Exchange, Krka considers that there is no need at present to issue any GDRs, due to: the increased liquidity of the shares in the recent past; the introduction of the euro as the Slovenian currency; additional promotion activities of the Ljubljana Stock Exchange on international capital markets; the potential partnership between the Ljubljana Stock Exchange and larger European stock exchanges; and the increasing research coverage.

OWNERSHIP STRUCTURE ON 31 DECEMBER  
(SHARE - %)



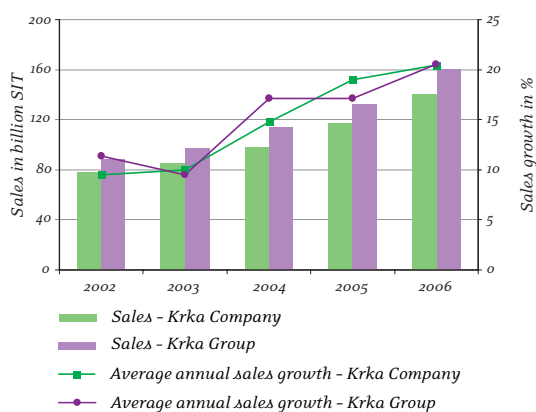
## Business operations analysis

All financial data for the period from 2004 to 2006, presented in the business operations analysis have been prepared in accordance with the International Financial Reporting Standards (IFRS), while the Slovenian Accounting Stand-

ards (SAS) were used for other years. The analysis includes data for the Krka Company and Krka Group, while the commentary relates primarily to the Group.

### Sales

SALES AND SALES GROWTH FOR THE KRKA COMPANY AND KRKA GROUP



The main strategic objective in the Krka Group's 2006–2010 development strategy is to achieve annual growth in overall sales of over 10%. The graph indicates the stable growth achieved. The average annual sales growth over the past five years has been 16%. In 2006 the Group achieved sales of products and services worth 160.1 billion SIT, with growth at 21%. Growth in sales was achieved in all five sales regions and in every product group. A more detailed analysis of the sales results achieved for individual markets and product groups is given in the section Marketing and Sales.

SALES PER EMPLOYEE AND SALES PER EMPLOYEE GROWTH FOR THE KRKA GROUP



The average sales per employee growth for the Group over the last five years was 7%, which is lower than overall sales growth, but has been increasing since 2004. The modest growth in the past has largely been due to intense recruitment activities abroad, in representative offices and in subsidiaries. A comparison of subsidiaries indicates that recruitment has been highest in the production and distribution centres, which have only started to make significant contributions to Group sales in the past three years. Given that the marketing and sales network is organised across the representative offices and subsidiaries abroad, the sales per employee is only given for the Group.

## Expenses

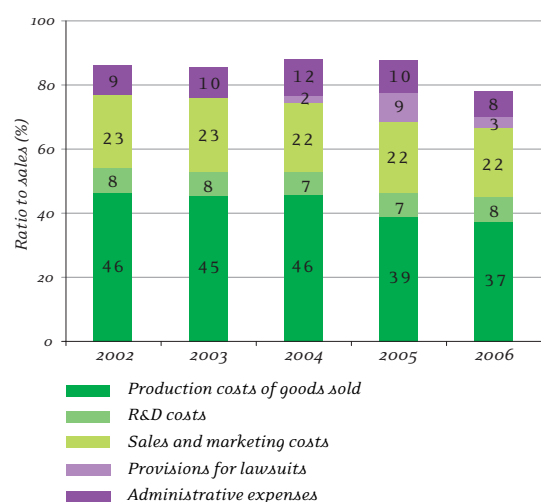
The Krka Group incurred operating expenses of 124.9 billion SIT, an increase of 7% compared to the previous year. Excluding newly formed provisions for lawsuits for the two years indicates that the increase in operating expenses was 15%, which is six percentage points less than the growth in sales.

The Krka Group operating expenses include 59.7 billion SIT of production costs of goods sold, 39.7 billion SIT of sales and marketing costs

(including 5.1 billion SIT for new provisions for lawsuits), 12.6 billion SIT of R&D costs, and 12.8 billion SIT of administrative expenses. The ratio of operating expenses to sales has fallen over a five-year period from 86% to 78% in 2006.

Compared to 2005, the production costs of goods sold, which are the largest expenses item at 48% of the total, increased for the Krka Group by 15%, which is 6 percentage points less than the sales growth. Their ratio to sales has fallen by nine percentage points over a five-year period to 37% in 2006.

STRUCTURE OF OPERATING EXPENSES



Sales and marketing costs (excluding provisions) came to 22% of sales. In 2006 they increased by 18%, primarily due to the expansion of the Krka sales network. The controlling company formed 5.0 billion SIT as provisions for lawsuits, compared to 12.5 billion SIT in 2005.

Intense investment in R&D, particularly many new development projects, new employees and contractual cooperation, led to a 31% increase in development costs, which represents 8% of sales. All R&D costs are recognized as expenses, since they are not capitalised.

The administrative expenses to sales ratio has been falling and is 8%.

## Financial income and expenses

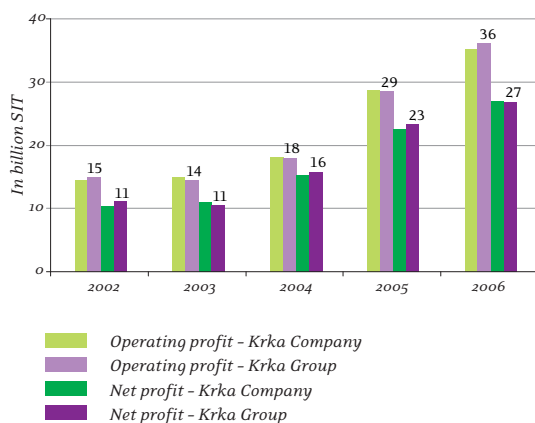
The systematic management of foreign exchange and interest risk in the Krka Company and Group has led to significant changes in the financial result in recent years, so that their effect on the

net profit has been largely neutral, unlike in the past when there was a negative impact on the net profit.

in million SIT	Krka Group					Krka Company				
	2006	2005	2004	2003	2002	2006	2005	2004	2003	2002
Financial income	3,714	3,989	3,546	3,256	3,050	3,541	3,283	3,044	3,870	3,180
Financial expenses	4,131	2,983	3,195	5,387	5,001	3,473	3,735	3,066	6,046	5,358
Net financial income/expenses	-417	1,006	351	-2,131	-1,951	68	-452	-22	-2,176	-2,178

## Operating results

OPERATING PROFIT AND NET PROFIT



The Group's operating profit of 36.1 billion SIT was 26% higher than in 2005. The profit before tax increased by 21% to 35.6 billion SIT. Income tax totalled 8.8 billion SIT, of which 10.3 billion SIT was actual income tax and 1.5 billion SIT deferred tax. Corporate income tax increased by 41%, which was mainly due to the termination of investment relief in Slovenia. The effective tax rate for the Group was 24.7%, which was 3.6 percentage points higher than last year.

The Krka Group's net profit was 26.9 billion SIT and increased by 15% compared to 2005 or 3.5 billion SIT.

## Assets

in million SIT	Krka Group					Krka Company				
	2006	Share in %	2005	Share in %	Index 2006/2005	2006	Share in %	2005	Share in %	Index 2006/2005
Non-current assets	137,756	65.4	120,455	63.8	114	134,446	65.7	116,900	64.1	115
- property, plant and equipment	121,455	57.7	108,165	57.3	112	90,450	44.2	78,104	42.9	116
- financial investments	2,954	1.4	2,441	1.3	121	31,960	15.6	30,158	16.5	106
- other	13,347	6.3	9,849	5.2	136	12,036	5.9	8,638	4.7	139
Current assets	72,918	34.6	68,394	36.2	107	70,275	34.3	65,351	35.9	108
- inventories	27,780	13.2	28,967	15.3	96	23,839	11.6	26,883	14.8	89
- receivables	36,878	17.5	33,009	17.5	112	37,740	18.4	33,775	18.5	112
- other	8,260	3.9	6,418	3.4	129	8,696	4.2	4,693	2.6	185
Total assets	210,674	100.0	188,849	100.0	112	204,721	100.0	182,251	100.0	112

The Krka Group's assets were worth 210.7 billion SIT on 31 December 2006, an increase of 12% from the start of the year. The ratio of current to non-current assets remained almost unchanged compared to the start of the year.

Of the non-current assets, with a total value of 137.8 billion SIT, the most important item is property, plant and equipment at 121.5 billion SIT, which has increased by 12% (13.3 billion SIT) due to new investments, and now represents 58% of total assets.

Current assets grew by 7% to 72.9 billion SIT and represent a 35% share in the asset structure. The main contribution to growth came from increased financial investments (purchase of shares and bonds), which increased by 70% over the year to 5.8 billion SIT. Compared to the start of the year, the value of inventories fell by 4% to 27.8 billion SIT, while operating receivables increased by 12% to 36.9 billion SIT due to increased sales, which is 9 percentage points less than the sales growth.

## Equity and liabilities

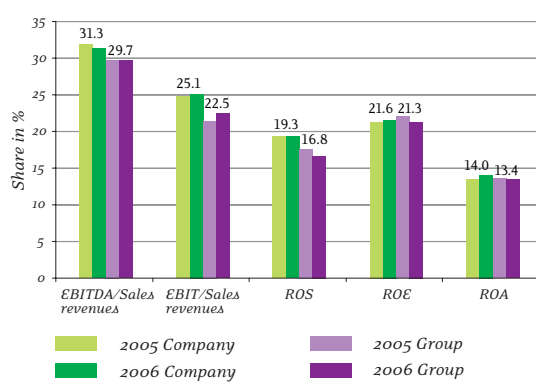
in million SIT	Krka Group					Krka Company				
	2006	Share in %	2005	Share in %	Index 2006/2005	2006	Share in %	2005	Share in %	Index 2006/2005
Equity	136,812	64.9	114,897	60.8	119	136,575	66.7	114,452	62.8	119
Non-current liabilities	39,286	18.7	36,368	19.3	108	36,030	17.6	33,058	18.1	109
Current liabilities	34,576	16.4	37,584	19.9	92	32,116	15.7	34,741	19.1	92
Total equity and liabilities	210,674	100.0	188,849	100.0	112	204,721	100.0	182,251	100.0	112

In the Group's non-current liabilities structure non-current provisions increased by 5.4 billion SIT, primarily due to newly formed provisions for lawsuits relating to pharmaceuticals for the treatment of cardiovascular diseases. Long-term borrowings were down by 29%, due to the ongoing repayment of borrowings.

Compared to the start of the year, the largest decrease among current liabilities was for income tax liabilities, which were down 75%. This was mainly due to the very high tax liabilities at the end of 2005, relating to Krka's net provisioning (release and formation of provisions) in 2005. Short-term borrowings increased by 28% or 2.6 billion SIT, which was mainly due to borrowings taken out by the controlling company. Operating liabilities increased by 4%.

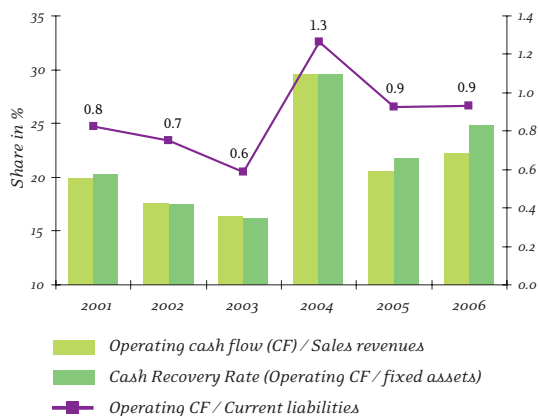
## Performance ratios

### PROFITABILITY RATIOS



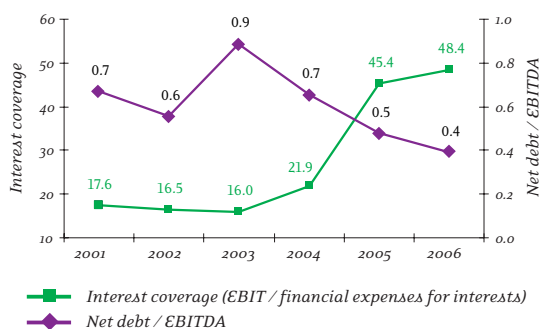
In 2006 the operating indicators were in compliance with the strategic guidelines and annual objectives. Compared to last year the Group achieved slightly lower return on assets, return on equity and return on sales. The reason is largely the increase in inventories of materials and products from sales within the Group, so part of the profit remains unrealised. The Group's net profit increased by just 15% compared to 2005, while the Krka Company's net profit increased by 21%, which had an impact on the profitability ratios. The increase in inventories held by subsidiaries was largely due to reciprocal supplies of materials and products in the final months of the year.

## CASH FLOW RATIOS



The cash flow ratio of operating cash flow (i.e. surplus operating inflows) to sales revenues was well above average compared to the other years, primarily due to sales from inventories, which were reduced by 1.6 billion SIT compared to the start of the year (due to preparations for increased sales in western Europe at the start of 2004, the value of inventories had fallen significantly at the end of 2003), and lower ongoing operating costs. For the same reason the cash recovery rate (operating cash flow/fixed assets) and operating cash flow/ current liabilities ratios were also higher in 2004.

## LIQUIDITY INDICATORS



Interest coverage indicates a positive trend. There was a significant increase in 2005, and in 2006 the trend continued. The 2006 operating profit covered interest liabilities for 48 years. An indicator value of 13 used to be sufficient in the United States for smaller, riskier companies to earn the top credit rating (AAA), while for larger, stable companies that figure is just 9. In recent years, credit rating has been calculated using the net debt/EBITDA ratio, which is improving due to the higher cash flow and reduced debt. In 2006 the ratio stood at 0.4, which is well above the banking sector's required level (1.5).

## OPERATING FIGURES 2002-2006

in million SIT	Krka Group					Krka Company				
	2006	2005	2004	2003	2002	2006	2005	2004	2003	2002
Sales	160,069	132,758	113,317	96,749	88,338	140,454	116,570	97,978	85,388	77,665
EBIT	36,065	28,523	17,950	14,440	15,017	35,219	28,801	18,017	14,928	14,479
EBIT margin	22.5%	21.5%	15.8%	14.9%	17.0%	25.1%	24.7%	18.4%	17.5%	18.6%
EBITDA	47,497	39,494	28,299	24,018	24,187	43,892	37,180	25,756	22,750	21,840
EBITDA margin	29.7%	29.7%	25.0%	24.8%	27.4%	31.3%	31.9%	26.3%	26.6%	28.1%
Net profit	26,860	23,319	15,661	10,563	11,080	27,086	22,459	15,310	11,022	10,413
Net profit margin	16.8%	17.6%	13.8%	10.9%	12.5%	19.3%	19.3%	15.6%	12.9%	13.4%
Assets	210,674	188,949	155,595	146,350	127,750	204,721	182,251	151,318	144,307	126,636
ROA	13.4%	13.5%	10.5%	7.7%	8.9%	14.0%	13.5%	10.4%	8.1%	8.5%
Equity	136,812	114,897	97,126	95,622	88,606	136,575	114,452	97,137	96,504	89,051
ROE	21.3%	22.0%	17.4%	11.4%	13.0%	21.6%	21.2%	16.8%	11.9%	12.2%



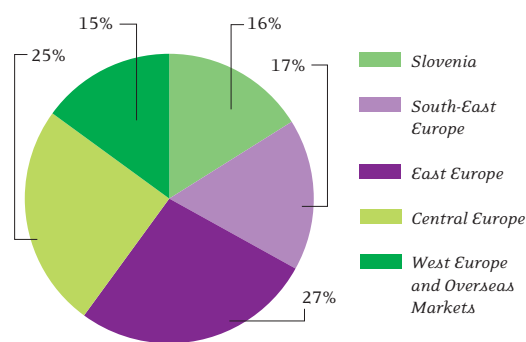
## Marketing and sales

In 2006 the Krka Group sold 160.1 billion SIT worth of products and services, which is a 21% increase on 2005. In 2006, the Krka Company sold 140.5 billion SIT worth of products, achieving a 20% increase in sales compared to 2005.

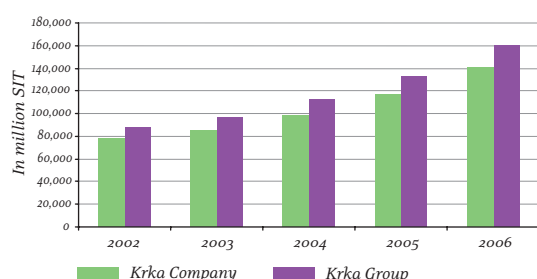
In 2006 the Krka Group achieved its highest sales growth in its Region East Europe, Region Central Europe and Region West Europe & Over-

seas Market, while growth in Region South-East Europe was not quite as high, but still in double digits. Sales in Region Slovenia grew by 4% compared to 2005.

KRKA GROUP SALES BY REGION IN 2006



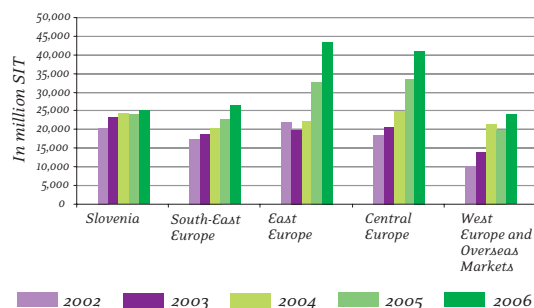
KRKA GROUP AND KRKA COMPANY SALES



KRKA GROUP AND KRKA COMPANY SALES BY REGION

in million SIT	Krka Group			Krka Company		
	2006	2005	Index 2006/2005	2006	2005	Index 2006/2005
Slovenia	25,061	24,185	104	18,051	18,337	98
South-East Europe	26,592	22,629	118	23,375	20,027	117
East Europe	43,300	32,763	132	42,505	31,501	135
Central Europe	40,921	33,425	122	32,626	26,708	122
West Europe and Overseas Markets	24,195	19,756	122	23,897	19,997	120
<b>Total</b>	<b>160,069</b>	<b>132,758</b>	<b>121</b>	<b>140,454</b>	<b>116,570</b>	<b>120</b>

KRKA GROUP SALES BY REGION



## Slovenia

Sales by the Group in Slovenia grew by 4% compared to the previous year, reaching 25.1 billion SIT, of which 18.1 billion SIT was generated by

the Krka Company, and 6.7 billion SIT by Terme Krka. Prescription pharmaceuticals contribute most to sales.

### KRKA GROUP MARKET POSITION IN SLOVENIA

Top-ranking pharmaceutical producer.

Leading market shares in individual therapeutic groups (sartans - 30%, ACE inhibitors - 35%, statins - 46%, proton pump inhibitors - 48%, oral antiseptics - 40%).

Four Krka products in the top 6 best selling pharmaceutical products in Slovenia.

Number one generics producer for launching medicines with new active ingredients and new pharmaceutical forms.

Krka's pharmaceuticals are priced to be accessible to patients.

The leading products by sales on the Slovenian market are also Krka's most important products. These are: Ultop®, Vasilip®, Atoris® and Enap®. The increasing number of products on the market has notably increased competition among generics, and we adapted our new product launch policy accordingly, including, for example, the launch of Prenessa®, expanding the product range with Ultop® in intravenous form (the only generic on the market), expanding the product range with urological products, Torendo® Q-Tab®

(only generic with an orodispersible pharmaceutical form), and expanding the self-medication product range with anti-cold products. Our price policy aims to make our prescription pharmaceuticals available without supplementary payments for patients. Significant reductions in the price of certain key products occurred, due to amendments to the Rules on the Prices of Medical Products for human use, which take into account the price of the cheapest generic medicine in reference countries.

## South-East Europe

On the markets of Region South-East Europe, Krka Group sold products worth 26.6 billion SIT, which is 18% higher than the preceding year. The highest growth in sales in the region was again achieved in Romania and Serbia, followed by Bulgaria and Albania. Sales growth was recorded in all product groups.

In **Croatia**, the largest individual market in the region with more than one third of sales, and one of Krka's key markets, the Krka Group achieved sales of 9.6 billion SIT. We continue to be the leading foreign pharmaceutical producer, just behind the two largest domestic producers. The product range at the production plant in Jastrebarsko was expanded to include Laaven®, while production of Zyllt® for other markets was started.

### KRKA GROUP MARKET POSITION IN CROATIA

Third-ranking pharmaceutical producer (right behind two local producers).

Acquisition of EU GMP certificates for the production plant in Croatia.

Start of production at Jastrebarsko for other markets.

In **Romania**, the second most important market in the region, product sales were worth 7.1 billion SIT. Since Krka's sales growth was significantly

higher than the sales growth for the overall market, our market share increased by 18% to 2.6% of the market. The growth in sales came largely

from newer products, primarily Vasilip®, Tenox®, Ultop® and the successful launch of Rawel® SR. We also increased sales of products that already held leading market shares – Enap®, Bilobil® and Ciprinol®.

The high sales growth in Serbia and Bulgaria was achieved thanks to successful introduction of new prescription pharmaceuticals onto the market. Sales trends on other markets in the region depended very much on the local economic climate.

## East Europe

The Krka Group recorded 32% growth in markets in the region compared to last year, recording sales of 43.3 billion SIT. The largest proportion of sales by product group came from prescription pharmaceuticals (75%), followed by self-medication products and cosmetics (23%), with animal health products representing under 3% of sale.

On the most important market in the region, the **Russian Federation**, the Group recorded 37% growth, and sales worth 31.4 billion SIT. Prescription pharmaceuticals represented the largest proportion of sales at 79%. The best selling product remains Enap®, while the products with highest growth came from the statins group,

Atoris® and Vasilip®. Initial sales of Asentra® were significant, which marked a move into the new indication group of treatment for the diseases of the central nervous system. Successful sales are expected in coming years, following the launch of the cardiovascular product, Zyllt® in November 2006. The best-selling self-medication and cosmetic products in the region are those under the Pikovit® and Duovit® umbrella brands (both groups were supplemented with new products), as well as Septotele®, Bilobil®, Panzynom® and the Vitaskin® cosmetic line. The subsidiary production company Krka-Rus acquired domestic producer status and is operating successfully.

### KRKA GROUP MARKET POSITION IN THE RUSSIAN FEDERATION

Second-ranking foreign generic producer.

Tenth-ranking pharmaceutical producer overall.

Krka one of the fastest growing generic producers.

Key Krka products are top sellers in individual indication groups.

**Ukraine** is the second largest market in the region. In the first half of 2006 the unstable political situation led to customers acting noticeably more conservatively in orders and reducing their stocks. The situation improved in the second half of the year, and over the entire year sales increased by 25% on 2005. The best-selling products were Enap®, Herbion®, Macropen®, Duovit®, Naklofen, Fromilid® and Vasilip®.

Sales results on our Central Asia markets were also successful, with growth of 21% achieved compared to the previous year.

We are strengthening our marketing and sales activities in Kazakhstan, Uzbekistan, Georgia and Azerbaijan, which are the most promising countries in terms of sales.

## Central Europe

The Krka Group recorded 22% growth on markets in this region compared to the previous year, achieving sales of 40.9 billion SIT. Sales of pre-

scription pharmaceuticals, which represent 90% of overall sales in the region, grew by 25%.

In **Poland**, the largest individual market in the region with 57% of all sales, and one of Krka's key markets, Krka achieved sales of 22.8 billion SIT. This successfully increased our share of the Polish market to 2.6%. Lanzul® and Atoris® remain among the most important prescription pharmaceuticals. Also very successful was the launch of Tanyz® and Lorista® medicines.

Lorista® became the third best-selling product in Poland with a market share of over 8%. Sales of self-medication products fell by 14% due to a 49% drop in sales of the Bilobil® product, despite successful sales under the Pikovit® umbrella brand. The growth in animal health product sales reached 18%, with Floron® contributing most to that figure (index 152).

#### KRKA GROUP MARKET POSITION IN POLAND

21% growth on last year.

Market share increased by 13%.

Third-ranking generic producer.

Ninth-ranking pharmaceutical producer overall.

In the **Czech Republic**, the second most important market for Krka in the region, sales growth of 7% was recorded, which achieved a 2.4% market share. The best-selling product was Atoris®. The highest growth in the region was once more achieved in **Hungary** (64%), where product sales were worth 4.8 billion SIT. The market share almost doubled, reaching 0.8%. Sales of animal health products were also successful with 41%

growth in sales achieved. Product sales in **Slovakia** were worth 2.4 billion SIT, a growth of 19% on the previous year. The best-selling product was Atoris®, followed by Fromilid®, Enap® and Lexaurin®. We also launched the Rawel® SR product. The second highest growth in the region of 30% was achieved on the **Lithuanian** market, which for Krka is the most dynamic of the Baltic markets.

## West Europe and Overseas Markets

Sales of 24.2 billion SIT were achieved on these markets, which represents growth of 22% compared to the previous year. The sale of generic prescription pharmaceuticals in **western Europe**, one of Krka's key markets, represents the bulk of sales in this Krka Region. Most generic medicines were sold via partners whose sales networks give them a presence in every western European country.

The Region recorded its highest growth in sales compared to the previous year in southern EU member states and Africa and on the Arabian Peninsula. In 2007 we are planning the largest

increase in sales on the Arabian Peninsula, in the Far East, and above all on the south European markets, where the subsidiary Krka Farmacêutica - based in Estoril, Portugal - is already operating, via which Krka will sell its own brand generic medicines on the Portuguese market. We are achieving high market shares for individual generic products on the markets of western Europe. Significant sales shares are being achieved for generic amlodipin, enalapril, simvastatin and mirtazapine. Krka also introduced generic glimepiride, doxazosin, indapamide and risperidone to the market.

#### KRKA GROUP MARKET POSITION ON WESTERN EUROPEAN MARKETS

Leading supplier of the generics lansoprazole, carvedilol and norfloxacin.

Among the leading suppliers of generic amlodipine, enalapril, simvastatin and mirtazapine.

Successful sales of own-brand prescription pharmaceuticals in the Nordic countries.

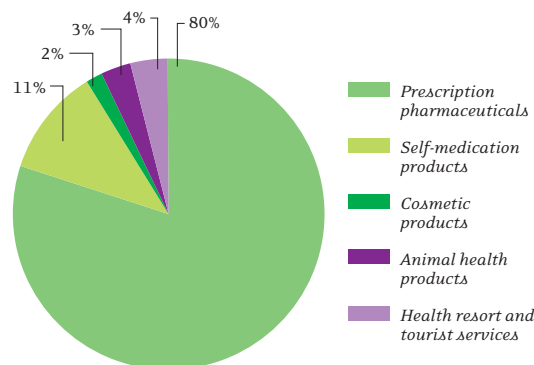
Opened the subsidiary Krka Farmacêutica in Estoril, Portugal.

Most important markets: Germany, United Kingdom, the Nordic countries, and the Netherlands.

## Product groups

Prescription pharmaceuticals represent Krka's main activity, and the largest proportion of its sales. This is followed by the self-medication pharmaceuticals group, including non-prescription or "over-the-counter" medicines, dietary supplements, and cosmetic products. The cosmetics product range was restructured in 2004 and 2005 and the decorative cosmetics and most perfume cosmetics were discontinued. The first growth from the new policy direction was seen in 2006. Krka produces and markets animal health products, and the Group also offers health resort and tourist services.

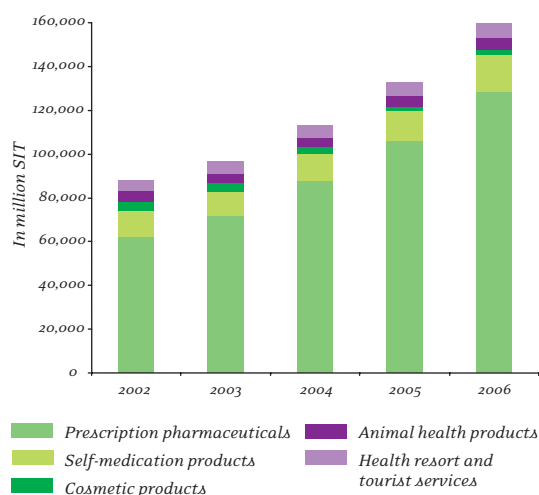
KRKA GROUP SALES BY PRODUCT AND SERVICE GROUP IN 2006



KRKA GROUP AND KRKA COMPANY SALES BY PRODUCT AND SERVICE GROUP

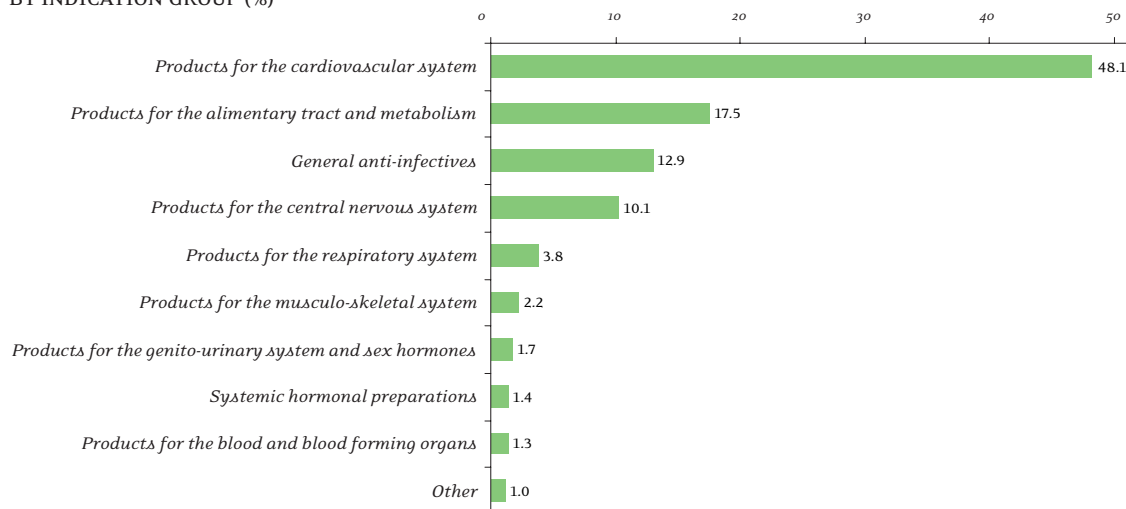
in million SIT	Krka Group			Krka Company		
	2006	2005	Index 2006/2005	2006	2005	Index 2006/2005
Human health products	147,734	121,884	121	134,971	111,762	121
- prescription pharmaceuticals	128,434	105,743	121	115,668	95,974	121
- self-medication products	17,006	14,108	121	17,083	13,826	123
- cosmetic products	2,295	2,033	113	2,220	1,962	113
Animal health products	5,472	4,796	114	5,323	4,603	116
Health resort and tourist services	6,702	5,848	115	-	-	-
Other	160	230	69	160	205	78
<b>Total</b>	<b>160,069</b>	<b>132,758</b>	<b>121</b>	<b>140,454</b>	<b>116,570</b>	<b>120</b>

KRKA GROUP SALES BY PRODUCT GROUP



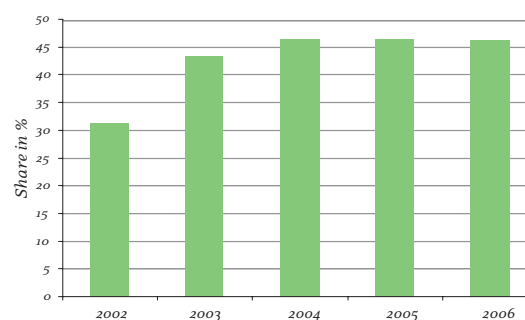
Krka produces numerous products across most key therapeutic groups. The leading products remain those for treating cardiovascular diseases. Compared to 2005 the proportion of products for the treatment of diseases of the alimentary tract and metabolism in overall sales increased (by over 2 percentage points), while the proportion of products for the treatment of infections decreased (by just under 2 percentage points).

Compared to sales five years ago, the largest increase has been in the proportion of medicines for the treatment of cardiovascular diseases (up over 5 percentage points) and medicines for the treatment of diseases of the central nervous system (up almost 4 percentage points), while the proportion of products for the treatment of infections decreased (by over 4 percentage points).

**KRKA GROUP PRESCRIPTION PHARMACEUTICALS AND SELF-MEDICATION PRODUCT SALES IN 2006  
BY INDICATION GROUP (%)**


## New products

The proportion of overall sales represented by new products is significant, and has remained high for the past two years. Products launched in the past few years have made a significant contribution to sales success and growth. In 2006 Krka again began the sale and marketing of a number of new products, while expanding the existing range with new strengths, new packaging, and new pharmaceutical forms.

**PROPORTION OF NEW PRODUCTS\* IN KRKA GROUP SALES**


\* New products: products launched in the last 5 years

**NEW PRODUCTS FOR 2006**

Prescription pharmaceuticals	
For the treatment of cardiovascular diseases	Ampril® HL, and Ampril® HD (ramipril with hydrochlorothiazide), marketed also as Amprilan® H Valsacor® (valsartan) Laaven® (lisinopril) and Laaven® HL20 (lisinopril with hydrochlorothiazide)
For the treatment of diseases of the central nervous system	Torendo® and Torendo® Q-Tab® (risperidone) Alventa® (venlafaxine) Zolsana® (zolpidem)
For the treatment of diseases of the genito-urinary system	Tanyz® (tamsulosin) Finpros® (finasteride)
For the treatment of diseases of the alimentary tract and metabolism	Meglimid® (glimepiride), also marketed under the name Eglymad®
Self-medication products	
For the oral cavity	NeoSeptolete® with three new flavours
Cosmetics	
For skincare	Vitaskin® line - Biobalance
For hair and scalp care	Fitoval® line - anti-dandruff

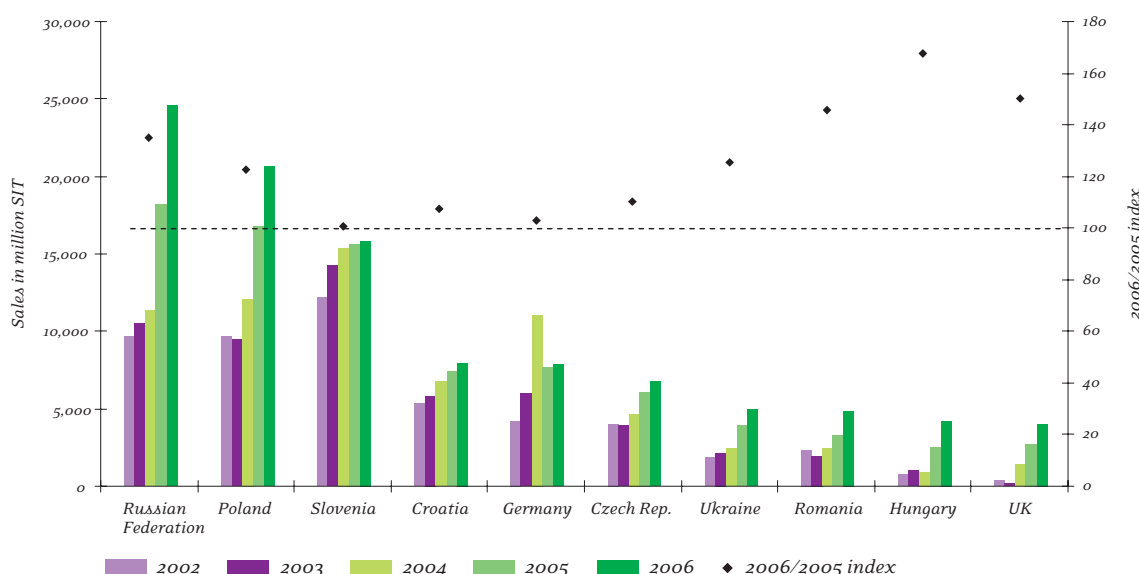


## Prescription pharmaceuticals

The Krka Group achieved prescription pharmaceutical sales worth 128.4 billion SIT in 2006, a growth of 21% on the previous year. Almost 85% of those products were sold under its own trademarks, and the remainder via partners in the Region West Europe.

On the 10 largest markets the largest increases in sales were in Hungary, the United Kingdom, Romania, the Russian Federation, Ukraine and Poland, while the highest increases on other markets came in Serbia, Azerbaijan, Armenia, Uzbekistan, Africa, the Arabian Peninsula, Lithuania, Bulgaria and Latvia.

PRESCRIPTION PHARMACEUTICALS SALES ON THE TEN LARGEST MARKETS



### Medicines for the treatment of cardiovascular diseases

**Statins.** On the markets of central, east and south-east Europe, Krka retains its positions as the leading producer of statins – the basic medicine group for lowering blood lipid levels. Krka's statins, **Vasilip**<sup>®</sup> (simvastatin) and **Atoris**<sup>®</sup> (atorvastatin), are the best-selling generic statins on the markets mentioned above. Krka started its involvement in treating dyslipidemias 10 years ago, when it launched the first Krka statin, **Holetar**<sup>®</sup> (lovastatin) in Slovenia. Today Krka is making a significant contribution to better treatment of dyslipidemias on numerous markets, which is helping to establish the market for our medicines. Krka is the leading statin producer on the individual markets of Slovenia, the Russian Federation, Poland and Lithuania, where it holds a high market share, and is also the leading gener-

ic statin producer in Croatia and Latvia. In 2006 Krka continued its rolling launch programme for the new 40 mg form of **Atoris**<sup>®</sup> (atorvastatin) on the markets of Region Central Europe.

**ACE inhibitors.** Krka has a very wide range of medicines to treat high blood pressure, which allows doctors to select just the right medicine for each patient. The best-selling medicine in this group remains **Enap**<sup>®</sup> (enalapril), together with the fixed combinations of enalapril and hydrochlorothiazide **Enap**<sup>®</sup>-H, **Enap**<sup>®</sup>-HL and **Enap**<sup>®</sup>-HL 20. **Enap**<sup>®</sup> remains the leading enalapril in Slovenia, the Russian Federation, Croatia, the Czech Republic and many other markets, and Krka is also one of the leading generic enalapril producers on the markets in its Region West Europe. **Ampril**<sup>®</sup> (ramipril), also marketed as **Amprilan**<sup>®</sup>, is Krka's latest ACE inhibitor, which has a market share of approximately 20% among ramiprils

in Slovenia and the Czech Republic. In 2006 it was offered on most markets in Regions Central Europe and South-East Europe, with the fixed combinations of ramipril and hydrochlorothiazide, **Ampril® HL** and **Ampril® HD/Amprilan® H**, being launched in Slovenia and the Czech Republic. **Prenessa®** (perindopril), produced by the Krka subsidiary in Poland, is Krka's very latest ACE inhibitor, which was launched in Hungary and Slovenia just before the end of 2005, and in Poland, the Czech Republic, Lithuania and Slovakia during 2006. In Croatia the range of ACE inhibitors was supplemented by two new products produced by the Krka production plant there in Jastrebarsko: **Laaven®** (lisinopril) and **Laaven®-HL 20** (lisinopril and hydrochlorothiazide).

**Sartans.** Krka is one of the leading producers of the most important group of medicines for treatment of high blood pressure, ACE inhibitors and sartans, on the markets of central, eastern and south-eastern Europe. These are among the most modern and most used treatments for high blood pressure. In 2006 Krka organised an international symposium to mark the fifth anniversary of **Lorista®** (losartan), which has a market share of 30% in Slovenia, and almost 50% in Lithuania and is the leading sartan on these two markets, and is also one of the leading sartans in Poland, the Czech Republic and Bulgaria, where it also enjoys a market share of over 30%. In future we plan to expand **Lorista®** to other markets at the same time as establishing Krka's new sartan **Valsacor®** (valsartan) across a wide range of markets, as we have already started marketing it in Slovenia.

**Other medicines.** Also successful on Krka's traditional markets in central, eastern and south-eastern Europe are the calcium channel blocker **Tenox®** (amlodipine) and the beta blocker **Coryol®** (carvedilol). Both are also successful in western Europe where Krka's amlodipine has been one of the leading generic amlodipines, and its carvedilol is also one of the leading generics in its class.

Since 2005 the Krka product range has also included the diuretic **Rawel® SR** (indapamide), in a modern prolonged-release tablet form. **Rawel** is only present on a smaller number of markets as yet, where it is achieving market shares between 20 and 40%. Expansion to new markets is already underway.

**Platelet aggregation inhibitors.** **Zyllt®** (clopidogrel), a medicine that prevents thrombocyte aggregation and the formation of blood clots, is mainly produced by Krka's Croatian subsidiary, and has achieved a 20% market share of the entire platelet aggregation inhibitor market in Croatia. Since 2006 it has also been available on various other markets in Krka's Region Central Europe, Region East Europe and Region South-East Europe.

### Medicines for the treatment of diseases of the alimentary tract and metabolism

**Proton pump inhibitors.** The major medicines for treating diseases of the upper alimentary tract are proton pump inhibitors, and Krka produces two medicines in this group: **Lanzul®** (lansoprazole) and **Utop®** (omeprazole), which have already been used to treat over 10 million patients. **Lanzul®**, which has a rapid effect on stomach secretion, is achieving significant market shares. In 2006 it was launched on some of new markets in Region Central Europe. In 2006 Krka became the leading producer of generic lansoprazole for western European markets as well. **Utop®** - produced by Krka for almost 20 years - remains an important proton pump inhibitor. Since spring 2006 it has also been available in parenteral form in Slovenia.

**Oral antidiabetics.** Krka has actively entered a new treatment area - diabetes - by introducing a new product to its range, **Meglimid®** (glimepiride), also marketed under the name **Eglymad®**. This medicine is from the sulfonylurea group, which are intended for oral treatment of diabetes. The product is available in Lithuania and the Czech Republic, while Krka glimepiride tablets are also available in western Europe.

### Medicines for the treatment of infections

Clarithromycin is the leading macrolide antibiotic in Europe, and has been part of the Krka product range since 1997. **Fromilid®** (clarithromycin) is today the leading generic clarithromycin on most of Krka's markets in its central, eastern and south-eastern regions, and achieves high market shares. Next to the regular dosage form Krka on most markets also offers **Fromilid® uno**, which is the first generic clarithromycin in a prolonged-

release form. In addition to macrolide antibiotics, Krka also has two products from another group of modern antimicrobial medicines – fluoroquinolones. For 15 years now Krka has been marketing **Ciprinol**<sup>®</sup> (ciprofloxacin), which is the leading ciprofloxacin on numerous markets. **Nolicin**<sup>®</sup> (norfloxacin) has been part of the range even longer. Both are still achieving growth in sales.

### Medicines for the central nervous system diseases

In 2006 Krka supplemented its range of medicines for the central nervous system with the addition of three new products: **Torendo**<sup>®</sup>, **Alventa**<sup>®</sup> and **Zolsana**<sup>®</sup>.

**Antipsychotics.** **Torendo**<sup>®</sup> (risperidone) is an atypical antipsychotic used to treat schizophrenia and bipolar disorder, and behavioural disorders in patients with dementia. Risperidone is the second best-selling antipsychotic in the world, immediately after olanzapine; both are among the two best-selling medicines overall. Krka offers both of these best-selling medicines within its product range, in addition to the new **Torendo**<sup>®</sup> product, it has also been marketing **Zalasta**<sup>®</sup> (olanzapine) for two years. **Torendo**<sup>®</sup> also represents another approach to modern medical treatment. The launch of **Torendo**<sup>®</sup> **Q-Tab**<sup>®</sup> was the first generic risperidone in orodispersible tablet form. After six months on the market in Slovenia, **Torendo**<sup>®</sup> and **Torendo**<sup>®</sup> **Q-Tab**<sup>®</sup> have achieved a market share of over 20% among risperidones. **Zalasta**<sup>®</sup> – a product produced by Krka Polska is also successful, with just under a 30% market share among olanzapines in Poland.

**Antidepressants.** Krka's range of antidepressants was expanded in 2006 to include **Alventa**<sup>®</sup> (venlafaxine). Venlafaxine is a modern, global leader among antidepressants and has a dou-

ble function, being used to treat depression and anxiety disorders. It is followed by sertraline, which Krka has been selling successfully under the **Asentra**<sup>®</sup> brand name for several years. **Asentra**<sup>®</sup> (sertraline) is the leading generic sertraline on the markets of central, south-eastern and eastern Europe, and in Slovenia, Lithuania and Poland has a 50% market share. **Mirzaten**<sup>®</sup> (mirtazapine) is also the leading generic mirtazapine on these markets.

**Other medicines.** **Yasnal**<sup>®</sup> (donepezil) represents the Krka presence in the field of medicines to treat Alzheimer's disease. Today, **Yasnal**<sup>®</sup> is one of the best-selling generic donepezils on Krka's traditional markets and one of the leading medicines for Alzheimer's disease on the global level. In Slovenia and Slovakia, **Yasnal**<sup>®</sup> has a market share of over 80% on the donepezil market, while its market share was 60% in Lithuania, and over 30% in Poland. Since 2006 **Yasnal**<sup>®</sup> has also been available on the Czech market. Last year saw the launch of **Zolsana**<sup>®</sup> (zolpidem), a medicine for the treatment of insomnia, which is currently available in Slovenia, the Czech Republic and Poland.

### Medicines for the urinary tract

Krka's range of modern products for the treatment of benign prostatic hypertrophy was completed by adding **Tanyz**<sup>®</sup> and **Finpros**<sup>®</sup> to the existing **Kamiren**<sup>®</sup> (doxazosin) and **Kamiren**<sup>®</sup> **XL** (prolonged-release doxazosin).

**Tanyz**<sup>®</sup> (tamsulosin) is a modern medicine that reduces the symptoms of benign prostatic hyperplasia. Tamsulosin is the world's best selling medicine for this disease. In 2006 **Tanyz**<sup>®</sup> had already been made available in Slovenia and most of the markets of central Europe and Romania. Just before the end of the year, we were the first generic producer to release **Finpros**<sup>®</sup> (finasteride), a product for prostate enlargement.

## Self-medication products

The Krka Group achieved self-medication product sales worth 17 billion SIT in 2006, a growth of 21% on the previous year. On the 10 largest markets the largest increases in sales were in Romania, Uzbekistan, the Russian Federation, and Ukraine while the highest increases on other

markets came in Azerbaijan, Latvia, Africa, Hungary and Albania. On the larger markets, there was a noticeable fall in Poland, where a turnaround was planned in 2006, which will only be attainable in 2007, due to delays in a number of planned launches.

SELF-MEDICATION PRODUCT SALES ON THE TEN LARGEST MARKETS



In 2006 activities focused on the key brands - Septolete®, Bilobil®, Duovit®, Pikovit® and Herbion®.

**Bilobil®** (ginkgo biloba extract) was selected in 2006 as the winner in the category of products for improving memory and concentration. It is the leading seller in its category in Romania, Slovenia and Poland, and just behind the market leader in the Russian Federation. The overall sales of Bilobil® are increasing, and were particularly high in 2006, when growth of 34% was achieved compared to the previous year. A new higher strength version **Bilobil® forte** was expanded to new markets. The most successful among products under the **Herbion®** brand name, which combines herbal medicines, were the two cough syrups enjoying growth on numerous markets in eastern and south-eastern Europe.

The **Duovit®** brand offers mineral-vitamin products that satisfy daily requirements for vitamin and mineral intake. The main Duovit® product has recently been joined by Duovit® for men and Duovit® for women, which were launched on a number of new markets in 2006. The market and

sales activities for Duovit® have been targeted at the markets of eastern Europe, particularly the Russian Federation and Ukraine. The Pikovit® brand is the umbrella trademark for a group of vitamin and mineral products for children that has been on the market for over 20 years. The line has been supplemented with products such as Pikovit® plus, launched in 15 new countries in 2006, and Pikovit® D and Pikovit® forte on some individual markets.

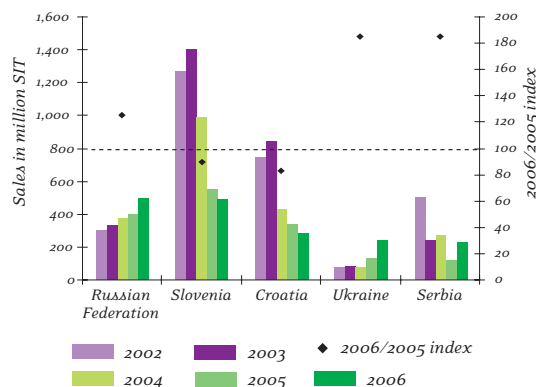
**Septolete®** is an oral antiseptic brand that includes a number of clinically tested products for self-treatment of mild infections of the mouth and throat. In 2006 Krka launched three new products in the range: NeoSeptolete® with lemon flavour, NeoSeptolete® with wild cherry flavour, and NeoSeptolete® with green apple flavour. They were launched in Slovenia at the beginning of the year, followed by launches across Krka's Region Central Europe. Septolete® plus, which was launched in Croatia in 2006, won the Gold OTIS award in Poland for mouth and throat medicines, as selected by consumers, while it is officially recommended by the association of otolaryngologists in the Russian Federation.

## Cosmetic products

The Krka Group achieved sales of cosmetics worth 2.3 billion SIT in 2006, a growth of 13% on the previous year. Of the five largest markets, sales increased in the Russian Federation, Ukraine and Serbia. A small fall in sales was recorded in Slovenia and Croatia, due to the recent rationalisation of the product range to focus on higher yield products and other sales channels.

The best selling products include the **Vitaskin®** line of skincare products, which was expanded in 2006 to include **Vitaskin® Biobalance** for women over 30. The **Fitoval®** haircare brand also returned high sales compared to the previous year. The range of products to strengthen hair and prevent hair loss was expanded to include an anti-dandruff shampoo and lotion. Products under the **Sun Mix®** trademark, available in Slovenia and Region South-East Europe are, of course, very seasonal.

COSMETIC PRODUCT SALES ON 5 LARGEST MARKETS

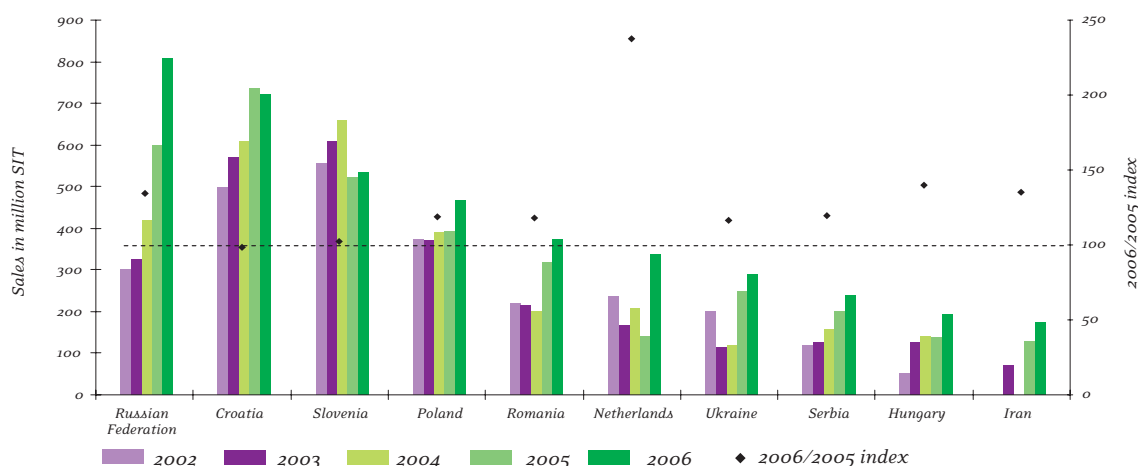


## Animal health products

The Krka Group achieved sales of animal health products worth 5.5 billion SIT in 2006, a growth of 14% on the previous year. On the ten largest markets sales increased most in the Netherlands, where they more than doubled, in the Russian Federation and Hungary. Sales also increased on all the top-10 markets with exception of Croatia (where one product was discontinued).

The most important brand, **Enroxil®** (enrofloxacin) retains its leading position in the animal health product range. Another impressive performance came with the high sales growth for **Floron®** (florfenicol) in the antimicrobial medicine range, which grew by 59%, and has already overtaken Enroxil® in Poland.

ANIMAL HEALTH PRODUCT SALES ON 10 LARGEST MARKETS



## Health resort and tourist services

Sales of health resort and tourist services were worth 6.7 billion SIT, which is 15% up on 2005.

Terme Krka company facilities realised a total of 340,048 overnight stays, which represents a 7%-growth on the preceding year. Foreign guests recorded 111,404 overnight stays in total, which is 33% of the total.

The average occupancy of accommodation capacity was 69%, while the average occupancy of our

health resort capacity was 82%. Particularly, attention will be paid to developing and expanding programmes for relaxation and improving quality of life, while further investments will also be made in health and rehabilitation programmes and equipment. Our objective is to retain our market share in the field of health treatments within the public health service, which already stood at 34% of the overall programme in Slovenia in this field.



## Research and development

The basic objectives of Krka's research and development policy are to develop technologies for the production of active pharmaceutical ingredients and pharmaceutical dosage forms, and to perform all the testing and research required to gain marketing authorisations for prescription pharmaceuticals, self-medication products, animal health products and cosmetics. The vital role this work plays in consolidating our position as a successful European pharmaceutical company means that development is one of our key function areas.

The start of 2006 was marked by an increase in the number of new development projects, with the aim being to ensure continued competitiveness of the Krka product portfolio. At present, Krka's R&D work includes around 100 projects in various developmental phases. We successfully concluded R&D activities for a range of products, submitting 11 new products in 28 different dosage forms for marketing authorisation.

The generic industry's product development has to respect the regulatory requirements and patent situation in individual markets. Products have to be adapted to individual groups of markets. Krka's ability to integrate research knowledge in preparation of active pharmaceutical ingredient (API) with research techniques in the development of pharmaceutical forms and their behaviour within the body significantly increases its flexibility in realising products targeted to individual markets and hence increasing the competitiveness of its portfolio.

The main area of work is the development of APIs, particularly the development of innova-

tive synthesis processes and the preparation of solutions for API properties that are adequate to meet the requirements of the regulatory authorities as well as intellectual property requirements. Chemical synthesis, pharmaceutical technology and evaluation techniques are essential fields of knowledge in the process. These have all proved to be key factors in successful obtaining of marketing authorisations and launch on individual markets of the following products: Prenessa® (perindopril) tablets and Co-Prenessa® (perindopril and indapamide) tablets and Zyllt® (clopidogrel) tablets.

Effective work in the field of gaining marketing authorisations demands the use of optimal procedures within national and European legislation. Past experience is used to full effect in the marketing authorisation management process. We are continually managing national procedures as well as MRPs (Mutual Recognition Procedures). Twelve MRPs have been successfully concluded. Some MRPs were initiated in Central European countries and the selection of RMSs (Reference Member State) was expanded. In 2006 Krka started to acquire experience in managing the latest marketing authorisation processes that will significantly increase the speed of obtaining marketing authorisations for products on desired markets. The so-called DCPs (Decentralised Procedures) that are only now being employed in Europe are of particular importance. Managing national procedures is also very important on markets that are not part of the European Union, such as Croatia and the Russian Federation. In the Russian Federation the Krka Company and the subsidiary Krka Rus have both successfully gained market authorisations.

NUMBER OF NEW MARKETING AUTHORISATIONS FOR KRKA GROUP BY REGION

	Slovenia		South-East Europe		East Europe		Central Europe	
	No. of products	No. of forms	No. of products	No. of forms	No. of products	No. of forms	No. of products	No. of forms
2006	23	36	114	234	97	152	84	210
2005	10	34	84	141	76	111	102	266
2004	16	22	220	355	66	89	63	110
2003	6	11	44	67	59	87	32	45

Development work concludes with obtaining marketing authorisation for the product, which then enables the product to be marketed. Our research and development results have led to us being granted the first marketing authorisation for 11 new products in 24 different strengths, while

we also obtained 436 marketing authorisations for various other products. On behalf of Krka d. d. Novo mesto and Krka Sverige AB - Krka's Swedish-based subsidiary - Krka obtained 38 marketing authorisations for 11 products in 31 forms in the countries of western Europe.

## Protecting our know-how and intellectual property

Krka respects the intellectual property of others and protects its own property. It uses patent applications to protect the results of its work in key fields. In 2006 the company submitted patent applications for 17 inventions on the basis of prioritised applications from 2005, and submitted 14 international patent applications.

The company markets its products under its own trademarked brands, which further enhances the added value of Krka products. In 2006 Krka made 31 applications to register its trademarks in Slovenia, and seven abroad, and submitted 29 applications for international trademark registration.

## Prescription pharmaceuticals

A new product was added to the cardiovascular range when **Valsacor**<sup>®</sup> gained marketing authorisation in Slovenia. The product has the active ingredient valsartan in 40, 80 and 160 mg film-coated tablets. A marketing authorisation for **Prenessa**<sup>®</sup> (perindopril) as 2 mg and 4 mg tablets has been granted in most European countries. We expanded our range by obtaining the first marketing authorisation for the product **Co-Prenessa**<sup>®</sup> (combination of perindopril and indapamide) in Hungary. The marketing authorisation for new strengths of **Lorista**<sup>®</sup> in the forms of 12.5 mg, 25 mg and 100 mg tablets in Slovenia consolidated the brand as a key product for the treatment of cardiovascular disease. Krka successfully concluded the MRP for **losartan** 50 mg tablets and **losartan tablets with hydrochlorothiazide**, expanding the marketing authorisation of the product to some western European markets. In Russia the marketing authorisation was granted for the product **Diab-Norm**<sup>®</sup> (pioglitazone) in the form of 15 mg and 30 mg tablets. Obtaining marketing authorisation for **Zylt**<sup>®</sup> (clopidogrel) in Russia and Bulgaria was an important achievement on those markets.

The Krka range of products that act on the central nervous system expanded with obtaining the marketing authorisation in Slovenia for the prod-

uct **Zolsana**<sup>®</sup> with the active ingredient zolpidem, in the form of 10 mg and 5 mg film-coated tablets. Another important achievement in the marketing of products for the central nervous system was obtaining the marketing authorisation for **Zalasta**<sup>®</sup> (olanzapine) and **Yasnal**<sup>®</sup> (donepezil) tablets in Croatia.

In addition to **Tanyz**<sup>®</sup> (tamsulosin), for which the marketing authorisation was obtained at the end of 2005, the range of products to treat benign prostatic hyperplasia was expanded with the new product **Finpros**<sup>®</sup> with the active substance finasteride in the form of a 5 mg film-coated tablets.

Special care in the development of new technologies is given to developing formulations with the special delivery systems, and the development of formulations in the form of orodispersible tablets. We successfully concluded an MRP for risperidone film-coated tablets and orodispersible tablets in most European countries, and also obtained a first marketing authorisation for the product **Mirzaten**<sup>®</sup> Q Tab<sup>®</sup> in the forms of 15 mg, 30 mg and 45 mg orodispersible tablets in Hungary.

We intensified external cooperation in the first half of 2006 in development activities through

## NUMBER OF MARKETING AUTHORISATIONS FOR PRESCRIPTION PHARMACEUTICALS BY REGION

	Slovenia		South-East Europe		East Europe		Central Europe	
	No. of products	No. of forms	No. of products	No. of forms	No. of products	No. of forms	No. of products	No. of forms
2006	13	26	82	189	61	104	57	175
2005	8	30	60	110	55	84	87	243
2004	8	14	136	271	23	40	48	94
2003	4	9	19	27	43	66	17	26

work with specialised development partners in the field of active ingredient synthesis and bio-synthesis, as well as in the field of pharmaceutical technology and ingredient and product

evaluation. Krka was also very successful in the development of new synthesis paths for active ingredient preparation for a ciprofloxacin product in injection form.

## Self-medication products

We added to the existing marketing authorisations for the Septolete® brand products marketing authorisations for three new products in the Czech Republic, Slovakia, Poland, Lithuania and

Ukraine: **NeoSeptolete® with lemon flavour,**  
**NeoSeptolete® with green apple flavour, and**  
**NeoSeptolete® with wild cherry flavour.**

## NUMBER OF SELF-MEDICATION PRODUCT MARKETING AUTHORISATIONS BY INDIVIDUAL REGION

	Slovenia		South-East Europe		East Europe		Central Europe	
	No. of products	No. of forms	No. of products	No. of forms	No. of products	No. of forms	No. of products	No. of forms
2006	8	8	30	42	35	45	22	31
2005	2	4	24	31	15	19	15	23
2004	6	6	67	67	37	43	10	10
2003	1	1	12	18	14	17	5	5

## Animal health products

Krka's biocide range was expanded with the notification of **Ecocid®** for human and veterinary medicine in Slovenia and the Czech Republic and

Slovakia. In the animal health field, Krka achieved significant R&D results for enrofloxacin, which is used to treat infections in farm animals.

NUMBER OF NEW ANIMAL HEALTH PRODUCT MARKETING AUTHORISATIONS

	Slovenia		South-East Europe		East Europe		Central Europe	
	No. of products	No. of forms	No. of products	No. of forms	No. of products	No. of forms	No. of products	No. of forms
2006	2	2	2	3	2	3	4	4
2005	-	-	-	-	6	8	-	-
2004	2	2	17	17	6	6	5	6
2003	1	1	13	22	2	4	10	14

## Cosmetic products

Intense work went on throughout the year to develop the strategic new trademarked brand **Vitaskin® Pharma**. The development focused on the Vitaskin® Pharma Age Formula anti-wrinkle products and anti-pigment spot products and the Vitaskin® Pharma Reactive Skin products for sensitive skin prone to redness. The successful formula development work was confirmed by the results of efficiency tests, sensitivity tests and

the satisfaction expressed in user tests. At the same time, development work continued on the Vitaskin® Pharma Age Formula nutritional supplements in capsule form for skin firmness and flexibility, which offer a comprehensive package of care for mature skin in tandem with the cosmetic products. These products will undoubtedly provide Krka with a distinct competitive advantage in points-of-sale.

## Health resort and tourist services

In the coming year, we will continue to pay particular attention to the continued development and expansion of the programmes for relaxation and improving quality of life.

This includes further investments in treatment and rehabilitation equipment and programmes, in order to retain our market share in the field of health treatments within the public health service, which in 2006 already stood at 34% of the overall programme in Slovenia in this field.

## Product supply

Krka increased and optimised its Product Supply capacity in 2006, and improved processes along the entire supply chain.

### Purchasing

Krka is continuing to build partnerships with suppliers. It is creating a system with two to three suppliers for key incoming materials, to ensure safety, reliability and competition in supplies.

Despite the continual increases in the price of oil derivatives, Krka was able to keep the price of major raw materials and intermediates at the same level as the previous year or even managed to reduce them. In 2006, we purchased 26.8 billion SIT worth of raw materials, packaging materials and finished products.

### Logistics

In the logistics field, Krka continued construction of warehouse capacity. The raw material warehouse was renovated and a new management system was introduced to the packaging

material warehouse. The solvents warehouse was linked to the API production site by a pipeline bridge.

### Production

High quality and efficient production, capable of responding rapidly to change, remains key to Krka's competitive advantage. This is confirmed by Krka's business partners and by numerous domestic and international regulatory inspections. Production, storage and quality control takes place in all Krka's plants according to good manufacturing practice (GMP), good warehousing practice and good laboratory practice (GLP), and in compliance with European and international standards and the provisions of other technological and technical regulations.

Fermentation production and chemical production of active pharmaceutical ingredients (APIs) is in accordance with Krka's strategy for vertically integrated products, which is directed above all towards production of APIs for our own finished products. In terms of quality and quan-

tity, we matched the production requirements for finished products, and for future launches we successfully carried out transfers to pilot and production testing for 14 new APIs.

A new pharmaceutical form, orodispersible tablets, was introduced into finished product production.

While achieving the same high level of physical production turnover as in the previous year, and with increasing differentiation in product packaging, we managed to improve our flexibility, improve our production responsiveness, and satisfy orders in full.

Krka is working to provide sufficient production capacity, not only through the construction of additional capacity, but also by establishing

a continual improvement system to expand the availability and efficiency of existing machinery. In line with the annual programme of improvement objectives improved by the Management Board, Krka sets measurable performance objectives which are monitored, and analysed and action is taken if necessary.

The continual improvement system was set up in the field of technological procedures

for the production of existing Krka products. Improvements are introduced when production is moved to new or alternative equipment in production plant in Slovenia, the Russian Federation, Poland and Croatia, or when an alternative source of raw materials is introduced or the production batch size is adjusted. The ideas are collected via the large-scale inventive work initiatives and at special workshops entitled Challenges to Improve Technological Processes.

## Supply chain management and control

This function ensures the optimal utilisation of production capacity in the Krka Company and its subsidiaries and allocation of production in accordance with orders for pharmaceutical preparations. In addition to planning, our task is to coordinate production for the launch of new products and to assist the services responsible for data maintenance.

If specific products are incompatible with products already in production or if bottlenecks occur, then production can be transferred to contracted partners.

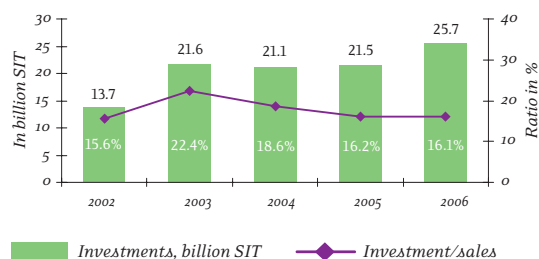
As part of the purchasing function we look for new sources of APIs produced in line with required procedures, and organise the transfer of production to patent-cleared countries.



## Investments

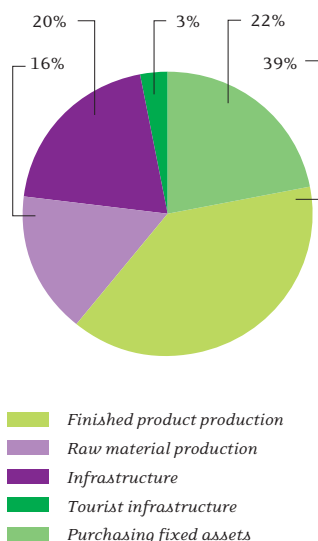
The Krka Group allocated 25.7 billion SIT or 16.1% of sales revenue for investments.

### KRKA GROUP INVESTMENTS



At present the Group is implementing over thirty projects mainly relating to the production of finished products and raw materials and the modernisation of infrastructure to provide high quality support for the business functions of the entire Group. Most of these projects take place in Slovenia, Croatia, the Russian Federation and Poland.

### STRUCTURE OF THE KRKA GROUP'S INVESTMENT SPENDING IN 2006



### Sinteza 4

In September test production started in the new Sinteza 4 active pharmaceutical ingredient (API) production plant, the largest investment project of 2006 in terms of both technological complexity and financial commitment. The plant will be used for the production of APIs, which can then be incorporated into our own finished products. In addition to statins, which are the main API into cholesterol-reducing products, Sinteza 4 will also be used to produce other APIs for products to treat cardiovascular diseases and pharmaceuticals in other indication areas.

### Pelete IV

The upgrading of the Pelete IV plant will double pellet production capacity. We will set up two new production lines in the new extension to the Specifika plant, where the spatial capacity required for production and R&D work will also be built.

### New ampoule plant

The new ampoule plant will be used for production from the preparation of solutions, ampoule filling, and autoclaving, while the present plant will be renovated and used for optical control and packaging. The two plants are connected. The start of test production is planned for the end of 2007.

### Capsule production and packaging plant

The first phase of modernising the capsule production and packaging plant is underway, and will increase the production capacity of the plant. The work has largely already been finished, and two high capacity packaging lines have been installed and are already in operation.

### Notol III

In the third phase of the Notol project we will increase the packaging facility, which will allow new packaging lines to be added. There will also be investment in additional capacity of the weighing, granulating and tableting facilities to coordinate the increased packaging capacity with intermediate product production capacity.

### Terme Krka

The Terme Krka company carried out a full renovation of Hotel Krka at the Šmarješke Toplice spa resort to complete the investment cycle of construction and renovation of accommodation and relaxation capacity at that site. The investment received co-financing from the European Regional Development Fund worth 503.9 million SIT. The company Golf Grad Otočec completed phase one of the golf course construction at Struga near Otočec.

### Production and distribution companies in Poland, Croatia and the Russian Federation

In Poland the purchase of a new packaging line, expanded boiler, and an additional air-drying installation in the production facility has increased plant production capacity. A new office building was also built. Production capacity in the Russian Federation was increased with a new tablet press. In 2007 we will buy a new packaging line, coating drum and capsule filler. The Krka-Farma Zagreb subsidiary upgraded its central energy supply control system.

## Integrated management system

As a generic producer, Krka manufactures medicines that can take their place alongside the world's leading pharmaceutical companies in terms of quality, safety and effectiveness. In its

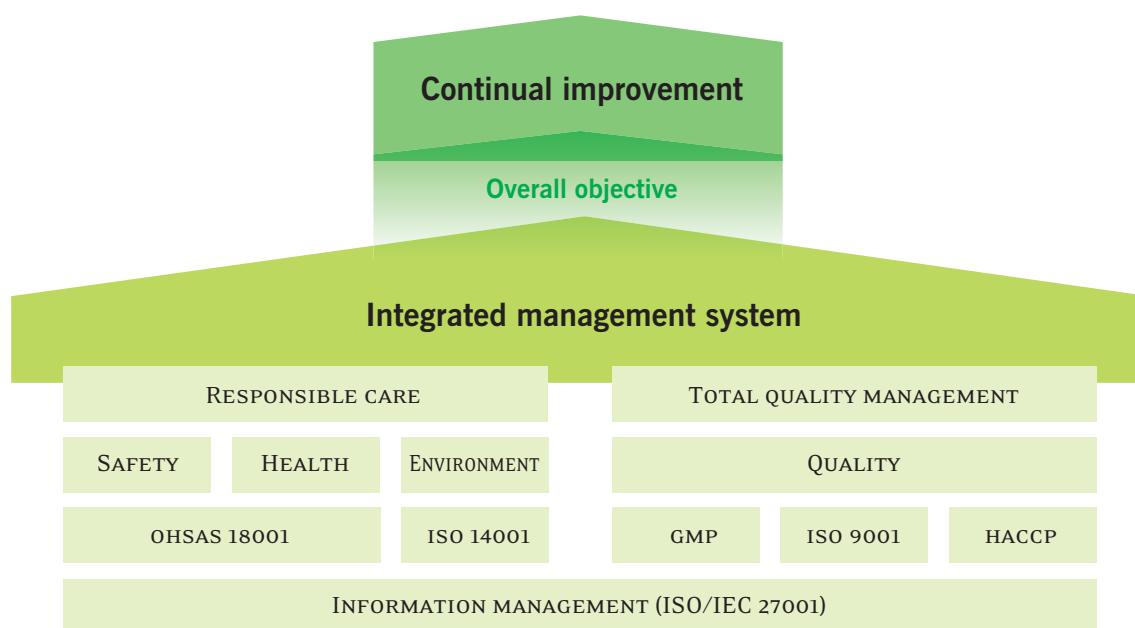
broadest sense, quality is something that all employees create and maintain, and is also the responsibility of all employees.

### Management system

The complete system is described in Krka's Quality Manual, which covers various aspects of operations with the same principles (quality - GMP, ISO 9001; environment - ISO 14001, health and safety at work - OHSAS 18001, foodstuffs safety - HACCP, and information security - ISO 27001).

The continual improvements dictated by standards and the PDCA approach (Plan, Do, Check, Act), and Krka's commitment to such standards, is the force behind progress and the continuous increase in quality throughout every phase of Krka operation.

#### INTEGRATED MANAGEMENT SYSTEM



Krka has increased its efforts involving the evaluation of key processes in order to increase their efficiency and effectiveness. The use of tools such as risk analysis, statistical operating indi-

cators and the management system for process improvement objectives has been expanded to all key areas in order to improve and monitor Krka's strategic objectives.

## Managing the quality system

The quality system was checked through internal control measures such as internal audits, supplier audits, and external audits by our business partners. The compliance of the quality assurance system with standards is also reviewed and confirmed by regular inspections by domestic and foreign state regulatory bodies. All regulatory body inspections and customer audits were concluded successfully, which fulfilled the basic objective – consolidating and developing Krka's reputation and trust with its target publics.

Inspectors from the Agency for Medicinal Products and Medical Devices of the Republic of Slovenia carried out regular follow-up inspections on the quality management system, warehouses, production plants and quality control laboratories and confirmed our compliance with the EU's GMP requirements, which form the basis for issuing the GMP certificate and manufacturing licence.

The verification process for one of the most modern API production plants in Europe (Sinteza 4) was completed, which means that regular API production can be started.

The success of Krka's integrated management system was reconfirmed by successfully passing an audit performed by SIQ Ljubljana (Slovenian Institute of Quality and Metrology) based on the following standards: ISO 9001:2000, ISO 14001:2004, Codex Alimentarius:1997 (HACCP) and OHSAS 18001:1999 and ISO 27001. A new feature of the audit in 2006 was the first verification of the information security system (ISO 27001). The SIQ inspectors did not find any compliance failures in any of the systems audited.

Regular inspections were also carried out by the Slovenian Veterinary Administration of the Republic of Slovenia. The inspection checks the safety and quality assurance system for products for animal consumption. The inspections renewed the permit to perform wholesale trade in animal health medicinal products.

Krka places special focus on the environment, and occupational health and safety (ISO 14001, OHSAS 18001) as well as positive and open public relations. It regularly informs the public about its systematic and preventive approach, and improvements to the system. The proof that our approach is successful and correct is our right to use the Responsible Care logo, which we receive each year.

## Information support development

### New solutions – more efficient performance

In 2006 Krka successfully organised the information support required for the introduction of the euro, and to bring the following systems online:

- GLORYA, which provides process support for regulatory document management and is based on the Documentum platform;
- SAP BW (business warehouse), which offers decision-making support and consolidation of business data using a business intelligence system;
- salaries and records of hours worked within the SAP system;
- systems supporting the automatic production and logistics process (Sinteza 4, Pelete IV, hydrogenation, warehousing, etc.).

In 2007 Krka will continue the process of rapid introduction of solutions offering information support for business process optimisation. The emphasis will be on:

- introducing SAP-SCM (Supply Chain Management), which will improve logistical processes in planning sales forecasts, inventory management and optimising utilisation of available capacity;
- transferring warehousing operations to the finished product warehouse in the SAP system. This is a strategic move to an internationally validated, stable and standardised solution;
- starting a project to expand the SAP information system to the Krka-Rus and Krka Farma companies in the Russian Federation.

### Information technology

In the IT field we kept in close touch with information technology developments and used new solutions to increase capacity, reliability and the security of computer systems:

- appropriate data security and archiving conditions were ensured within an ILM (information lifecycle management) project
- a data protection system was built into laptop computers

- a systems operations control system (MOM) was implemented.

In 2007 we will continue activities to ensure secure and reliable operations in line with the company's security standards, and will carry out a full renovation of the local network at Krka's Novo mesto location.