KRKA

Annual Report 2006

Contents

Boldness.

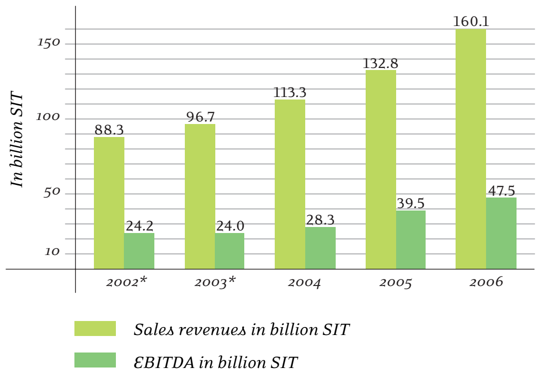
JOSEF RESSEL
Invented a boat propeller.
He worked as forestry engineer in Kostanjevica na Krki, where he tested a boat with a hand-run screw in the Krka river back in 1825. He patented the invention in 1827.

Introduction

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

Significant achievements

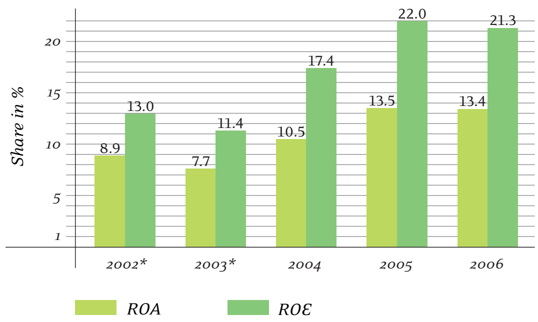
Sales revenues and EBITDA



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

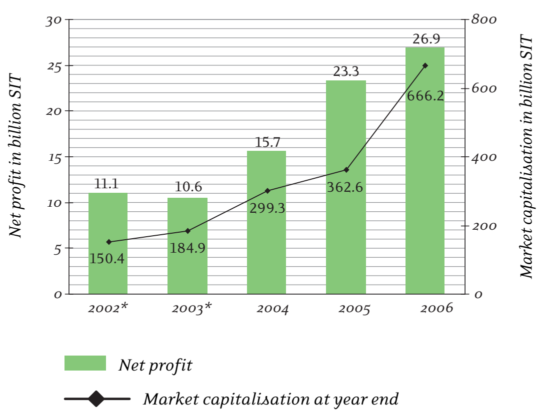
Earnings before interest, taxes, depreciation and amortisation (EBITDA) grew by 20%.

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[1]	21.3%	22.0%
ROA[2]	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[3]	7,918	6,890	4,627	3,113	3,266
Earnings per share in EUR[3]	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

1 Net profit/average equity balance in the period
2 Net profit/average total assets balance in the period
3 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.

Registered office:	Šmarješka cesta 6 8501 Novo mesto Slovenia
Telephone:	+386 7 331 21 11
Fax:	+386 7 332 15 37
E-mail:	info@krka.biz
Web pages:	www.krka.si
Basic activity:	Production of pharmaceutical preparations
Activity code:	DG 24.420
Year established:	1954
Registration entry:	1/00097/00, Novo mesto District Court
VAT number:	82646716
Company ID number:	5043611
Called-up capital:	14,170,448,000 SIT
Shares:	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.

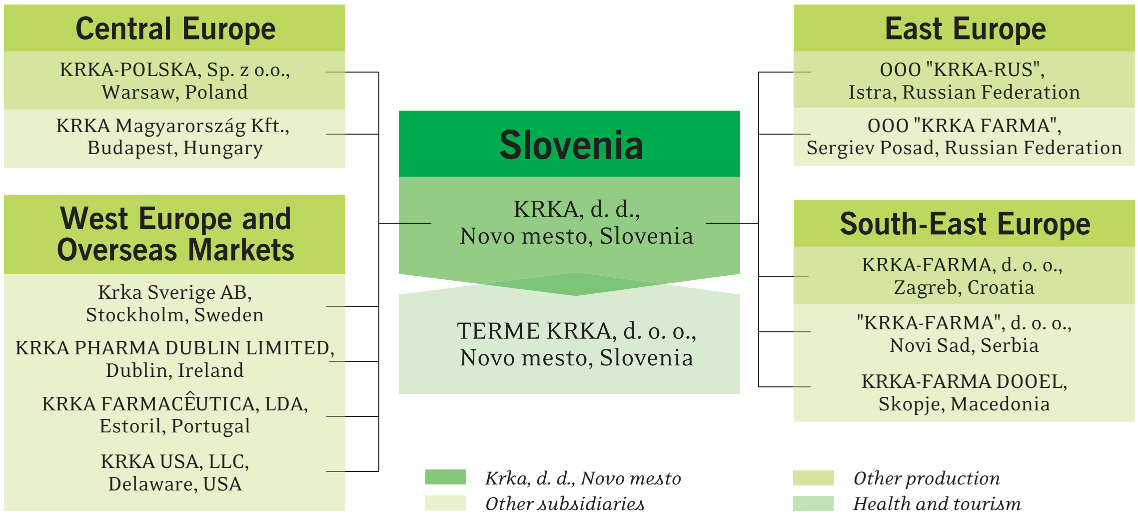
The Krka Group is engaged in the development, production, sale and marketing of human health products (prescription and self-medication pharmaceuticals, and cosmetics), animal health products, and health and tourism services. Production takes place at the controlling company and in three production and 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, Farmacevtski 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 partnerships. 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 Gomiščček, 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/*).

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 executive 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 co-ordinating 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 facilitates 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 supported 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.*

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 circumstances 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 macroeconomic 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 positions 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 accordance 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 individual 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

	2006			2005			2004		
in billion SIT	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.

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 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.

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

Liquidity ratios		2006	2005	2004	2003*	2002*	Krka average	Average for global pharmaceutical companies**	Average for Slovenian companies***
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.

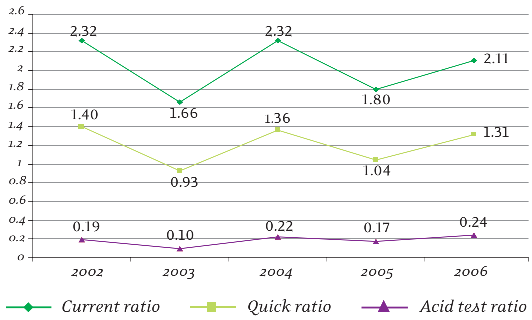
When considering liquidity ratios, it is important to examine their dynamics, namely whether the current, quick and acid test ratio move in accordance to each other. If these ratios move alike, that is an indication of stability between liquid assets and liabilities.

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.

Movement in liquidity ratios for the Krka Group

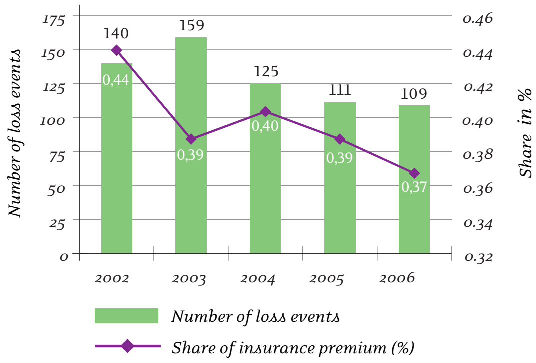


Property, business interruption and liability insurance

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

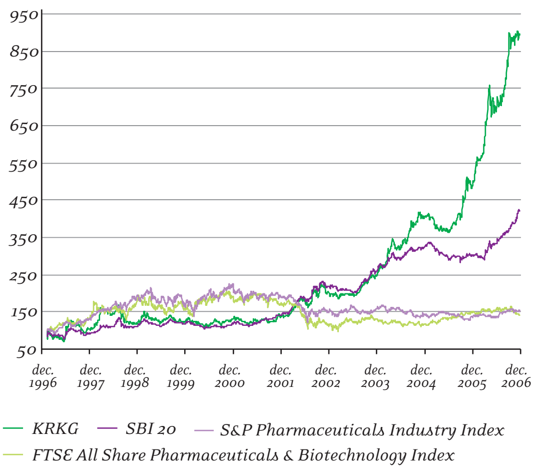
Shareholder return

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[1] in SIT	7,890	6,890	4,627	3,113	3,266
Gross dividend per share[2] in SIT	1,650	1,400	1,200	1,050	950
Dividend pay out[3] (%)	24	30	39	32	38
Dividend yield[4] (%)	0.9	1.4	1.4	2.0	2.2

1 Net profit of Krka Group majority shareholders/average number of shares issued in the period excluding own shares
2 Dividend paid out from net profit from previous period
3 Gross dividend per share/earnings per share from previous period
4 Applying share price on 31 December of the year

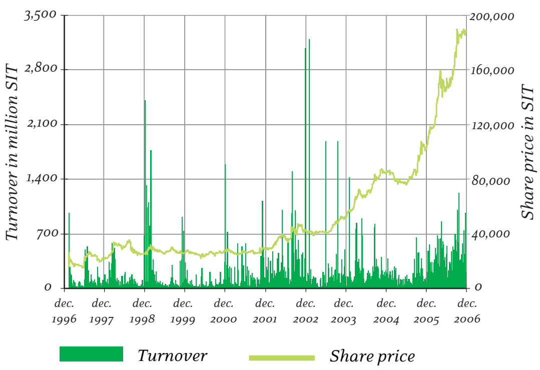
The 2007 dividend proposal from the Management and Supervisory Board is included in the notice convening the Annual General Meeting.

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.

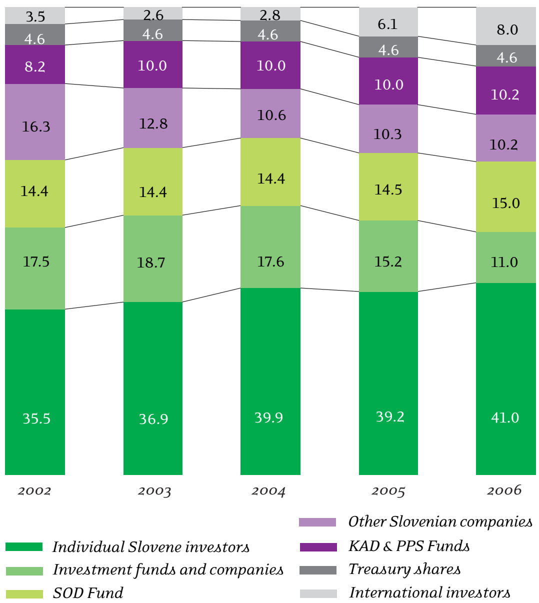
Krka's shares are one of the more liquid securities on the Ljubljana Stock Exchange. In 2006 the trading turnover in Krka shares was 98 billion SIT, an increase of 128% compared to 2005. The average daily turnover in Krka shares was 398 million SIT in 2006, an increase of 131% compared to 2005.

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 - %)

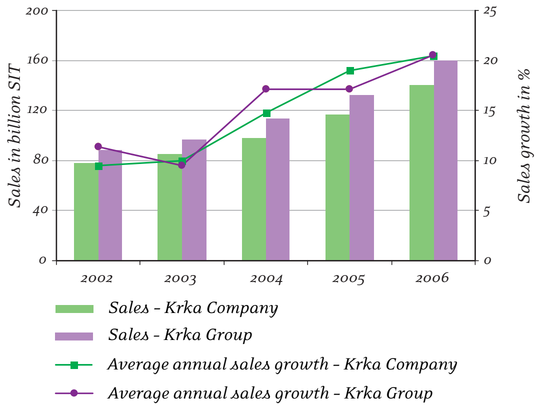


Business operations analysis

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 Standards (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

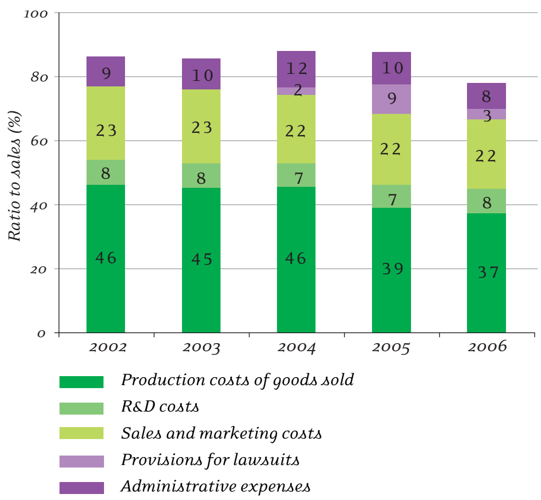
The average sales per employee growth for the Group over the last five years was 7%, which is lower than overall sales growth, but has been increasing since 2004. The modest growth in the past has largely been due to intense recruitment activities abroad, in representative offices and in subsidiaries. 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.

Structure of operating expenses



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.

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%.

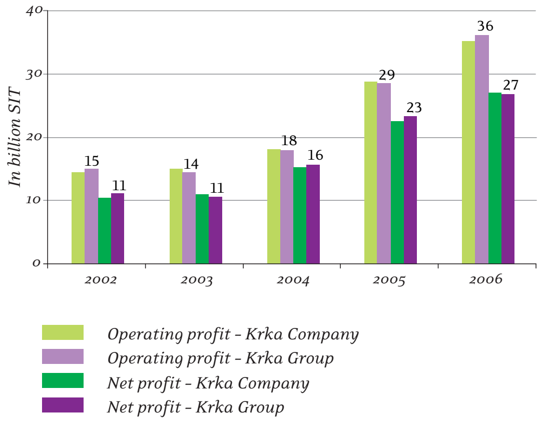
Financial income and expenses

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.

	Krka Group					Krka Company				
in million SIT	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 SIT billion 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

	Krka Group					Krka Company				
in million SIT	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 then the sales growth.

Equity and liabilities

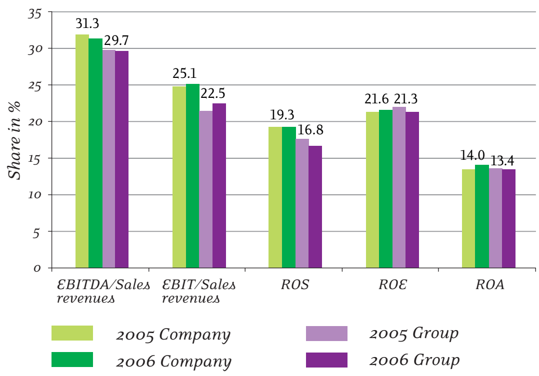
in million SIT	Krka Group					Krka Company				
	2006	Share in %	2005	Share in %	Index 2006/ /2005	2006	Share in %	2005	Share in %	Index 2006/ /2005
Equity	136,812	64.9	114,897	60.8	119	136,575	66.7	114,452	62.8	119
Non-current liabilities	39,286	18.7	36,368	19.3	108	36,030	17.6	33,058	18.1	109
Current 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%.

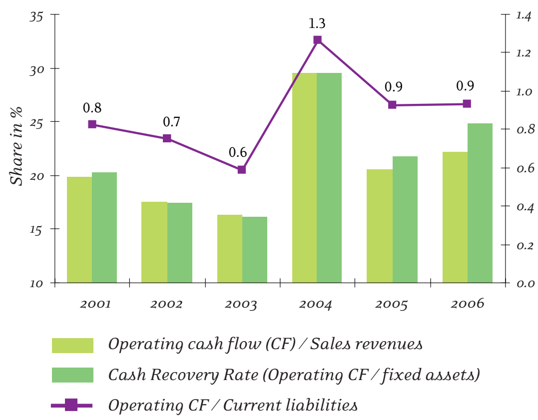
Performance ratios

PROFITABILITY RATIOS



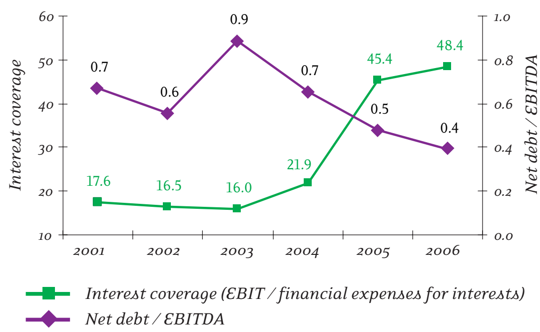
In 2006 the operating indicators were in compliance with the strategic guidelines and annual objectives. Compared to last year the Group achieved slightly lower return on assets, return on equity and return on sales. The reason is largely the increase in inventories of materials and products from sales 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

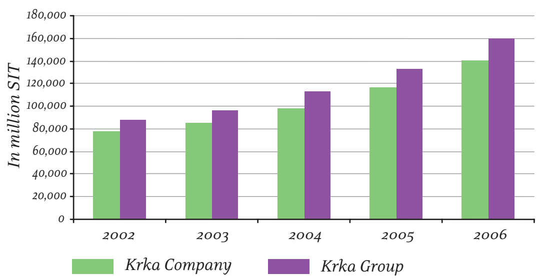
	Krka Group					Krka Company				
in million SIT	2006	2005	2004	2003	2002	2006	2005	2004	2003	2002
Sales	160,069	132,758	113,317	96,749	88,338	140,454	116,570	97,978	85,388	77,665
EBIT	36,065	28,523	17,950	14,440	15,017	35,219	28,801	18,017	14,928	14,479
EBIT margin	22.5%	21.5%	15.8%	14.9%	17.0%	25.1%	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

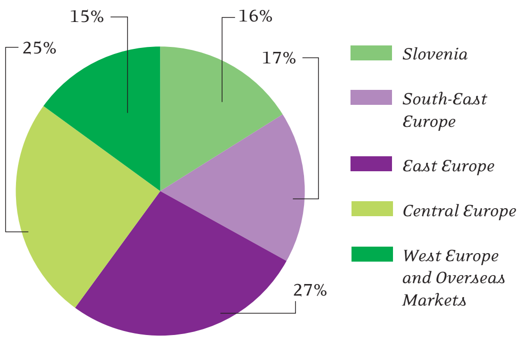
In 2006 the Krka Group sold 160.1 billion SIT worth of products and services, which is a 21% increase on 2005. In 2006, the Krka Company sold 140.5 billion SIT worth of products, achieving a 20% increase in sales compared to 2005.

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



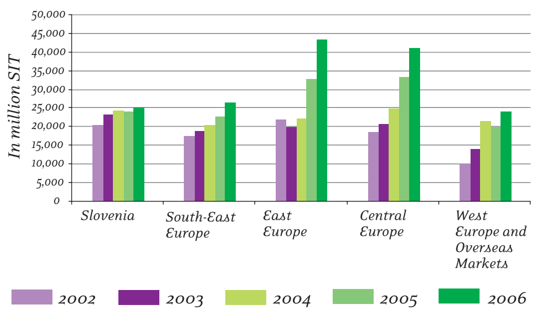
Krka Group sales by Region in 2006



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
Total	160,069	132,758	121	140,454	116,570	120

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 Septolete®, Bilobil®, Panzynorm® 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 prescription 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.

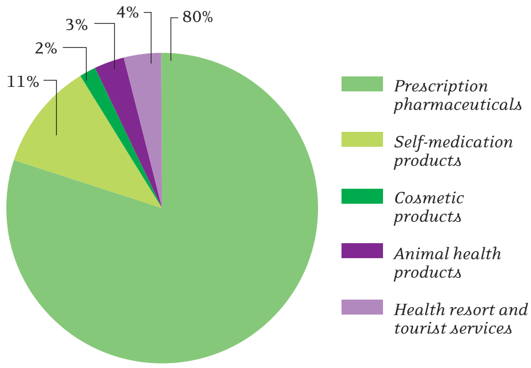
The Region recorded its highest growth in sales compared to the previous year in southern EU member states and Africa and on the Arabian Peninsula. In 2007 we are planning the largest increase in sales on the Arabian Peninsula, in the Far East, and above all on the south European markets, where the subsidiary 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.

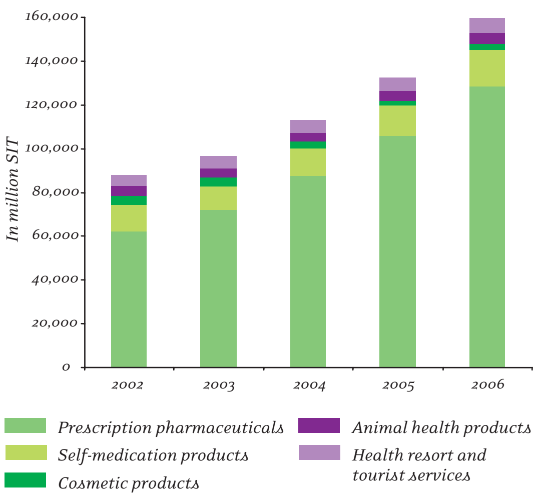
Krka Group sales by product and service group in 2006



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
Total	160,069	132,758	121	140,454	116,570	120

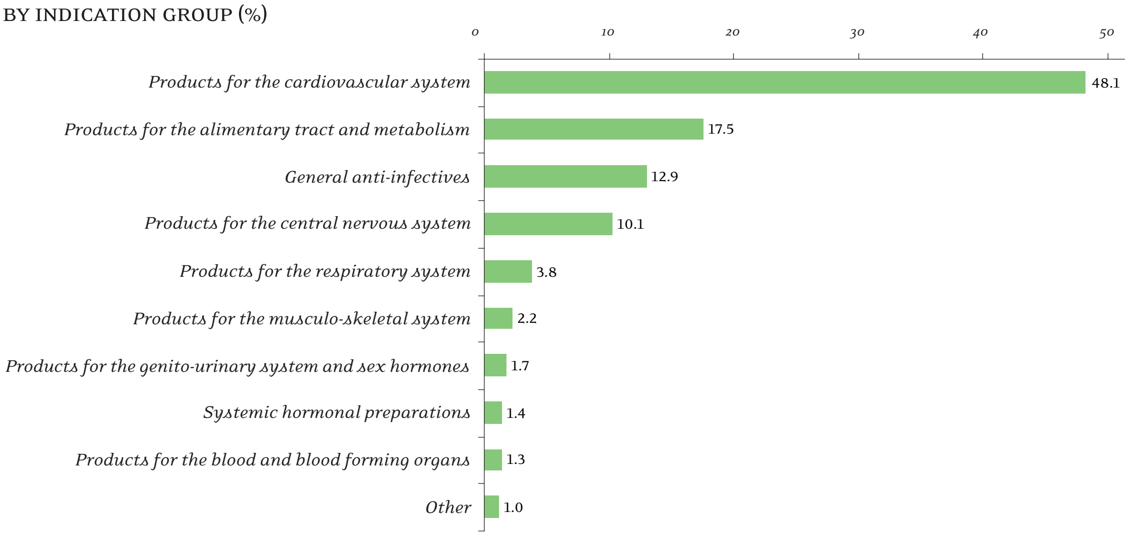
Krka Group sales by product group



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).

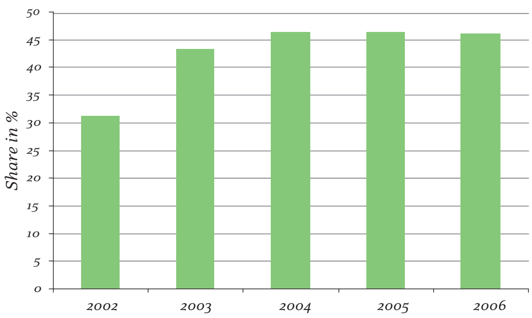
Krka Group prescription pharmaceuticals and self-medication product sales in 2006 by indication group (%)



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

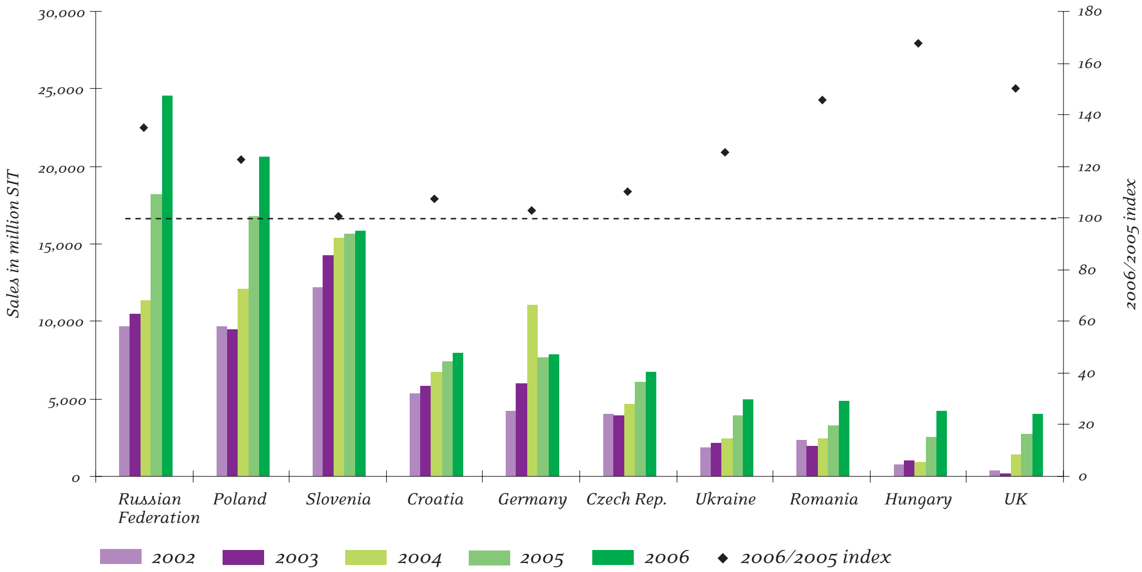
Prescription pharmaceuticals	
For the treatment of cardiovascular diseases	Ampril® HL, and Ampril® HD (ramipril with hydrochlorothiazide), marketed also as Amprilan® H Valsacor® (valsartan) Laaven® (lisinopril) and Laaven® HL20 (lisinopril with hydrochlorothiazide)
For the treatment of diseases of the 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®** (simvastatin) and **Atoris®** (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® (lovastatin) in Slovenia. Today Krka is making a significant contribution to better treatment of dislipidemias 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 generic statin producer in Croatia and Latvia. In 2006 Krka continued its rolling launch programme for the new 40 mg form of Atoris® (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®** (enalapril), together with the fixed combinations of enalapril and hydrochlorothiazide **Enap®-H**, **Enap®-HL** and **Enap®-HL 20**. Enap® 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®** (ramipril), also marketed as **Amprilan®**, 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 **Ultop®** (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. Ultop® – 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®** (ciprofloxacin), which is the leading ciprofloxacin on numerous markets. **Nolicin®** (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®, Alventa® and Zolsana®.

Antipsychotics. **Torendo®** (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® product, it has also been marketing **Zalasta®** (olanzapine) for two years. Torendo® also represents another approach to modern medical treatment. The launch of **Torendo® Q-Tab®** was the first generic risperidone in orodispersible tablet form. After six months on the market in Slovenia, Torendo® and Torendo® Q-Tab® have achieved a market share of over 20% among risperidones. Zalasta® – 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®** (venlafaxine). Venlafaxine is a modern, global leader among antidepressants and has a double function, being used to treat depression and anxiety disorders. It is followed by sertraline, which Krka has been selling successfully under the Asentra® brand name for several years. **Asentra®** (sertraline) is the leading generic sertaline on the markets of central, south-eastern and eastern Europe, and in Slovenia, Lithuania and Poland has a 50% market share. **Mirzaten®** (mirtazapine) is also the leading generic mirtazapine on these markets.

Other medicines. Yasnal® (donepezil) represents the Krka presence in the field of medicines to treat Alzheimer's disease. Today, Yasnal® 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® 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® has also been available on the Czech market. Last year saw the launch of **Zolsana®** (zolpidem), a medicine for the treatment of insomnia, which is currently available in Slovenia, the Czech Republic and Poland.

Medicines for the urinary tract

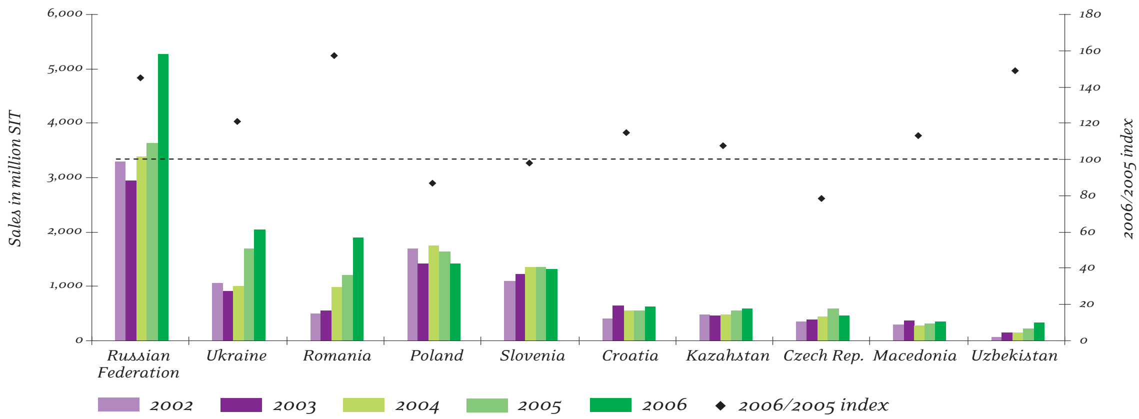
Krka's range of modern products for the treatment of benign prostatic hypertrophy was completed by adding Tanyz® and Finpros® to the existing **Kamiren®** (doxazosin) and **Kamiren® XL** (prolonged-release doxazosin).

Tanyz® (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® 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®** (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.

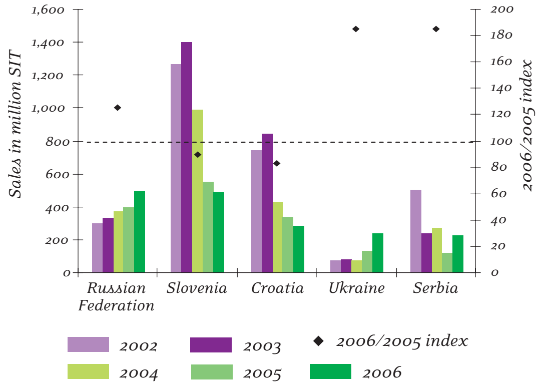
Septolete® is an oral antiseptic brand that includes a number of clinically tested products for self-treatment of mild infections of the mouth and throat. In 2006 Krka launched three new products in the range: NeoSeptolete® with lemon flavour, NeoSeptolete® with wild cherry flavour, and NeoSeptolete® 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 innovative 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®** 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®** (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®** (combination of perindopril and indapamide) in Hungary. The marketing authorisation for new strengths of **Lorista®** 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®** (pioglitazone) in the form of 15 mg and 30 mg tablets. Obtaining marketing authorisation for **Zyllt®** (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 product **Zolsana®** 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®** (olanzapine) and **Yasnal®** (donepezil) tablets in Croatia.

In addition to **Tanyz®** (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®** 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® Q Tab® 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 quantity, we matched the production requirements for finished product s, 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.

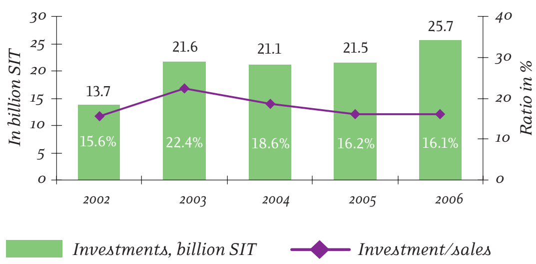
If specific products are incompatible with products already in production or if bottlenecks occur, then production can be transferred to contracted partners.

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

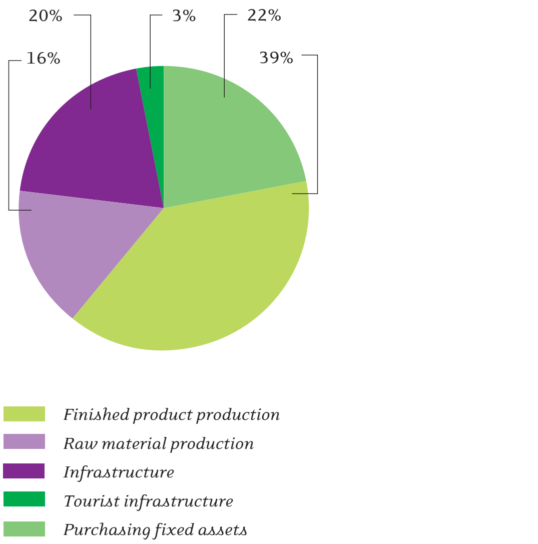
The Krka Group allocated 25.7 billion SIT or 16.1% of sales revenue for investments.

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 tabletting 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

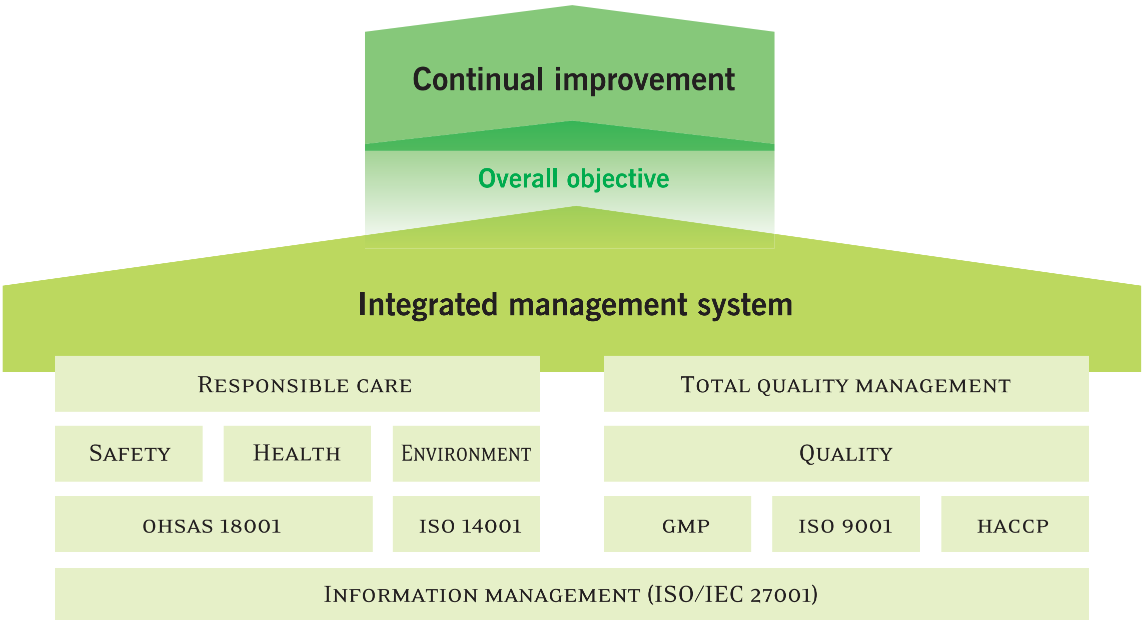
As a generic producer, Krka manufactures medicines that can take their place alongside the world's leading pharmaceutical companies in terms of quality, safety and effectiveness. In its broadest sense, quality is something that all employee create and maintain, and is also the responsibility of all employees.

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 indicators 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.

Symbiosis

Janez Vajkard Valvasor
Author of the book The Glory of the Duchy of Carniola (1689), which contains exceptional inventory of Slovenian flora and fauna and other characteristics of the natural environment. His work was intended to present his homeland to an international audience.

Sustainable Development

There is a perfect balance in nature that we have to preserve.

Sustainable development and social responsibility are two essential elements in a company's performance. Ethical conduct to the social and natural environment is a precondition for successful long-term development.

Employees

Employees' potential and their actions makes a decisive contribution to Krka's business performance. Krka allows capable individuals to develop their personal and professional skills regardless of sex, race, colour, age health condition or disability, religion, political orientation or other belief, trade union membership, national or social origin, family status, property status, sexual orientation or other personal circumstances.

The rapid growth of business and market expansion is reflected in the increasing staff numbers. The highest growth in employment in Slovenia is in research and development and marketing, while the representative offices and companies abroad significantly increased the number of employees in marketing and sales. A total of 2113 employees worked in companies and representative offices outside Slovenia, which is 37% of all employees in the Krka Group.

NUMBER OF EMPLOYEES (ON 31 DECEMBER)

	2006	2005	2004	2003	2002	Index 2006/ /2005
Krka Company in Slovenia	3016	2954	2932	2973	2975	102
Krka Company representatives outside Slovenia	1256	1024	716	555	424	123
Krka Company	4272	3978	3648	3528	3399	107
Subsidiaries outside Slovenia	857	620	539	442	393	138
Terme Krka Group	630	626	594	552	540	101
Krka Group	5759	5224	4781	4522	4332	110

GROWTH IN THE NUMBER OF EMPLOYEES IN THE KRKA COMPANY AND KRKA GROUP

Educational structure

The timely development of products, investment in new production capacity and effective performance on the global markets requires highly trained specialists in all areas. The proportion of university-educated employees is continually on the increase and now represents 46% of all employees. At the end of 2006 there were 2633 employees holding at least a first university degree. Their numbers include 63 people with doctorates, and 162 people holding master-of-science degrees and specialisation qualifications. Sixty-nine per cent of those with a university degree work in Krka companies and representative offices abroad.

LEVEL OF EDUCATION

	2006	2005
Doctorate	63	51
Master of Science	162	153
University education	2408	2018
Higher professional education	324	221
Vocational college education	222	206
Secondary school education	1138	1104
Other	1442	1471
On 31 December	5759	5224

We promote the engagement of new specialists with 69 scholarships, primarily for students of pharmacy and chemistry and through close links and contacts with students that enable them to get to know the company through internships or preparing thesis research. A special form of encouragement for the most creative is the Krka Prizes for Young Researchers and Scientists, which have been awarded 36 times to date.

Education and training

Krka's burgeoning internationalisation and its dedication to development, and the intensely competitive environment in which it operates demands investment in the knowledge and skills of all employees. Most education takes place in Krka's own training centre.

The key education areas are management and personal development training, learning foreign languages – primarily English and Russian, information technology, quality and various specialist areas. On average each Krka employee participated in four different forms of training, spending an average of 30 hours updating their knowledge; 92% of that time was spent at internal seminars, 6% at external seminars in Slovenia and 2% abroad.

Krka's long-term investment in knowledge is continuing with support for employees that are studying; 350 Krka employees are engaged in part-time studies, 134 of these at postgraduate level for MSc or PhD degrees. Fifty-six employees in the production sector completed training for the national vocation qualification, and another 56 employees started NVQ studies.

Measuring organisational culture

Krka regularly evaluates its organisational culture and employee satisfaction. It uses its findings to plan and implement measures to improve internal organisation, interpersonal relations, leadership, the conditions required for employee initiative and development, and a unified understanding of the Krka mission, vision and objectives. This is all intended to release the inner potential of employees in order to realise Krka's long-term objectives. In parallel with the growth in the business results, 2006 also saw a significant increase in scores for organisational culture and employee satisfaction. Activities and investments aimed at leadership development, improving information, efficient organisation, training, a more target-oriented culture, excellence in all fields have borne growth for employees, as they are very committed to the company, dedicated to their work, and motivated for personal and professional development.

Leadership

Krka builds its leadership quality via the Krka international leadership school and the school for operational level leadership and specialist teams. This helps consolidate the multicultural, global nature of Krka. Direct work with employers is enhanced by the Krka appraisal interview, which has been grown in importance over the past two years, as senior management have used the interviews with all key staff and staff identified as potential leaders, as well as employees with a university education. The cycle of interviews was also expanded to cover employees with secondary education as well. The Krka appraisal interviews are used to set objectives for work and responsibilities and expectations relating to an employee's educational and professional development.

Management-employee relations

Two unions are organised within the company, which are representative at the national level in Slovenia: the KNG Krka Novo mesto and the Krka Sindikat. Approximately half of all employees are union members. The Works Council has 15 members via whom all employees participate directly in the company management.

The President of the Management Board participates at all meetings of the Works Council, which has been operating at Krka for ten years, as well as at all 15 worker assemblies in 2006, in which over 1800 employees participated in. He informed those present of the business results for 2005 and the plans for 2006, and emphasised the importance of every organisational unit and every employee, and the fact that we can only be effective if everyone is working together to achieve the common objectives – the development and growth of an independent Krka.

Clear and comprehensive replies were also given to every question and initiative, both at the Works Council and at the worker assembly.

Members of the Works Council are very aware of their duties, and inform their colleagues of any information and replies given to the questions and initiatives raised. The Works Council website is used to public minutes of Council meetings and all the questions and initiatives raised at Works Council meetings and worker assemblies. Every employee can raise questions and make initiatives via the website, and will receive a response on the website.

The major events in this area in 2006 include the signing of the Agreement on Employee Participation in Company Management (Participation Agreement), with which the Management Board and Works Council defined their reciprocal rights and obligations within company management, in accordance with the Act on Employee Participation in Management, and the signing of a significantly revised Collective Enterprise Agreement.

Employee care

The high level of employee commitment to the company is evident from the low employee turnover level. At the Krka awards ceremony 391 employees received awards in recognition of long service ranging from 10 to 40 years' work at Krka. Taking care of health and interpersonal relations at Krka includes organising preventive, recreational and social programmes at a wide range of cultural and sporting events. The Krka Trim Club organises preventive sporting activities in which over 800 employees take part. Krka’s Culture and Arts Society brings together gallery activities, a choir, a drama club, creative workshops and organising visits to events, which all goes towards further enriching the quality of life for our employees.

Employee gatherings are an important part of Krka culture. Employees get together at the Krka sports day, the Krka awards ceremony, New Year's events for different organisational unit and other gatherings (meetings for disabled staff, blood donors, volunteer firefighters, and others). Meetings for retired employees are also organised every year.

As part of our commitment to healthcare for everyone, we created a programme to cut down and give up smoking, in agreement with employees. In the past two years smoking has only been permitted in a small number of smoking rooms. Smokers are offered advice and help on stopping smoking. The project will conclude with a complete ban on smoking within the Krka Group in April 2008. This will be backed up by a range of specialist seminars for employees on healthy lifestyles.

To help Krka employees who have dependency problems, we have a club for recovering alcoholics led by Krka's two social workers.

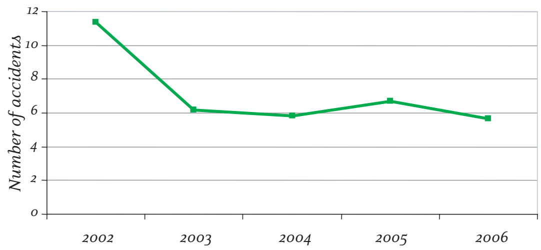
Health and safety at work

Krka provides a safe working environment for its employees. The latest developments in occupational health and safety and fire prevention are incorporated into every new project and technology. The risk of accident and potential health implications is monitored for every work position and technology. Action is taken to reduce risks to acceptable levels to ensure continual long-term improvements in working conditions.

The heads of individual organisation units, personal physicians and occupational health specialists, and the Health and Safety at Work Service are all involved in caring for employee health. Special health teams are organised within every organisation unit to resolve social and health problems. The Reciprocal Relations and Sick Leave project, which contributes to reducing sick leave, is continuing. There has been a significant fall in sick leave taken since the project started, and was 4.6% last year.

The health and safety at work management system is part of the integrated management system and meets the OHSAS 18001 standard. It involves active health and safety at work working groups for each organisational unit, which include an authorised health and safety officer. At the company level, there is a health and safety team that prepare key objectives and programmes that are submitted to the Management Board for approval. At the end of 2006, the Management Board approved the key objectives and programmes for the next two years.

Number of workplace accidents



Accident data is monitored continually. The indicator in the graph, which indicates the number of accidents in the workplace requiring three or more days of sick leave per million hours of work, had a value of 5.6.

In 2006 organisational culture measurements, employee satisfaction with working conditions increased to 4.1 (on a scale of 1 to 5).

Krka has a Fire Safety Department and industrial fire service crew to ensure an adequate response in case off accidents. Ten exercises were organised in 2006.

Encouraging inventive work

Krka's inventive work system allows every employee to propose innovations and improvements either on their own account, or as part of a specific campaign. The company leadership has a very special role in this, being responsible for creating a positive atmosphere and encouraging employees to engage in innovative thinking, and carrying out and rewarding their proposals.

The inventive work system is incorporated into the continual improvement system, the quality system and hence, the integrated management system. Twice a year, heads of organisational units select the fields of innovation for their organisational unit in the coming period. These are areas where useful proposals and improvement should improve processes and or eliminate problems that have arisen.

The number of proposals increased by 79% compared to 2005, and the number of people putting forward proposals by 108%. The inventive work system is becoming a system involving more and more staff from a range of organisational units. In addition to the monetary rewards they receive, the proposers are also included in the Krka awards ceremony, which is an additional stimulus for innovative thinking.

Communications

Krka uses communications with all those who come into contact with Krka – our investments, customers, employees, the media and social environment – to create and strengthen long-term relationships. Through open dialogue we affirm their trust, promoting awareness of Krka and its brands, and enhancing the reputation of the Company on every market.

Krka's has a very good and very stable reputation. According to a research work entitled Company Reputations (Kline & Partner), Krka is one of the best reputed companies in Slovenia among the business public and the general public.

Communications with investors

We aim to provide regular, transparent and accurate communication with existing and potential shareholders. The main communication content relates to past business performance and the company's future strategy and development, taking into account the company's information disclosure policy.

The main objectives are:
- achieving a fair value for Krka on the market
- easier and favourable access to financing
- creating influential groups of people to support and trust Krka, and
- appropriate trading liquidity.

We achieve these objectives as follows:
- regular meetings with investors at the Company headquarters
- attending investor conferences at home and abroad
- organising roadshows in financial centres around the world
- issuing publications for investors (the review Utrip prihodnosti and other representative and promotional material for investors)
- regular General Meetings
- business results press conferences
- through communications with financial media.

Establishing Krka's credibility on Slovenian and international financial markets demands regular visits and promotion of the Krka business story in large financial centres around the world.

Krka publishes its financial calendar on its corporate web pages (www.krka.si). The calendar contains provisional publication dates for business performance reports and other important investor events.

The business performance reports are available in Slovene and English on the Ljubljana Stock Exchange portal – SEOnet (*http://seonet.ljse.si*). The business performance reports are also available on Krka's corporate website. A brief summary of the annual report and semi-annual report is also published in Delo newspaper.

For further information, shareholders can contact Peter Skubic, Head of Capital Markets, Finance Division,
tel: +386 7 331 22 87, fax: +386 7 332 15 23.

Any questions may be submitted by e-mail to the following address: *finance@krka.biz.*

Communications with customers

At Krka, we divide our customers into four groups:
- institutions (health, regulatory, industrial property services, health insurance etc.)
- direct customers (distributors, other pharmaceutical companies)
- indirect customers (pharmacies, hospitals, pharmacists, and doctors)
- final consumers (patients, customers).

We actively cooperate with institutions as part of regular working meetings, and in various joint projects. These initiatives include working visits, and inspections from regulatory bodies, which help us to continually improve processes and approaches and to adapt our work to regulatory requirements and good practice. Krka participates in creating the regulatory environment through direct contact with authorities, and via industrial and professional associations. We propose amendments to legislation, monitoring amendment procedures and adapted to any such changes, depending on the specifics of the individual markets.

Regular personal contact is the main way in which we ensure our direct and indirect customers are satisfied. We can achieve this due to our very expansive network abroad, which enables quarterly, and often also monthly, meetings with individual customers. We regularly check the satisfaction of our direct customers, using surveys and taking effective action too, based on feedback. In general, we find that customer satisfaction with Krka is growing. We monitor the satisfaction of indirect customers and final consumers with our products and services in various ways, including market research data and various analyses, which offer pointers for continued work.

We are particularly active in preparing information and professional material for our indirect customers, physicians and pharmacists, and organising numerous professional gatherings, such as conferences, symposia, and workshops. Our activities and projects help them offer better treatment to patients.

For some years now, we have prepared booklets entitled Caring for Your Health and Your Doctor has Prescribed You, which are primarily aimed at patients but are also of use to doctors. The Caring for Your Health booklet provides information on health problems and treatment advice. Your Doctor has Prescribed You provides patients with additional information on safer and more effective use of the pharmaceuticals prescribed by their doctor.

We only address final consumers directly within the legally permitted framework, which means self-medication products and cosmetics. We prepare informational material, advertisements, and television advertisements for both product groups.

In 2006 we started to issue a magazine called Caring for Your Health in Slovenia as well, aimed at the general public and available in pharmacies. People can also subscribe to the magazine. The magazine focusing on selected themes, with individual issues addressing a specific health problem from a range of different points of view, and providing advice on the healthy lifestyles. For some years we have also been preparing the e-newspaper E-zdravje (E-Health). There is also a related, public access website *(www.ezdravje.com)* intended to educate and disseminate knowledge about healthier lifestyles.

All our publications are also published on our website *www.krka.si.* There is also information on our pharmaceutical products aimed at the general public, while there is also a restricted access section with information for health professional target audiences.

Communications with employees

Satisfied and motivated employees are a key factor in the company's success, which plays a vital role in customer satisfaction. We plan our internal communication strategies very carefully. We ensure positive relations between the management and employees and for good all-round reciprocal relations (see Employees chapter). This increases employee loyalty and creates a pleasant and positive organisational culture. We use various communications tools to achieve this.

Krkanet A key communications tool, which employees use on a daily basis, is the internal website, called Krkanet. In addition to current information on events in the company, there are also various documents, internal acts, forms, and other aids to ensure better quality and more effective work.

Bilten Each week we issue Bilten, an electronic and printed bulletin. We use this publication to inform employees about current events, inside and outside the company.

Utrip For over 40 years, we have been publishing the monthly internal magazine Utrip (which means pulse) for all employees and retired former workers, which makes a significant contribution to people sharing and spreading the Krka vision, mission and values. It lets employees know about major business decisions, achievements in individual areas, and actual events within the company and on Krka's markets. It comes with a supplement called Utrip zdravja (Utrip Health), which addresses health issues, and promotes a healthy way of life.

Communications with the media

We constantly work on developing professional relations with representatives of the mass media, which are based on honest and straightforward cooperation and mutual trust and contribute to maintaining Krka's positive media image.

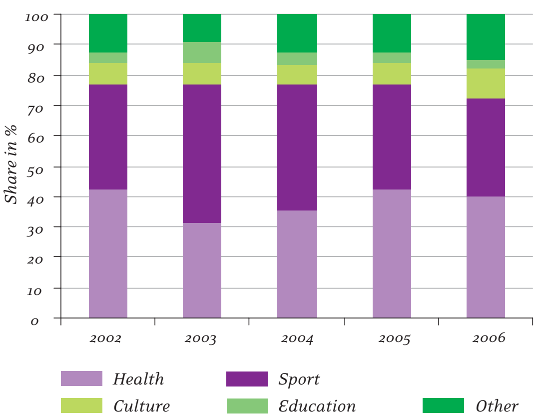
In 2006 we held meetings with the media on a quarterly basis at conferences for business journalists, and other formal and informal events. We responded actively and quickly to their questions, and informed them of significant events and business decisions by means of press releases. On average the media published 32 press releases per month in 2006. A total of 179 media operators reported on Krka, 135 of which were print media, and 44 electronic media.

Communications with the community

Krka has built good relations with the community on the basis of respect, understanding, and dialogue. Our basic guideline in decisions to support activities in the wider community is the Krka mission – Living a Healthy Life, so our aim is to place caring for health and quality of life at the centre of our activities.

We commit most funds to humanitarian projects relating to health and humanitarian institutions. We also support sport, science, school and other forms of education, culture, keeping the environment clean campaigns, and other activities aimed at increasing the quality of life in the community. We also donate Krka products, in special cases, especially natural catastrophes.

KRKA SPONSORSHIPS AND GRANTS



Most of the funds we put into sponsorship and grants are intended to promote not-for-profit activities. We focus on the environment at the local and national level, and also support individual activities outside Slovenia. We give priority to cooperation on long-term projects, which can contribute to improved lives for as many people as possible. In additional to monetary assistance, we also offer organisation support to our partner organisations and cooperation from our employees on specific projects.

Last year, the Krka Company allocated 791 million SIT to sponsorship and grants, which is 0.6% of total sales revenues.

We also supported numerous projects, associations, clubs and institutions. A selection of the main ones is listed below.

Healthcare

In cooperation with the Slovenian Hypertension Society of the Slovenian Medical Association, last year we organised the second campaign to measure blood pressure and raise awareness about healthy lifestyles among passers-by in nine towns around Slovenia. We co-founded the Slovenian Society for Cardiovascular Health, and have supported its work every year. Last year we were the general sponsor of World Heart Day, and the publication of a book called Evidence-Based Medical Guidelines.

Humanitarian actions

For a number of years, we have been the major donor to the Novo mesto-based society Sožitje za pomoč osebam z motnjami v duševnem razvoju, a charity helping people with mental health problems. We always respond to initiatives of the Slovenian Red Cross with donations, either in Slovenia or in other countries. In different ways we also help those in need, and also donate our products to people affected by natural disasters. Last year, Red Cross Slovenia gave us an award for our responses to calls for help.

Science and education

Professional achievements go hand in hand with economic achievements. For almost 40 years we have been using the Krka Prizes to encourage young researchers and mentors to participate in research and development projects. Last year, we were also the silver sponsor for the 12th Slovenian International Science Festival, which led the Slovenian Science Foundation to make us its 2006 Sponsor of the Year.

Sport

We primarily sponsor projects and associations that support large-scale participation and work with young people. For many years, we have supported the ski-flying competition at Slovenia's famous ski-jumping centre in Planica, and the Slovenian racing yacht, Maxi Jena, as well as donating considerable funds to a range of sports clubs.

Culture

In January our sponsorship enabled the performance of the Sergey Prokofiev opera The Love for Three Oranges at the Cankarjev Dom cultural centre in Ljubljana. We also gave a grant to a new theatre in Novo mesto, the Anton Podbevšek theatre, and also support numerous other cultural institutions and their projects.

Employees and the community

Our employees also represent Krka in public, as members of various professional associations and organisations, and by becoming involved in voluntary actions. Many of them participate in sector-based organisations, professional consultations, seminars, and congresses or work in a number of not-for-profit organisations.

Environmental protection

The basic principle of environmental protection in Krka is to coordinate all the activities on a sustainable and future-oriented basis. For many years, we have dedicated considerable attention to the use of natural resources and reducing the environmental impact. By focusing on a set of prioritised objectives, which we have achieved in recent years, and by raising the environmental awareness of all employees we have managed to improve in every area of environmental protection. In 2006 we submitted an application for an integrated environmental protection licence for the central location in Novo mesto, which will be compulsory after 31 October 2007.

Environmental policy

The basic objective of our environmental policy is to improve the state of the environment. We successfully achieve this objective by fulfilling our annual plans, objectives and programmes. The ISO 14001 standard is a vital part of this work, and its now part of every organisational unit.

Significant achievements in the field of environmental protection in 2006

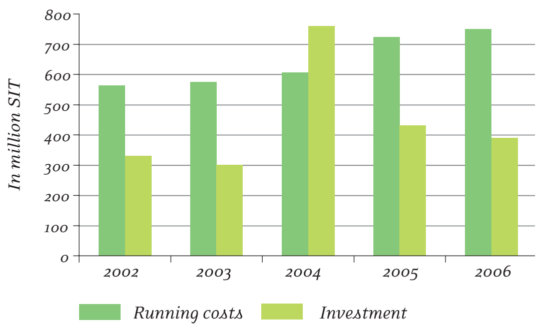
- Reduced outflow of environmental load units (ELU) from waste water treatment plant by 24%.
- Reduced consumption of river water by 14%.
- Reduced quantity of landfill waste by 10%.
- Increased the quantity of useful separated waste by 20%.
- Reduced specific energy use by 17%.
- Started waste air cleaning system for the Sinteza 4 plant.

Environmental protection objectives and programmes for 2007

- To acquire the environmental protection licence.
- To upgrade the waste air cleaning system at the waste water treatment plant.
- To increase the quantity of useful separated waste by 5%.
- To maintain the quantity of landfilled waste at the level already achieved.
- To guarantee the quality of waste water treatment plant effluent remains within the legally defined limits.
- Reducing emissions to air of volatile organic compounds to below 5% of total consumption.

Environmental protection costs

INVESTMENT IN ENVIRONMENTAL PROTECTION



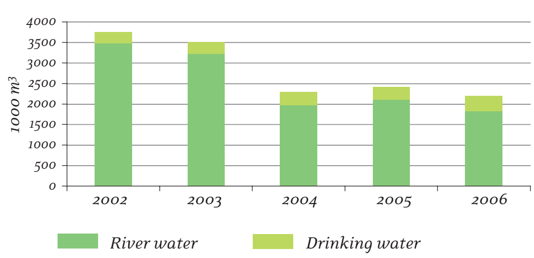
Krka invests over 1 billion SIT in environmental protection every year. The running costs of environmental management in 2006 came to 751 million SIT, while investments were worth 390 million SIT.

Use of natural resources

Water

Water is increasingly an economic issue for industry, as the costs of water consumption and protecting water sources are continually increasing. Regular maintenance of the water supply network prevents losses, and where the process permits, we replace drinking water with process water from the Krka river. The slight increase in consumption of drinking water in 2006, was due to the reconstruction of the water plant, and the temporary switch on of all water preparation systems on the water supply network.

DRINKING WATER AND RIVER WATER



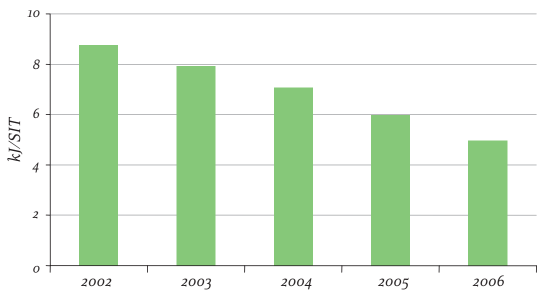
In the last five year period, Krka has used 2,551,000 m3 less drinking water, which is a 58% decrease.

Energy

Krka's main sources of energy are:

- natural gas
- LPG
- electricity, and
- extra light fuel oil, as a back-up fuel.

SPECIFIC ENERGY USE



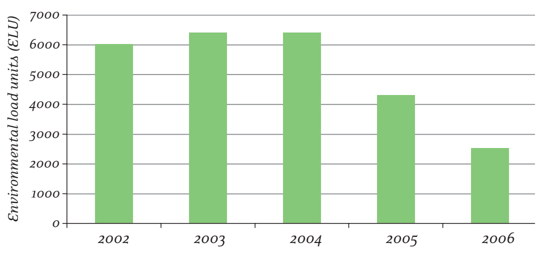
A wide range of measures to ensure efficient use of energy has allowed us to reduce our specific energy use - calculated as the ratio between energy consumption in kJ and production value. Since 2005, by purchasing part of our electrical energy from renewable sources, we have been contributing to a fund intended to promote research and development and the improvement of existing and construction of new renewable sources of electricity in Slovenia.

Emissions

Waste water

Our approach to finding a solution to the waste water issue is a very comprehensive one, as the aim is to achieve the best possible quality of cleaned waste water. The total load from Krka's waste water discharge ducts has been reduced by 61% over the past two years.

WASTE WATER MANAGEMENT



With the help of the recently-constructed waste water treatment plant we have reduced the load on the Krka river by a quarter. In 2006 we reduced the load on the river by a further 24%. We carried out an extensive pilot tests on the additional waste water outflow from the waste water treatment plant using ultrafiltration technology. The tests served a dual purpose:

- additional reduction of waste water outflow load, and
- achieving a waste water quality level where the water is suitable for reuse.

By cofinancing construction of a central waste water treatment plant in Ljutomer we have ensured smooth long-term operation for Krka's plant there, and reduced the pharmaceutical process water load on the Ščavnica river by 95%.

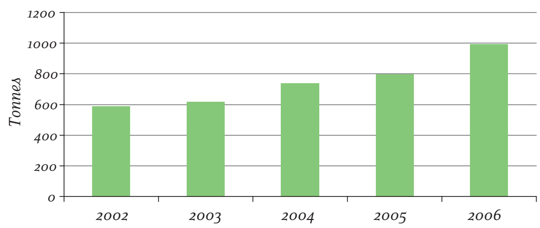
Noise

Excess noise in a residential environment is very disturbing, so Krka has been sure to install modern equipment and use preventive measures to correct some sources of noise, achieving significant reductions. Annual noise measurements carried out by a certified external organisation, indicate that the legally permissible limits are not exceeded.

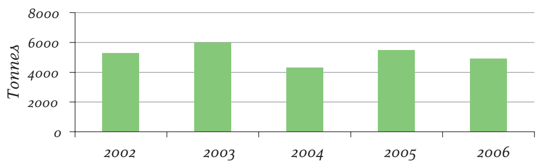
Waste

For many years Krka has been reducing the quantity of waste it landfills, and increasing the quantity of separately collected packaging. The company has set up its own system for separated collection, waste management and waste packaging management. Hazardous waste is collected via a specially controlled system, suitably packaged, and handed over to contracted collectors.

USEFUL SEPARATED WASTE



LANDFILL WASTE



In 2006 we increased the quantity of useful separated waste by 195 tonnes (20%), while reducing the quantity of landfill waste by 10%.

Air emissions

Krka has made significant reductions to its air emissions in recent years. With absolute filtration of all particle emissions, we have reduced dust emission to below 0.5 mg/m3, which is as low as under 0.3% of the legally defined limit value. The commissioning of the Sinteza 4 plant, saw the start of a modern waste air cleaning system. Special care is taken to reduce emissions with an unpleasant odour, which often occur around the waste water treatment plant, and which are the most disturbing source of air pollution for local residents. Krka uses consistent management of waste water cleaning technology, and air cleaning devices to reduce emissions into the environment. In future we will continue to upgrade our air cleaning systems.

Hazardous substance storage

All hazardous substances are stored in suitable facilities that provide a high level of safety during normal working conditions and in emergencies. The very highest environmental protection standards were applied in the construction of the liquid raw material storage facility in Novo mesto.

Environmental protection in Krka's foreign subsidiaries

Our responsible environment management principles are gradually spreading throughout our subsidiaries abroad, which all operate in full compliance with local environmental protection legislation. Emissions that occur in these companies are low, as they are involved in pharmaceutical activities with lower load levels. The Krka operating plants in Croatia, Poland and Russia are only involved in production of solid dosage form pharmaceutical products, so lower quantities of process water are required for equipment cleaning in those plants. Waste water with a low load level is discharged into the public sewerage system. The exception is the Krka-Rus plant, where a slightly heavier load means that pre-cleaning of waste water does take place in an on-site treatment plant.

The entire Group pursues the same waste management objectives and guidelines, and the separated waste collection system has been put into practice in all subsidiaries abroad. Hazardous waste is collected separately and sent to appropriate destruction facilities. Particle emissions are being reduced by installing modern filtration systems that complete eradicate particle emissions.

Intellect.

Jurij Bartolomej Vega
A world famous Slovenian mathematician, physicist, geodesist, nobleman and artillery officer. His crowning achievement in the field of mathematics came in 1794 with the milestone book Treasury of All Logarithms.

Financial Statements

Formula for success:
systematic approach + knowledge + x

Content

Financial statements of Krka, d. d., Novo mesto and the Krka Group and the related notes

Introduction to the financial statements

The financial statements consist of two separate sections.

The first section comprises the financial statements and related notes of the Krka Group, whereas the second section presents the financial statements and related notes of the Krka, d. d., Novo mesto (hereinafter also 'Company'). The financial statements have been prepared in compliance with the International Financial Reporting Standards (hereinafter IFRS), which is in compliance with the resolution adopted at the 11th annual meeting held on 6 July 2006. As defined by the said resolution, the Company no longer prepares reports according to provisions of the Slovenian Accounting Standards.

Each section of financial statements was audited by KPMG SLOVENIJA, podjetje za revidiranje, d. o. o. and two separate reports as individual chapters have been prepared accordingly.

The Statement of Management's Responsibility includes an acknowledgement of responsibility for all financial statements of both the Company and the Group. It is presented at the beginning of the financial statements.

The financial statements of the Company and the Krka Group are presented in Slovenian tolars. However, in the enclosure at the end of the financial statements, the amounts in the financial statements are denominated in euro.

Statement of compliance

The Company's Management Board is responsible for the preparation of the annual report of the Company and the Krka Group including the financial statements so as to provide the general public with a true and fair view of the financial position and the results of operations of the Company and its subsidiaries in 2006.

The Management Board hereby acknowledges that:
- the financial statements were prepared on a going concern basis,
- the selected accounting policies are applied consistently and any changes in accounting policies have been reported,
- the accounting estimates have been prepared in a fair and reasonable manner and are in compliance with the principles of prudence and due diligence,
- the financial statements and the notes thereto both for the Company and the Group have been prepared in accordance with the effective legislation and the IFRS.

The Company's Management Board is responsible for taking the measures required to maintain the company's and the Group's value and to prevent and detect fraud and other forms of misconduct.

Novo mesto, March 2007

Management Board of
Krka, d. d., Novo mesto

Consolidated financial statements of the Krka Group

Consolidated balance sheet

in thousand SIT	Notes	31 Dec 2006	31 Dec 2005
Assets			
Property, plant and equipment	13	121,454,523	108,165,231
Intangible assets	14	5,657,387	5,058,450
Investments in associates	15	484,924	270,761
Long-term loans	16	854,125	889,825
Other investments	17	1,614,502	1,280,164
Deferred tax assets	12	7,630,242	4,778,324
Other non-current assets	18	60,523	12,312
Non-current assets		137,756,226	120,455,067
Inventories	19	27,780,408	28,966,629
Trade and other receivables	20	36,878,315	33,008,703
Current investments	21	5,767,420	3,391,005
Cash and cash equivalents	22	2,491,950	3,027,752
Current assets		72,918,093	68,394,089
Total assets		210,674,319	188,849,156
Equity			
Share capital	23	14,170,448	14,170,448
Own shares	23	-4,670,280	-4,670,280
Reserves	23	35,385,325	34,885,325
Retained earnings	23	89,160,409	68,131,642
Reserves for fair value	23	833,938	561,602
Translation reserve	23	36,962	4,648
Equity holders of the parent		134,916,802	113,083,385
Minority interest	23	1,894,871	1,813,556
Total equity		136,811,673	114,896,941
Liabilities			
Borrowings	25	8,287,723	11,669,435
Provisions	26	29,368,758	23,967,902
Grants received	27	665,588	445,849
Deferred tax liabilities	12	964,560	285,236
Total non-current liabilities		39,286,629	36,368,422
Trade payables	28	14,591,502	14,043,571
Borrowings	25	11,686,988	9,120,664
Income tax liabilities		1,682,258	6,689,431
Other liabilities	29	6,615,269	7,730,127
Total current liabilities		34,576,017	37,583,793
Total liabilities		73,862,646	73,952,215
Total equity and liabilities		210,674,319	188,849,156

Consolidated Income Statement

in thousand SIT	Notes	2006	2005
Sales revenues	1	160,068,654	132,757,626
Production cost of goods sold	3	59,666,880	51,847,673
Gross operating yield		100,401,774	80,909,953
Sales and marketing	4	39,742,948	41,609,639
R&D costs	5	12,617,134	9,611,856
Administrative expenses	6	12,831,170	13,386,461
Other operating income	2	854,137	12,221,261
Operating profit		36,064,659	28,523,258
Financial income	10	3,714,449	3,989,327
Financial expenses	10	4,131,242	2,982,607
Net financial expenses / income		-416,793	1,006,720
Profit before tax		35,647,866	29,529,978
Income tax expense	11	8,787,472	6,210,850
Profit for the period		26,860,394	23,319,128
Equity holders of the parent		26,763,403	23,288,582
Minority interest		96,991	30,546
Earnings per share (in SIT)	24	7,918	6,890

Consolidated Statement of Changes in Equity

in thousand SIT	Called capital	Own shares	Reserves			Retained earnings			Fair value reserves	Minority interest	Total equity
			Share premium	Legal reserves	Statutory reserves	Profit reserves	Net profit for the period	Net profit carried forward			
Balance at 01 Jan 2005	14,170,448	-4,670,280	28,993,129	3,592,196	1,500,000	45,467,881	10,637,826	-4,964,998	579,946	1,819,476	97,125,624
Entry of net profit for the period	0	0	0	0	0	0	23,288,582	0	0	30,546	23,319,128
Formation of statutory reserves	0	0	0	0	800,000	0	-800,000	0	0	0	0
Formation of other revenue reserves under the resolution of the Management and the Supervisory Board of the Krka Company	0	0	0	0	0	6,500,000	-6,500,000	0	0	0	0
Transfer of previous period's net profit to retained earnings	0	0	0	0	0	0	-10,637,826	10,637,826	0	0	0
Transfer to other revenue reserves under the resolution of the Annual Meeting	0	0	0	0	0	5,886,801	0	-5,886,801	0	0	0
Dividends paid	0	0	0	0	0	-3,874,859	0	-911,438	0	-31,850	-4,818,147
Recognised income and expenses	0	0	0	0	0	0	0	-711,352	-13,696	-4,616	-729,664
Balance at 31 Dec 2005	14,170,448	-4,670,280	28,993,129	3,592,196	2,300,000	53,979,823	15,988,582	-1,836,763	566,250	1,813,556	114,896,941
Entry of net profit for the period	0	0	0	0	0	0	26,763,403	0	0	96,991	26,860,394
Formation of statutory reserves	0	0	0	0	500,000	0	-500,000	0	0	0	0
Formation of other revenue reserves under the resolution of the Management and the Supervisory Board of the Krka Company	0	0	0	0	0	4,800,000	-4,800,000	0	0	0	0
Transfer of previous period's net profit to retained earnings	0	0	0	0	0	0	-15,988,582	15,988,582	0	0	0
Transfer to other revenue reserves under the resolution of the Annual Meeting	0	0	0	0	0	7,312,001	0	-7,312,001	0	0	0
Dividends paid	0	0	0	0	0	0	0	-5,631,286	0	-15,676	-5,646,962
Recognised income and expenses	0	0	0	0	0	0	0	396,650	304,650	0	701,300
Balance at 31 Dec 2006	14,170,448	-4,670,280	28,993,129	3,592,196	2,800,000	66,091,824	21,463,403	1,605,182	870,900	1,894,871	136,811,673

Consolidated Cash Flow Statement

in thousand SIT	Notes	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit for the period		26,860,394	23,319,128
Adjustments for:		20,518,784	18,432,818
– amortisation / depreciation		11,431,881	10,970,573
– foreign exchange gain		-470,159	-572,441
– foreign exchange loss		993,772	836,799
– investment income		-2,355,852	-9,694
– financial income		871,404	-70,253
– financial expenses		1,193,527	1,012,153
– income taxes and other taxes not included in operating expenses		8,787,472	6,210,850
– other		66,739	54,831
Operating profit before changes in net operating current assets		47,379,178	41,751,946
Change in trade receivables		-4,524,385	-8,954,104
Change in inventories		1,186,221	-8,931,557
Change in operating liabilities		-263,937	3,254,225
Change in other current liabilities and provisions		4,733,198	3,662,565
Income taxes paid		-15,699,329	-4,528,103
Cash generated from operations		32,810,946	26,254,972
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest received		184,159	116,262
Proceeds from sale of current investments		243,050	64,744
Dividends received		48,200	40,496
Proceeds from property, plant and equipment		374,982	365,498
Purchase of intangible assets	14	-1,748,992	-1,847,877
Purchase of property, plant and equipment	13	-23,223,475	-18,018,146
Proceeds / payments in connection with long-term loans	16	-6,081	86,150
Proceeds / payments in connection with non-current assets	18	-275,504	-1,529
Acquisition of current investments		-1,869,729	-1,820,853
Acquisition of derivative financial instruments		435,486	-334,251
Net cash used in investing activities		-25,837,905	-21,349,506
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from an increase in current financial liabilities		2,514,404	3,965,392
Interest paid		-1,141,607	-547,754
Payment of non-current financial liabilities		-3,154,116	-3,337,574
Dividends paid		-5,639,582	-4,809,077
Net cash used in financing activities		-7,420,901	-4,729,013
Net increase in cash and cash equivalents		-447,860	176,453
Cash and cash equivalents at beginning of period		3,027,752	2,841,099
Effect of exchange rate fluctuations on cash held		-87,942	10,200
Net cash and cash equivalents at end of period		2,491,950	3,027,752

Notes to the consolidated financial statements

Summary of significant accounting policies

Krka, d. d., Novo mesto (Company) is the controlling or the parent company in the Krka Group with its registered seat at Šmarješka cesta 6, 8501 Novo mesto in Slovenia. The consolidated financial statements for the year ended 31 December 2006 refer to the Krka Group that comprises the parent company, its subsidiaries and an associated company.

1. Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the EU.

The financial statements of the Group were authorised for issue by the Management Board on 15 March 2007.

2. Basis of preparation

These consolidated financial statements are presented in Slovene tolar (SIT), which is the Company's functional currency. All financial information presented in SIT has been rounded to the nearest thousand.

The consolidated financial statements have been prepared on the historical cost basis. The fair value has been taken into account by derivative financial instruments, financial instruments held for trading, and financial instruments available for sale.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in the following notes:
Note 26 – measurement of defined benefit obligations,
Note 26 – provisions for lawsuits,
Note 31 – valuation of financial instruments.

3. Significant accounting policies

The Group applies the same accounting policies in all periods, presented in the accompanying consolidated financial statements.

The Group companies apply uniform accounting policies.

The comparable data are in accordance with the information referring to the current financial year. Where necessary, they were adjusted so as to comply with the information referring to the current financial year.

4. Basis of consolidation

Subsidiaries
Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Associates
Associates are those entities in which the Group has significant influence, but not control, over the financial and operating policies. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. When the Group's share of losses exceeds its interest in an associate, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate.

Transactions eliminated on consolidation
Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

5. Foreign currency

Foreign currency transactions
Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortised cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortised cost in foreign currency translated at the exchange rate at the end of the period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments or a financial liability designated as a hedge of the net investment in a foreign operation.

Financial statements of foreign operations
The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to SIT at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations, excluding foreign operations in hyperinflationary economies, are translated to SIT at rates approximating to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on retranslation are recognised directly in a separate component of equity – translation reserve.

Hedge of net investment in foreign operation
Foreign currency differences arising on the retranslation of a financial liability designated as a hedge of a net investment in foreign operation are recognised directly in equity, in the translation reserve, to the extent that the hedge is effective. To the extent that the hedge is ineffective, such differences are recognised in profit or loss. When the hedged net investment is disposed of, the cumulative amount in equity is transferred to profit or loss as an adjustment to the profit or loss on disposal.

6. Financial instruments

Non-derivative financial instruments
Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus (for instruments not recognised at fair value through profit or loss) any directly attributable transaction costs, except as described below. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.
Accounting for financial income and expense is discussed in note 12.

Available-for-sale financial assets
The Group's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value. Changes in fair value are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss. Impairment losses and foreign exchange gains and losses on available-for-sale monetary items are recognised directly in profit or loss.

Investments at fair value through profit or loss
An instrument is classified as at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Group manages such investments and makes purchase and sale decisions based on their fair value. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Other
Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

Derivative financial instruments
The Group holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Cash flow hedges
Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

Economic hedges
Hedge accounting is not applied to derivative instruments that economically hedge monetary assets and liabilities denominated in foreign currencies. Changes in the fair value of such derivatives are recognised in profit or loss as part of foreign currency gains and losses.

Share capital
Repurchase of share capital
When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity.

Dividends
Dividends are recognised as a liability in the period in which they are declared by the annual meeting.

7. Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses (see accounting policy "Impairment"). Property, plant and equipment revalued to their fair value at 01 January 2004 or the date of transition to IFRS, were determined by reference to its fair value at that date.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs, and (if applicable) costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Subsequent costs
The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

Depreciation
Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated.

The estimated useful lives are as follows:

• land	3-60 years
• plant and equipment	5-20 years
• furniture	5 years
• computer equipment	4-6 years
• means of transportation	5-15 years

8. Intangible assets

Research and development
As for the research and development function, the item of intangible assets comprise the purchase of the registration documentation. All other costs referring to the research development work within the Group are recognised in the income statement as expense upon their accrual.

Other intangible assets
Other intangible assets that are acquired by the Group, which have finite useful lives, are measured at cost less accumulated amortisation and accumulated impairment losses (see accounting policy "Impairment").

Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

Subsequent expenditure
Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognised in profit or loss when incurred.

Amortisation
Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use.

The estimated useful lives are as follows:

• recognised development costs	5 years
• software	2-10 years
• other intangible assets	5-10 years

9. Inventories

An inventory unit of raw materials and materials, as well as supporting and packaging materials is valued at cost including all direct cost of purchase. Inventories of material are stated at the fixed price variances. Inventories of finished products and work in progress are valued at fixed prices, which in addition to direct cost of material include also cost of production (direct labour, direct cost of depreciation, direct cost of services and indirect cost of production such as energy, maintenance, quality, etc.). Inventories of work in progress and finished products are carried at fixed prices. An inventory unit of merchandise is valued at cost including cost of purchase, import duties and all costs directly attributable to the acquisition, decreased by discounts. Inventories of merchandise are carried at fixed price variances.

Inventories of materials are stated at the lower of cost and net realisable value, whereas inventories of finished products at the lower of fixed price and net realisable value.

10. Impairment

Financial assets
A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

Non-financial assets
The carrying amounts of the Group's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised in the previous periods.

11. Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Provisions for lawsuits
The Group discloses provisions for lawsuits related to alleged patent infringements. Provisions entirely refer to drugs for heart and cardiovascular diseases. Each year the Group verifies the justification of the formed provisions with a view to the litigation status and the prospects for a favourable or unfavourable lawsuit outcome. The amounts of provisions are defined on the basis of the noted amount of the indemnification claim, or on the basis of anticipated potential amount, if the indemnification claim is not yet disclosed.

Provisions for termination pay and anniversary bonuses
Pursuant to the legislation, the Group is liable to pay to its employees anniversary bonuses and termination pay upon retirement. For these obligations, long-term provisions are formed. There is no other obligation in respect of pension.

Provisions are determined by discounting, at the balance sheet date, the estimated future benefits in respect of termination pays and anniversary bonuses paid to employees in those countries, where this legal obligation exists. The obligation is calculated by estimating the costs of termination pay upon retirement and the costs of all expected anniversary bonuses until retirement. The selected annual discount rate is set at 4.75% and represents the return rate on long-term government bonds. The calculation is performed by a certified actuary. Actuarial gains and losses are recognised in the income statement.

Provisions for ecological improvements and provisions for grants were both already used up and decreased by the depreciation amount.

12. Sales revenues

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Transfers of risks and rewards vary depending on the individual terms of the sales contract. Revenue from services rendered is recognised in the income statement in proportion to the stage of completion of the transaction at the balance sheet date. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due, associated costs or the possible return of goods, also continuing managerial involvement with the goods. Revenues from the sale of goods and services rendered are measured at selling prices stated in invoices or other documents, reduced by rebates approved either when the sale is made or subsequently, including those granted for early payment.

Government grants
Government grants are recognised initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions associated with the grant. Grants that compensate the Group for expenses incurred are recognised in profit or loss on a systematic basis in the same periods in which the expenses are recognised. Grants that compensate the Group for the cost of an asset are recognised in profit or loss on a systematic basis over the useful life of the asset.

13. Financial income and financial expenses

Financial income comprises interest income on funds invested, dividend income, gains on the disposal of available-for-sale financial assets, changes in the fair value of financial assets at fair value through profit or loss, foreign currency gains, and gains on hedging instruments that are recognised in profit or loss. Interest income is recognised as it accrues, using the effective interest method. Dividend income is recognised on the date that the Group's right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

Financial expenses comprise interest expense on borrowings, foreign currency losses, changes in the fair value of financial assets at fair value through profit or loss, impairment losses recognised on financial assets, and losses on hedging instruments that are recognised in profit or loss. All borrowing costs are recognised in profit or loss using the effective interest method.

14. Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Also deferred tax on these items is recorded within equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognised for the temporary differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

15. Earnings per share (EPS)

The Group presents basic earnings per share (EPS), which is calculated by dividing the profit or loss attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the period. The diluted EPS is not determined, as the Group issued solely ordinary shares.

16. Segment reporting

With respect to the strategic direction of its operations and criteria for the formation of business segments (common therapeutic characteristics of products, marketing and advertising methods and level of risk) the Group distinguishes between following three segments: human health products (prescription pharmaceuticals, OTC products and cosmetics), animal health products and health-resort and tourist services.

Geographical segments, within which we find geographically related countries with a similar level of economic development and purchasing power, as well as similar economic and political characteristics, are as follows: the European Union, South-East Europe, Eastern Europe, Central Europe and the remaining Western Europe and overseas markets.

The Group's basic form of reporting bases on geographical segments, which reflect the Group's internal organisation. Certain business functions are entirely or mostly carried out by the parent company that holds the controlling share in terms of sale as well as asset value. The Group boasts of an own strong sales marketing network, with the emphasis on five key markets i.e. Slovenia, the Russian Federation, Croatia, Poland and the Western Europe. Each of these markets is involved in one of the geographical regions that are specified as geographical segments. In the light thereof the geographical segments are given priority during reporting. Operating results, assets and liabilities by geographical segments include items that may directly be attributable to the segment, as well as items that may reasonably be allocated to the segment.

As for business segments the Group reports solely on the revenue. Within the structure of business segments, the share of human health products represents more than 90% of the Group's sale in terms of value.

17. New standards and interpretations not yet adopted

The list below presents the new standards, amendments to standards and interpretations that are not yet effective for the year ended 31 December 2006, and have thus not been applied in preparing the consolidated financial statements:

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures
The standard requires extensive disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and amended IAS 1, which become mandatory for the Group's 2007 financial statements, will require extensive additional disclosures with respect to Group's financial instruments and share capital.

IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
addresses the application of IAS 29 when an economy first becomes hyperinflationary and in particular the accounting for deferred tax. IFRIC 7, which becomes mandatory for the Group's 2007 financial statements, is not expected to have any impact on the consolidated financial statements.

IFRIC 8 Scope of IFRS 2 Share-based Payment
addresses the accounting for share-based payment transactions in which some or all of goods or services received cannot be specifically identified. IFRIC 8 will become mandatory for the Group's 2007 financial statements, with retrospective application required. The Group has not yet determined the potential effect of the interpretation.

IFRIC 9 Reassessment of Embedded Derivatives
requires that a reassessment of whether embedded derivative should be separated from the underlying host contract should be made only when there are changes to the contract. IFRIC 9, which becomes mandatory for the Group's 2007 financial statements, is not expected to have any impact on the consolidated financial statements.

IFRIC 10 Interim Financial Reporting and Impairment
prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. IFRIC 10 will become mandatory for the Group's 2007 financial statements, and will apply to goodwill, investments in equity instruments, and financial assets carried at cost prospectively from the date that the Group first applied the measurement criteria of IAS 36 and IAS 39 respectively (i.e. 1 January 2004). The adoption of IFRIC 10 will result in a decrease in deferred tax.

18. Determination of fair values

A number of the Group's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. Where applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

Investments in equity and debt securities
The fair value of financial assets at fair value through profit or loss, held-to-maturity investments and available-for-sale financial assets is determined by reference to their close price as regards foreign securities, whereas with investments made in Slovenia the average price per share at the reporting date is considered.

Trade and other receivables
The fair value of trade and other receivables, excluding construction work in progress, is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

Derivatives
The fair value of forward exchange contracts is based on their listed market price, if available. If a listed market price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate (based on government bonds).

The fair value of interest rate swaps equals the market price recorded as at the balance sheet date.

Non-derivative financial liabilities
Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

19. Cash flow statement

The cash flow statement has been prepared under the indirect method based upon items from the balance sheet as at 31 December 2006 and 31 December 2005, the income statement for the year that ended 31 December 2006, as well as additional data required for the adjustment of inflows and outflows.

1. Geographical and business segments

Segment information is presented in respect of the Group's business and geographical segments. The primary reporting format is geographical segments, whereby these are presented both by location of customers and by location of assets. A considerable portion of immovable and movable property is located at the parent company's headquarters in Slovenia. It must be taken into consideration that the major part of the assets held by the parent company in Slovenia are also used for business activities (production, storage, quality control etc.) referring to other geographical segments.

Those items of revenue, expenses, assets, and liabilities that are not directly attributable to reportable segments or cannot be reliably allocated to reportable segments by the application of certain criteria are presented under the item "Unallocated".

Sales revenues by business segments

in thousand SIT	2006	2005
Human health products	147,733,973	121,884,064
– prescription pharmaceuticals	128,433,891	105,743,337
– self-medication products	17,005,552	14,107,551
– cosmetic products	2,294,530	2,033,176
Animal health products	5,472,455	4,795,829
Health-resort and tourist services	6,702,075	5,848,349
Other	160,151	229,384
Total sales revenues	160,068,654	132,757,626
– of which sales revenues from sale of services	7,794,661	6,671,441

Geographical segments

in thousand SIT	European Union		South-East Europe		Eastern Europe		The remaining western Europe and overseas markets		Eliminations		Total	
	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Sales revenue to non-Group entities	86,864,894	74,744,853	26,591,750	22,629,039	43,299,480	32,762,642	3,312,530	2,621,092	0	0	160,068,654	132,757,626
Sales revenues to Group entities	14,041,427	17,465,891	10,052,048	9,453,177	6,928,574	2,558,096	926,023	0	-31,948,072	-29,477,164	0	0
Total sales revenues	100,906,321	92,210,744	36,643,798	32,082,216	50,228,054	35,320,738	4,238,553	2,621,092	-31,948,072	-29,477,164	160,068,654	132,757,626
Segment's results from operations	22,937,371	16,771,965	7,256,129	6,237,398	9,292,593	5,232,387	759,429	562,900	0	0	40,245,522	28,804,650
Other operating income											854,137	12,221,261
Unallocated costs											5,035,000	12,502,653
Operating profit											36,064,659	28,523,258
Net financial income/ expenses											-416,793	1,006,720
Income tax expense											-8,787,472	-6,210,850
Profit for the period											26,860,394	23,319,128
Segment's assets	136,060,877	126,294,480	21,989,112	23,098,921	30,863,251	22,809,361	1,067,290	965,541	0	0	189,980,530	173,168,303
Unallocated assets	0	0	0	0	0	0	0	0	0	0	20,693,789	15,680,853
Total assets	0	0	0	0	0	0	0	0	0	0	210,674,319	188,849,156
Investments	23,613,037	19,842,467	711,665	1,446,984	602,158	210,754	0	0	0	0	24,926,860	21,500,205
Impairment of receivables and inventories											1,285,889	998,214
Total liabilities											73,862,646	73,952,215

2. Other operating income

in thousand SIT	2006	2005
Utilisation and reversal of non-current provisions	87,583	11,534,731
Reversal of allowances for receivables	157,705	162,436
Profit from the sale of fixed assets	235,219	306,133
Other operating income	373,630	217,961
Total other operating income	854,137	12,221,261

3. Production cost of goods sold

In 2006, production cost of goods sold increased by 15% over the previous year's results. As for their share among the sales revenues, the production costs decreased from 39.1% in 2005 to 37.3% in 2006. The decrease is a result of a more favourable product mix of goods sold, as well as stronger cost efficiency due to a better productivity (contemporary technological procedures, an improved utilisation level of production capacities) achieved in the parent company, as well as in production facilities of subsidiaries located abroad.

4. Sales and marketing

Sales and marketing expenses comprise the costs of the domestic and foreign marketing sales network, as well as provisions formed for lawsuits, which may cause an irregular increase of these costs in individual periods. In 2006, the sales and marketing expenses recorded a decrease of 4% if compared to the previous year's figures. The decrease was mostly due to the fact that the amount includes 5,035,000 thousand SIT of newly formed provisions for the lawsuit relating to drugs for heart and cardiovascular diseases, which is less than the amount of provisions formed for lawsuits in 2005 (12,502,563 thousand SIT). Sales and marketing expenses have increased by 19%, provided that provisions are not taken into account.

5. R&D costs

All R&D costs recorded are charged against the income statement of 2006, since research and development costs are not capitalised. Compared to 2005, the relevant costs increased by 31%, while their share among the sales revenues records an increase from 7.2% to 7.9% over the previous year.

6. Administrative expenses

Compared to 2005, administrative expenses decreased by 4%, whereby its share in the structure of sales revenues decreased from 10.1% to 8.0%. The item of administrative expenses is inclusive of other operating expenses.

7. Costs in terms of type

in thousand SIT	2006	2005
Cost of goods and materials	38,391,428	35,766,811
Cost of services	29,976,820	24,044,136
Employee benefits expense	37,300,534	33,955,292
Depreciation	11,431,881	10,970,573
Provisions formed for lawsuits	5,132,507	12,822,817
Provisions formed for termination pay and anniversary bonuses	901,582	638,563
Other operating expenses	3,439,087	3,335,794
Total costs in terms of type	126,573,839	121,533,986
Changes in the value of inventories	1,715,708	5,078,357
Total	124,858,131	116,455,629

8. Employee benefits cost

in thousand SIT	2006	2005
Gross wages and salaries, continued pay	29,155,508	25,971,593
Social security contributions and payroll tax	6,416,336	6,363,912
Other employee benefits cost	1,728,690	1,619,787
Total employee benefits costs	37,300,534	33,955,292

Other employee benefits cost in the reporting period include the vacation bonus, travel allowances, meal allowance and some other repayments to employees.

9. Other operating expenses

in thousand SIT	2006	2005
Grants, assistance	536,555	520,989
Environmental levies	353,892	342,076
Fiscal charges irrespective of operating results	537,684	496,470
Loss in the sale of fixed assets	303,233	252,734
Impairments and inventory write-offs	988,329	549,916
Impairments and receivable write-offs	297,560	448,298
Other costs	421,834	725,311
Total	3,439,087	3,335,794

10. Financial income and financial expenses

in thousand SIT	2006	2005
Exchange differences	1,391,549	3,696,640
Interest income	175,561	140,348
Change in fair value of investments (through profit or loss)	396,828	19,159
Gain on the sale of securities	259,212	64,744
Income from derivative financial instruments	1,101,095	27,726
Dividend income	390,204	40,710
Total financial income	3,714,449	3,989,327
Exchange differences	2,609,267	1,611,147
Interest paid	920,674	730,177
Impairments due to revaluation of investments at fair value	131,778	39,748
Expense from derivative financial instruments	180,508	589,690
Other expenses	289,015	11,845
Total financial expenses	4,131,242	2,982,607
Net financial expenses / income	-416,793	1,006,720

11. Income tax expense

in thousand SIT	2006	2005
Actual income tax	10,297,864	9,758,335
Deferred tax	-1,510,392	-3,547,485
Total	8,787,472	6,210,850
Profit before tax	35,647,866	29,529,978
Income tax calculated using the tax rates of individual countries	8,807,103	7,382,495
Non-deductible expenses	763,994	1,272,294
Tax incentives	-1,434,724	-1,161,781
Tax exempt revenues	-28,660	-750,533
Effect of restatements due to the transition to IFRS	0	-233,479
Effects of differences in tax rates and other items	679,759	-298,146
Total income tax expenses	8,787,472	6,210,850

12. Deferred tax assets and deferred tax liabilities

	Assets		Liabilities		Assets – Liabilities	
in thousand SIT	2006	2005	2006	2005	2006	2005
Investments	162,462	288,338	248,772	367,165	-86,310	-78,828
Receivables	64,194	116,585	-7,211	0	71,405	116,585
Inventories	146,635	131,112	0	-1,026	146,635	132,138
Provisions for lawsuits	4,033,639	3,125,641	0	0	4,033,639	3,125,641
Provisions for termination pay	2,522,923	391,269	0	0	2,522,923	391,269
Tax effects of the transition and adjustment to IFRS	700,389	725,380	722,999	-80,904	-22,610	806,284
Total	7,630,242	4,778,324	964,560	285,236	6,665,682	4,493,089

	Assets – Liabilities		Through profit and loss		Through equity	
in thousand SIT	2006	2005	2006	2005	2006	2005
Investments	-86,310	-78,828	63,234	273,220	-149,544	-352,048
Receivables	71,405	116,585	68,302	106,184	3,103	330,307
Inventories	146,635	132,138	154,398	178,334	-7,763	-46,196
Provisions for lawsuits	4,033,639	3,125,641	1,158,050	3,125,641	2,875,589	0
Provisions for termination pay	2,522,923	391,269	54,611	2,801	2,468,312	68,562
Tax effects of the transition and adjustment to IFRS	-22,610	806,284	118,142	-383,141	-140,752	1,189,424
Total	6,665,682	4,493,089	1,616,736	3,303,039	5,048,946	1,190,049

13. Property, plant and equipment

in thousand SIT	31 Dec 2006	31 Dec 2005
Property	5,425,712	5,168,313
Plant	60,154,990	52,732,548
Equipment	41,105,886	33,583,619
PPE under construction	14,767,935	16,680,751
- advances for PPE	1,446,574	996,748
Total property, plant and equipment	121,454,523	108,165,231

Movements of property, plant and equipment in 2006

in thousand SIT	Property	Plant	Equipment	PPE under construction	Advances for PPE	Total
Cost at 01 Jan 2006	5,168,313	90,153,423	88,698,184	15,684,003	996,748	200,700,671
Additions	0	0	0	23,157,122	930,943	24,088,065
Capitalisation – transfer from PPE under construction	271,086	11,473,438	14,119,887	-25,864,411	0	0
Disposals, deficits, surpluses	-13,687	-465,459	-2,143,158	0	0	-2,622,304
Transfers among assets, reclassifications	0	-45,635	43,530	481,113	-481,117	-2,109
Cost at 31 Dec 2006	5,425,712	101,115,767	100,718,443	13,457,827	1,446,574	222,164,323
Accumulated depreciation at 01 Jan 2006	0	37,420,875	55,114,565	0	0	92,535,440
Depreciation	0	3,886,518	6,425,037	0	0	10,311,555
Capitalisation – prolongation of useful life	0	-136,381	-26,100	136,466	0	-26,015
Disposals, deficits, surpluses	0	-209,802	-1,899,273	0	0	-2,109,075
Transfers among assets, reclassifications	0	-433	-1,672	0	0	-2,105
Accumulated depreciation at 31 Dec 2006	0	40,960,777	59,612,557	136,466	0	100,709,800
Carrying amount at 01 Jan 2006	5,168,313	52,732,548	33,583,619	15,684,003	996,748	108,165,231
Carrying amount at 31 Dec 2006	5,425,712	60,154,990	41,105,886	13,321,361	1,446,574	121,454,523

Movements of property, plant and equipment in 2005

in thousand SIT	Property	Plant	Equipment	PPE under construction	Advances for PPE	Total
Cost at 01 Jan 2005	5,064,126	86,930,566	82,682,313	8,145,374	1,384,168	184,206,547
Additions	0	0	0	20,976,956	-385,972	20,590,984
Capitalisation – transfer from PPE under construction	311,174	3,641,745	9,482,991	-13,434,462	-1,448	0
Disposals, deficits, surpluses	-206,987	-417,225	-3,473,771	-3,865	0	-4,101,848
Transfer to intangible assets	0	-1,663	6,651	0	0	4,988
Cost at 31 Dec 2005	5,168,313	90,153,423	88,698,184	15,684,003	996,748	200,700,671
Accumulated depreciation at 01 Jan 2005	0	33,822,675	51,843,958	0	0	85,666,633
Depreciation	0	3,614,385	6,402,707	0	0	10,017,092
Capitalisation – prolongation of useful life	0	4,424	-6,545	0	0	-2,121
Disposals, deficits, surpluses	0	-19,850	-3,127,025	0	0	-3,146,875
Transfer to intangible assets	0	-759	1,470	0	0	711
Accumulated depreciation at 31 Dec 2005	0	37,420,875	55,114,565	0	0	92,535,440
Carrying amount at 01 Jan 2005	5,064,126	53,107,891	30,838,355	8,145,374	1,384,168	98,539,914
Carrying amount at 31 Dec 2005	5,168,313	52,732,548	33,583,619	15,684,003	996,748	108,165,231

Expenses for property, plant and equipment, presented in the cash flow statement, differ from those stated in the schedule of movement by the amount e.g. difference that occurs between the opening and the closing balance of trade payables.

14. Intangible assets

in thousand SIT	31 Dec 2006	31 Dec 2005
R&D cost	682,254	603,482
Long-term property rights	4,002,911	3,611,856
Intangible assets under construction	972,222	843,112
Total intangible assets	5,657,387	5,058,450

The most significant share in the structure of the Group's intangible assets refers to the purchase of new software, namely for the Synthesis 4 (273,675 thousand SIT), for handling of registration documentation (121,389 thousand SIT) and the upgrading of the SAP software (84,557 thousand SIT).

Intangible assets under construction comprise payments for the registration documentation as regards new drugs.

Movements of intangible assets in 2006

in thousand SIT	R&D cost	Long-term property rights	IA under construction	Total
Cost at 01 Jan 2006	1,338,613	5,197,931	843,112	7,379,656
Additions	0	2	1,743,726	1,743,728
Transfer from IA under construction	416,816	1,203,063	-1,614,616	5,263
Disposals	-40,630	-1,722	0	-42,352
Transfers to property, plant and equipment	0	2,105	0	2,105
Cost at 31 Dec 2006	1,714,799	6,401,379	972,222	9,088,400
Accumulated amortisation at 01 Jan 2006	735,131	1,586,075	0	2,321,206
Amortisation	297,843	822,483	0	1,120,326
Disposals	-429	-12,195	0	-12,624
Transfers to property, plant and equipment	0	2,105	0	2,105
Accumulated amortisation at 31 Dec 2006	1,032,545	2,398,468	0	3,431,013
Carrying amount at 01 Jan 2006	603,482	3,611,856	843,112	5,058,450
Carrying amount at 31 Dec 2006	682,254	4,002,911	972,222	5,657,387

Movements of intangible assets in 2005

in thousand SIT	R&D cost	Long-term property rights	IA under construction	Total
Cost at 01 Jan 2005	1 160,561	4,049,427	358,544	5,568,532
Additions	0	67	1,862,381	1,862,448
Transfer from IA under construction	222,508	1,170,053	-1,377,813	14,748
Disposals	-43,484	-17,600	0	-61,084
Transfers to property, plant and equipment	-972	-4,016	0	-4,988
Cost at 31 Dec 2005	1,338,613	5,197,931	843,112	7,379,656
Accumulated amortisation at 01 Jan 2005	566,002	850,727	0	1,416,729
Amortisation	211,576	741,905	0	953,481
Disposals	-42,131	-6,163	0	-48,294
Transfers to property, plant and equipment	-316	-394	0	-710
Accumulated amortisation at 31 Dec 2005	735,131	1,586,075	0	2,321,206
Carrying amount at 01 Jan 2005	594,559	3,198,700	358,544	4,151,803
Carrying amount at 31 Dec 2005	603,482	3,611,856	843,112	5,058,450

15. Investments in associates

The item of investments in associates fully refers to interests of the subsidiary Terme Krka in the associate company Golf Grad Otočec, d.o.o.. As for this item, no goodwill or bad will was calculated.

16. Long-term loans

Long-term loans are extended by the parent company, whereas some Group companies extend loans also to its employees for housing, scholarship and relocation purposes in compliance with internal acts. Loans of the parent company bear the annual interest rate, which equals the contractually agreed rate set by the Minister of Finance in accordance with the Corporate Income Tax Act that defines the interest rate for related parties; the repayment period must not exceed 15 years.

Movements of long-term loans in 2006

in thousand SIT	Long-term loans
Cost at 01 Jan 2006	903,839
New loans	385,687
Repayments	-413,919
Exchange differences	590
Transfer to short-term loans	-10,517
Cost at 31 Dec 2006	865,680
Value adjustment at 01 Jan 2006	14,014
Decrease (write-off)	-2,459
Value adjustment at 31 Dec 2006	11,555
Carrying amount at 01 Jan 2006	889,825
Carrying amount at 31 Dec 2006	854,125

Movements of long-term loans in 2005

in thousand SIT	Long-term loans
Cost at 01 Jan 2005	949,114
New loans	294,028
Repayments	-335,458
Exchange differences	1,652
Transfer to short-term loans	-5,497
Cost at 31 Dec 2005	903,839
Value adjustment at 01 Jan 2005	16,884
Increase	91
Decrease (write-off)	-2,961
Value adjustment at 31 Dec 2005	14,014
Carrying amount at 01 Jan 2005	932,230
Carrying amount at 31 Dec 2005	889,825

17. Other non-current investments

in thousand SIT	31 Dec 2006	31 Dec 2005
Instruments available-for-sale	1,552,111	1,217,773
Other non-current investments	62,391	62,391
Total non-current investments	1,614,502	1,280,164

Other non-current investments include items of cultural and historical value.

Movements of non-current investments in 2006

in thousand SIT	AFS instruments	Other non-current investments	Total
Cost at 01 Jan 2006	1,225,475	62,391	1,287,866
Increase	315	0	315
Change in fair value	334,023	0	334,023
Balance at 31 Dec 2006	1,559,813	62,391	1,622,204
Value adjustment at 01 Jan 2006	7,702	0	7,702
Balance at 31 Dec 2006	7,702	0	7,702
Carrying amount at 01 Jan 2006	1,217,773	62,391	1,280,164
Carrying amount at 31 Dec 2006	1,552,111	62,391	1,614,502

Movements of non-current investments in 2005

in thousand SIT	AFS instruments	Other non-current investments	Total
Cost at 01 Jan 2005	1,176,369	62,391	1,238,760
Increase	313	0	313
Decrease	-6,783	0	-6,783
Change in fair value	55,576	0	55,576
Balance at 31 Dec 2005	1,225,475	62,391	1,287,866
Value adjustment at 01 Jan 2005	7,595	0	7,595
Increase	107	0	107
Balance at 31 Dec 2005	7,702	0	7,702
Carrying amount at 01 Jan 2005	1,168,774	62,391	1,231,165
Carrying amount at 31 Dec 2005	1,217,773	62,391	1,280,164

18. Other non-current assets

Other non-current assets include collaterals given in connection with representations abroad (40,393 thousand SIT), payments made for the reserve housing fund (2,162 thousand SIT) and other assets in the amount of 17,968 thousand SIT.

19. Inventories

in thousand SIT	31 Dec 2006	31 Dec 2005
Material	8,780,740	9,900,962
Work in progress	7,288,730	4,986,820
Products	11,196,713	13,440,723
Merchandise	449,825	630,146
Advances	64,400	7,978
Total inventories	27,780,408	28,966,629

Impairment and write-off of inventories was carried out in the reporting period in the amount of 988,329 thousand SIT; in 2005 the same amounted to 549,916 thousand SIT.

20. Receivables

in thousand SIT	31 Dec 2006	31 Dec 2005
Trade receivables	33,684,499	30,255,828
Other receivables	3,193,816	2,752,875
Total receivables	36,878,315	33,008,703

Trade receivables

in thousand SIT	Gross value	Adjustment	Net value at 31 Dec 2006	Net value at 31 Dec 2005
Domestic customers	2,960,141	60,316	2,899,825	3,212,640
Foreign customers	31,742,135	957,462	30,784,674	27,043,188
Total	34,702,276	1,017,778	33,684,499	30,255,828

Trade receivables are not secured. The Group formed allowances for receivables in the amount of 297,560 thousand SIT, whereas in 2005 they were recorded at 448,298 thousand SIT.

Other receivables

Other receivables refer mostly to VAT receivables.

21. Current investments

in thousand SIT	31 Dec 2006	31 Dec 2005
Instruments held for trading	2,849,357	1,524,869
Interest bearing current investments	904,434	665,431
Other current investments	1,751,139	994,546
Short-term loans granted	262,490	206,159
Total current investments	5,767,420	3,391,005

Purchases made in 2006 resulted in an increase of instruments held for trading, which comprise shares issued by other companies (2,200,563 thousand SIT), marketable shares (372,045 thousand SIT), non-marketable shares 3,917 thousand SIT).

Interest bearing current investments include government bonds in the amount of 719,973 thousand SIT, debt certificates in the amount of 100,587 thousand SIT, and bank deposits in the amount of 83,874 thousand SIT.

Current investments bore the fixed interest rate (2005: 83%) and none of the investments bore the variable interest rate (2005: 17%).

Most of other current investments refer to mutual funds (domestic and foreign) in the amount of 1,158,389 thousand SIT and managed funds in the amount of 216,902 thousand SIT.

92% of short-term loans bear the fixed interest rate (2005: 100%) and 8% (2005: 0%) of short-term loans the variable interest rate.

22. Cash and cash equivalents

in thousand SIT	31 Dec 2006	31 Dec 2005
Cash in hand	18,508	19,219
Bank balances	2,332,669	2,964,091
Other	140,773	44,442
Total cash and cash equivalents	2,491,950	3,027,752

23. Equity

in thousand SIT	31 Dec 2006	31 Dec 2005
Share capital	14,170,448	14,170,448
Own shares	-4,670,280	-4,670,280
Reserves	35,385,325	34,885,325
- share premium	28,993,129	28,993,129
- legal reserves	3,592,196	3,592,196
- statutory reserves	2,800,000	2,300,000
Retained earnings	89,160,409	68,131,642
Fair value reserves	833,938	561,602
Translation reserve	36,962	4,648
Equity holders of the parent	134,916,802	113,083,385
Minority interest	1,894,871	1,813,556
Total equity	136,811,673	114,896,941

Share capital

Share capital is divided into 3,542,612 ordinary shares of the parent company at par value of 4,000 SIT. There is only one class of shares, whose first and only issue was carried out in 1995.

Own shares

As of the balance sheet date the parent company recorded 162,662 own shares amounting to 650,648 thousand SIT, i.e. 4.6% of the share capital value. The number of shares in this reporting period remained unchanged if compared to 2005.

Reserves

The Group's reserves comprise the share premium, legal and statutory reserves. None of the aforesaid reserve may be used for payout of dividends and other equity interests. With respect to legal possibilities, the Group has increased reserves in the reporting period by 500,000 thousand SIT of additionally formed statutory reserves.

Retained earnings

The increase in Group's retained earnings is attributable to the net profit (26,763,403 thousand SIT) and the net income and expense recognised directly in equity (396,650 thousand SIT). The decrease, on the other hand, is a result of statutory reserves (500,000 thousand SIT) additionally formed pursuant to the resolution adopted by the Management Board of the parent company, and the dividend payout (5,631,286 thousand SIT). The amount of the dividend payout, shown in the cash flow statement, differs from the figure, confirmed by the annual meeting and included in the statement of changes in equity, by the amount of change between the opening and closing balance of liabilities for dividend payout.

Fair value reserves

Fair value reserves record an increase of 272,336 thousand SIT, i.e. amount of the revaluation of non-current investments to market price.

Translation reserve

Translation reserve is a result of exchange differences that occurred among the operating results of subsidiaries presented in the consolidated income statement (average exchange rate) or the consolidated balance sheet (exchange rate of 31 December).

Minority interest

Minority interest includes shares of minority stockholders in subsidiaries of Terme Krka (1,888,527 thousand SIT) and Helvetius (6,344 thousand SIT).

STATEMENT OF RECOGNISED INCOME AND EXPENSE

in thousand SIT	31 Dec 2006	31 Dec 2005
Purchase of shares in subsidiaries	0	-4,616
Translation reserve	32,314	-55,312
Deferred taxes	709,458	-799,015
Tax effects of the transition and adjustment to IFRS	-379,547	0
Refund of default interest paid in respect of taxes	66,739	87,663
Total recognised income and expense for the period	428,964	-771,280

24. Earnings per share

Earnings per share amount to 7,918.28 SIT and show an increase of 15% compared to the previous year's result (2005: 6,890.21 SIT). The calculation for both years bases upon the equity interest of the majority stockholder and 3,379,950 shares, whereas 162,662 own shares of the parent company were not taken into account. All shares issued by the Company are ordinary shares, hence the diluted earnings per share ratio was not calculated.

25. Borrowings

in thousand SIT	31 Dec 2006	31 Dec 2005
Long-term borrowings	8,287,723	11,669,435
- borrowings from domestic banks	8,287,723	11,631,002
- borrowings from other entities	0	38,433
Short-term borrowings	11,493,010	8,972,820
- borrowings from domestic banks	5,952,072	5,107,105
- borrowings from foreign banks	2,817,265	1,339,308
- borrowings from other entities	2,723,673	2,526,407
Interest payable	193,978	147,844
Total borrowings	19,974,711	20,790,099

Movement of long-term borrowings

in thousand SIT	Borrowings from banks	Borrowings from other entities	Total
Balance at 01 Jan 2005	14,509,441	86,702	14,596,143
New borrowings	1,433,426	0	1,433,426
Repayments	-1,547,507	-49,745	-1,597,252
Balance of transfer at 01 Jan 2005	1,426,068	49,421	1,475,489
Transfer to current liabilities at 31 Dec 2005	-4,586,389	-50,938	-4,637,327
Exchange differences	395,963	2,994	398,957
Balance at 31 Dec 2005	11,631,002	38,434	11,669,436
Repayments	-4,043,925	-49,983	-4,093,908
Balance of transfer at 01 Jan 2006	4,101,618	50,938	4,152,556
Transfer to current liabilities at 31 Dec 2006	-3,166,554	-39,389	-3,205,943
Exchange differences	-234,418	0	-234,418
Balance at 31 Dec 2006	8,287,723	0	8,287,723

Long-term borrowings are denominated in euro and US dollar and were extended by three domestic banks for the period of up to 7 years. The borrowings were raised for financing the investments in current assets. The Group raised no new long-term borrowing in the reporting period.

Long-term borrowings obtained from banks are neither secured by mortgages nor by bank guarantees. The Group issued bills of exchange for the borrowings which are pursuant to IFRS 4 considered as Insurance Contracts and treated as contingent liabilities (Note 30). The Group hedged three long-term borrowings that are considered to form the major part of the borrowed amount by using interest rate swaps.

Movement of short-term borrowings

in thousand SIT	Short-term borrowings from banks	Short-term borrowings from other entities	Total
Balance at 01 Jan 2005	2,075,748	3,009,396	5,085,144
New borrowings	21,690,840	2,838,964	24,529,804
Repayments	-21,906,564	-3,372,891	-25,279,455
Transfer from non-current liabilities	4,586,389	50,938	4,637,327
Balance at 31 Dec 2005	6,446,413	2,526,407	8,972,820
New borrowings	35,772,467	729,636	36,502,103
Repayments	-36,618,544	-571,759	-37,190,303
Transfer from non-current liabilities	3,166,554	39,389	3,205,943
Exchange differences	2,447	0	2,447
Balance at 31 Dec 2006	8,769,337	2,723,673	11,493,010

26. Provisions

in thousand SIT	Balance at 31 Dec 2005	Formation	Utilisation and reversal	Balance at 31 Dec 2006
Provisions for termination pay and anniversary bonuses	10,664,604	901,582	596,652	10,969,534
Other provisions	13,303,298	5,145,756	49,830	18,399,224
– provisions for lawsuits	13,141,610	5,132,507	552	18,273,565
– provisions for ecological restoration	119,937	6,895	40,543	86,289
– other provisions	41,751	6,354	8,735	39,370
Total provisions	23,967,902	6,047,338	646,482	29,368,758

The amounts of provisions for lawsuits referring to intellectual property are defined on the basis of the noted amount of the indemnification claim, or on the basis of anticipated potential amount, if the indemnification claim is not yet disclosed. External advisors for litigations referring to intellectual property are engaged for defining the anticipated potential amounts. Furthermore, the management verifies the justification of the formed provisions with a view to the prospects for a favourable or unfavourable lawsuit outcome every year. The Group formed additional provisions for lawsuits in the amount of 5,132,507 thousand SIT, of which 5,035,000 thousand SIT refers to the alleged patent infringements in connection with atorvastatin. As for the income statement, the newly formed and utilised provisions are included among other operating expenses or other operating income.

Provisions for payables to employees are based on a calculation performed by a certified actuary, whereby a discount rate of 4.75% p.a. (that grounds on the profitability of 10-year corporate bonds of high credit rating in the euro-zone), as well as certain estimates and assumptions were made regarding the amount of termination pay and anniversary bonuses, age structure of employees, employee turnover, etc. The estimates and the assumptions that have been applied are based on the actual state of affairs during the preparation of the calculation of the actuary. The projected unit method was applied in the calculation. No material discrepancies from the assumptions applied may be expected in the near future.

27. Grants received

in thousand SIT	Balance at 31 Dec 2005	Formation	Utilisation and reversal	Balance at 31 Dec 2006
Grants for the subsidiary Krka-Rus	4,573	0	2,286	2,287
Grants for the plant BETA in Šentjernej	83,033	0	10,600	72,433
Assets for the health resorts Dolenjske and Šmarješke Toplice	358,243	233,787	33,948	558,082
Grants by the European Regional Development Fund	0	6,420	160	6,260
Free receipt of fixed assets	0	26,526	0	26,526
Total grants received	445,849	266,733	46,994	665,588

The recorded amounts of grants received are decreased by the proportionate share of depreciation of assets to which the grants refer to.

28. Trade payables

in thousand SIT	31 Dec 2006	31 Dec 2005
Payables to domestic suppliers	8,556,001	7,743,740
Payables to foreign suppliers	5,923,779	5,776,651
Payables from advances	111,722	523,180
Total trade payables	14,591,502	14,043,571

29. Other current liabilities

in thousand SIT	31 Dec 2006	31 Dec 2005
Accrued contractual discounts on products sold to other customers	1,777,280	3,487,917
Payables to employees – gross wages, other charges	4,131,511	3,421,795
Liabilities in connection with derivative financial instruments	0	234,840
Other	706,478	585,575
Total other current liabilites	6,615,269	7,730,127

30. Contingent liabilities

in thousand SIT	31 Dec 2006	31 Dec 2005
Bills issued in connection with loans	9,840,498	14,164,115
Other guarantees issued	260,386	264,280
Other	539,289	362,579
Total contigent liabilities	10,640,173	14,790,974

31. Financial instruments

Long-term stability of the Group's performance is managed by means of active risk management policies as presented in detail under 'Hedging'. Due to the high amount of international import and export business, the Group is primarily exposed to foreign exchange and interest rate risks, as well as to credit risks. Derivative financial instruments are used for hedging the Group's exposure against foreign exchange and interest rate risks.

Credit risk

Credit risk is hedged by the assessment of the customers' credit rating as well as by debt collection procedures. No major debt write-offs due to customers' failures of payments were recorded in 2006.

Interest rate risk

In 2004, three non-current loans (two of them denominated in US dollars, one in euros) were hedged by using interest rate swaps. No further hedging instruments were applied in 2005 and 2006. As at 31 December 2006, the contract value of the hedged item amounted to 9,389,169 thousand SIT, and the Group's interest rate swaps recorded at fair value amounted to 173,353 thousand SIT.

A detailed schedule of long-term and short-term borrowings is presented below.

Long-term borrowings

in thousand SIT	31 Dec 2006	31 Dec 2005
Long-term borrowings	11,493,666	16,306,762
– short-term portion of long-term borrowings	3,205,943	4,637,327
Average balance of long-term borrowings	13,900,214	16,444,884
Interest paid (financial year)	520,484	546,648
Other costs of raising long-term borrowings	0	0
Average cost of long-term borrowings (financial year)	3.7%	3.3%
Contracted to mature in three years or less	18%	67%
Contracted to mature in more than three years	82%	33%
Currency structure of long-term borrowings:		
– US dollar	14%	18%
– Euro	84%	79%
– Slovenian tolar	2%	3%
Structure of long-term borrowings in terms of interest rates:		
– Variable	100%	100%
– Fixed	0%	0%

Short-term borrowings

in thousand SIT	31 Dec 2006	31 Dec 2005
Short-term borrowings including short-term portion of long-term borrowings	11,493,010	8,972,820
– from banks	8,769,337	6,446,413
– from other entities	2,723,673	2,526,407
Short-term borrowings	8,287,067	4,335,493
Average balance of short-term borrowings (financial year)	6,311,280	3,889,709
Interest paid (financial year)	288,995	183,529
Other costs of raising short-term borrowings	734	1,253
Average cost of short-term borrowings (financial year)	4.6%	4.8%
Currency structure of short-term borrowings		
– Euro	68%	41%
– Slovenian tolar	32%	59%
Structure of short-term borrowings in terms of interest rates:		
– Variable	68%	41%
– Fixed	32%	59%

Foreign currency risk

Currency options (i.e. range forwards) and futures are used to hedge against foreign currency risks. The contract value of both derivative financial instruments as at the balance sheet date amounted to 11,279,660 thousand SIT, and the fair value recorded in the Balance Sheet as at 31 December 2006 is 201,539 thousand SIT.

Liquidity risk

Due to an accurate planning of cash flows and short-term credit lines that were agreed with the banks in advance, the liquidity risk was low in 2006.

Sensitivity analysis

The lowering imbalances in currency positions resulting from the improved structure of the Group's import and export activities, the growing ratio of transactions performed in euros, as well as the hedging instruments have contributed to a lower impact of exchange currency changes upon the Group's financial results. We believe that any future considerable changes in exchange rates will not have a significant impact on the Group's financial results. Due to a relatively low indebtedness and hedging instruments enacted in the past, the same applies to any considerable changes in interest rates that may occur in the future.

Fair value

in thousand SIT	2006		2005	
	Carrying amount	Fair value	Carrying amount	Fair value
Non-current investments	2,468,627	2,468,627	2,169,989	2,169,989
– interests and shares	1,552,111	1,552,111	1,217,773	1,217,773
– other non-current investments	62,391	62,391	62,391	62,391
– long-term loans granted	854,125	854,125	889,825	889,825
Current investments	5,767,420	5,767,420	3,391,005	3,391,005
– instruments held for trading	2,849,357	2,849,357	1,524,869	1,524,869
– interest-bearing current investments	904,434	904,434	665,431	665,431
– other current investments	1,751,139	1,751,139	994,546	994,546
– short-term loans granted	262,490	262,490	206,159	206,159
Trade and other receivables	36,878,315	36,878,315	33,008,703	33,008,703
Cash and cash equivalents	2,491,950	2,491,950	3,027,752	3,027,752
Interest bearing derivatives	173,353	173,353	58,491	58,491
– assets	173,353	173,353	65,619	65,619
– liabilities	0	0	-7,128	-7,128
Embedded foreign currency derivatives	201,539	201,539	-168,699	-168,699
– assets	201,539	201,539	59,013	59,013
– liabilities	0	0	-227,712	-227,712
Borrowings	-19,974,711	-19,861,686	-20,790,099	-20,790,099
Trade and other payables	-14,591,502	-14,591,502	-14,043,571	-14,043,571
Total	13,414,991	13,528,016	6,653,571	6,653,571

Fair value measurement

The manner of the fair value measurement of the individual types of financial instruments is presented below.

Securities held for trading

The fair value is computed on the basis of the stock exchange quotation of the respective securities as at the balance sheet date, and it is not decreased by any costs that may arise upon the sale or purchase of securities.

Futures

The fair value of futures is recorded as the difference between the agreed spot rate upon closing a contract and the rate for futures of the same maturity as at the balance sheet date, multiplied by the value of the futures as at the last day of the Quarterly for the last entire financial year. The rate as at the balance sheet date is a sum of the current rate and the market points, reflecting the difference between the interest rates of the two currencies of the futures, under consideration of the maturity. The information on market points may be obtained from any of the Slovenian banks with which an ISDA Master Agreement was signed, or from the specific derivatives valuation models within Reuters information platform.

Options

The fair value of currency options is computed as at the last day of the Quarterly for the last entire financial year, by the use of specific derivatives valuation models available within Reuters information platform.

Interest rate swaps

The fair value of interest rate swaps is computed as at the last day of the Quarterly for the last entire financial year, by the use of specific derivatives valuation models available within Reuters information platform.

Financial assets available for sale

If the shares are listed on the stock exchange market, their fair value equals to the market value as at the balance sheet date, not decreased by any costs that may arise upon the sale or purchase of the said shares. Other financial assets available for sale are recorded at the net carrying amount as at the balance sheet date, representing the assessed fair value.

Interest bearing loans and borrowings

The fair value of loans and borrowings with a repayment period exceeding 5 years is recorded under consideration of the discounted cash flow of the principal and interest.

A 4.00% discount rate was applied. It has been computed under consideration of yield to maturity for government bonds of the Republic of Slovenia, based on the information published by the Ljubljana Stock Exchange and/or the TUVL, authorised for secondary trading in government securities. In our opinion, the applied discount rate appropriately reflects the financial market situation in Slovenia as well as in other European financial markets.

Receivables and liabilities

Short-term receivables and payables are recorded at net carrying amount, which is considered to be their fair value.

32. Transactions with related parties

The transactions carried out among the Group companies were based upon sales contracts, under the application of the market prices of the services performed and products.

Data on groups of persons

As at the year-end, the members of the Management Board of the Krka Company held 5693 of shares in the Krka Company, representing a 0.16% of the total equity, and the Managing Directors of subsidiaries held 2514 of shares or 0.07% of the total equity. A questionnaire on related entities is filled in by the members of the Management Board and other management staff on a yearly basis, which is afterwards used by the Company to check the occurrence of any other business relations between the Company and the employees. No such business relations were recorded in 2006.

Emoluments of groups of persons in 2006

in thousand SIT	Total receipts (gross)	Hereof participation in profit according to the annual meeting resolution
Management Board members in the parent company and managers of subsidiaries	595,216	0
Members of the Supervisory Board / Boards of Directors	105,139	51,291
Persons employed under individual employment contracts	4,732,303	0
Other employees	26,112,313	0
Total emoluments of groups of persons	31,544,970	51,291

Emoluments of the Management Board members in the parent company and of managers in subsidiaries, as well as emoluments of employees include salaries and wages, fringe benefits and any other receipts.

Emoluments of the Supervisory Board members in the parent company represent remuneration for the tasks performed within the Supervisory Board. Emoluments of the Supervisory Board members in subsidiaries, who simultaneously act as Management Board members in the parent company or are employed under individual employment contracts, also include solely remuneration for the tasks performed within the Supervisory Boards.

Loans granted to groups of persons

	Loan balance at 31 Dec 2006	Repayments in 2006
Members of the Management Board	4,928	1,064
Members of the Supervisory Board / Boards of Directors (employee representatives)	362	155
Persons employed under individual employment contracts	97,065	20,859
Other employees	1,251,944	147,204
Total loans to groups of persons	1,354,300	169,282

The loans granted to the above-mentioned persons were used for housing purposes.

33. Group profile

	Ownership share at 31 Dec 2006	Share capital	Currency	Number of employees at 31 Dec 2006	Number of employees at 31 Dec 2005
Parent company:					
KRKA, d. d., Novo mesto, Slovenia		14,170,448,000	SIT	4272	3978
Subsidiaries in terms of region:					
Terme Krka, d. o. o., Novo mesto, Slovenia**	100%	3,535,466,000	SIT	630	626
KRKA-FARMA d. o. o., Zagreb, Croatia	100%	76,369,900	HRK	115	105
"KRKA-FARMA", d. o. o., Novi Sad, Serbia	100%	119,745	CSD	9	9
KRKA-FARMA DOOEL, Skopje, Macedonia	100%	49,060,618	MKD	23	22
OOO "KRKA-RUS", Istra, Russian Federation	100%	1,111,374,765	RUB	83	53
OOO "KRKA FARMA", Sergiev Posad, Russian Federation	100%	130,000	RUB	17	15
KRKA-Polska, Sp. z o. o., Warsaw, Poland	100%	17,490,000	PLZ	507	410
KRKA Magyarország Kft, Budapest, Hungary	100%	12,600,000	HUF	98	0
KRKA ČR, s. r. o., Prague, Czech Republic *	100%	100,000	CZK	0	0
KRKA Pharma Dublin Limited, Dublin, Ireland	100%	1,000	EUR	0	0
KRKA Sverige AB, Stockholm, Sweden	100%	150,000	SEK	5	4
KRKA Aussenhandels GmbH, Munich, Germany*	100%	255,646	EUR	0	0
HELVETIUS- S. R. L., Trieste, Italy***	80%	51,600	EUR	0	2
Total				5729	5224

* companies, where no operations are carried out
** inclusive of Terme Krka – Strunjan
*** company in the process of dissolution

The subsidiary Terme Krka, d. o. o., Novo mesto holds interests in the companies Terme Krka – Strunjan, d. o. o. (51%) and Golf Grad Otočec, d. o. o. (49.71%).

The consolidated (Group) Annual Report 2006 is available for review at the registered office of the parent company and the web site *www.krka.si.*

Educational structure of employees in the Krka Group

	2006		2005	
	Headcount	Share (in %)	Headcount	Share (in %)
PhD	56	1.0	49	1.0
MSc	156	2.8	146	2.9
University education	2232	40.6	1867	37.1
Higher professional education	266	4.8	190	3.8
Vocational college education	214	3.9	205	4.1
Secondary school education	1120	20.4	1089	21.7
Skilled workers	1202	21.9	1223	24.3
Unskilled workers	248	4.5	261	5.2
Total (average for the period)	5494	100	5030	100

34. Transaction with audit firms

The annual service fee for audit services amounted to 61,441 thousand SIT. In addition to audit services, some of the said companies provided also tax advisory services, which amounted to 8,231 thousand SIT.

35. Events after the balance sheet date

At the beginning of 2007, the parent company paid in initial capital for two new companies, namely KRKA FARMACÊUTICA, LDA, Estoril, Portugal and KRKA USA, LLC, Delaware, USA. Krka is the sole owner of the two companies.

Auditor's report

KPMG

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of the Krka Group which comprise the consolidated balance sheet as at 31 December 2006, the consolidated income statement, the consolidated statement of changes in equity, the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

We also read the Management Report.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements prepared in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatements.

An audit involves procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Krka Group as at 31 December 2006, the result of its operations and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as endorsed by the European Union.

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

KPMG SLOVENIJA,
podjetje za revidiranje, d.o.o.

Marjan Mahnič, B.Sc.Ec.
Certified Auditor
Partner

Andrej Korinšek, B.Sc.Ec.
Certified Auditor
Partner

Ljubljana, 15 March 2007

KPMG Slovenija, d.o.o.

1

Financial statements of Krka, d. d., Novo mesto

Balance Sheet

in thousand SIT	Notes	31 Dec 2006	31 Dec 2005
Assets			
Property, plant and equipment	13	90,450,247	78,103,851
Intangible assets	14	5,367,992	4,897,744
Investments in subsidiaries	15	29,119,419	27,561,602
Long-term loans	16	1,275,760	1,364,769
Other investments	17	1,564,637	1,230,301
Deferred tax assets	12	6,625,469	3,732,861
Other non-current assets	18	42,555	8,828
Non-current assets		134,446,079	116,899,956
Inventories	19	23,839,435	26,883,175
Trade and other receivables	20	37,739,554	33,774,998
Current investments	21	7,618,122	3,933,668
Cash and cash equivalents	22	1,077,973	758,768
Current assets		70,275,084	65,350,609
Total assets		204,721,163	182,250,565
Equity			
Share capital	23	14,170,448	14,170,448
Own shares	23	-4,670,280	-4,670,280
Reserves	23	35,385,325	34,885,325
Retained earnings	23	90,855,702	69,504,498
Reserves for fair value	23	833,938	561,602
Total equity		136,575,133	114,451,593
Liabilities			
Borrowings	25	6,983,844	10,011,560
Provisions	26	27,991,402	22,692,910
Grants received	27	107,506	87,605
Deferred tax liabilities	12	947,465	265,879
Total non-current liabilities		36,030,217	33,057,954
Trade payables	28	13,492,783	12,713,863
Borrowings	25	11,288,168	8,495,030
Income tax liabilities		1,604,999	6,598,933
Provisions and other liabilities	29	5,729,863	6,933,192
Total current liabilities		32,115,813	34,741,018
Total liabilities		68,146,030	67,798,972
Total equity and liabilities		204,721,163	182,250,565

Income Statement

in thousand SIT	Notes	2006	2005
Sales revenues	1	140,453,546	116,570,332
Production cost of goods sold	3	51,102,823	45,055,228
Gross operating yield		89,350,723	71,515,104
Sales and marketing	4	32,098,091	35,056,183
R&D costs	5	12,404,660	9,487,512
Administrative expenses	6	10,108,574	10,050,639
Other operating income	2	479,384	11,880,171
Operating profit		35,218,782	28,800,941
Financial income	10	3,541,467	3,283,180
Financial expenses	10	3,473,256	3,734,629
Net financial income / expenses		68,211	-451,449
Profit before tax		35,286,993	28,349,492
Income tax expense	11	8,201,153	5,890,302
Profit for the period		27,085,840	22,459,190
Earnings per share (in SIT)	24	8,014	6,645

Statement of Changes in Equity

			Reserves			Retained earnings				
in thousand SIT	Called capital	Own shares	Share premium	Legal reserves	Statutory reserves	Profit reserves	Net profit for the period	Net profit carried forward	Fair value reserves	Total
Balance at 31 Dec 2004	14,170,448	-4,670,280	28,993,129	3,592,196	1,500,000	45,467,881	10,309,617	-2,745,507	519,986	97,137,470
Correction (Refer to Note 16)								310,966		310,966
Balance at 01 Jan 2005	14,170,448	-4,670,280	28,993,129	3,592,196	1,500,000	45,467,881	10,309,617	-2,434,541	519,986	97,448,436
Entry of net profit for the period	0	0	0	0	0	0	22,459,190	0	0	22,459,190
Formation of statutory reserves	0	0	0	0	800,000	0	-800,000	0	0	0
Formation of other revenue reserves under the resolution of the Management and the Supervisory Board	0	0	0	0	0	6,500,000	-6,500,000	0	0	0
Transfer of previous period's net profit to retained earnings	0	0	0	0	0	0	-11,187,984	11,187,984	0	0
Transfer to other revenue reserves under the resolution of the Annual Meeting	0	0	0	0	0	5,886,801	0	-5,886,801	0	0
Dividends paid	0	0	0	0	0	-3,874,859	0	-911,438	0	-4,786,297
Recognised income and expenses	0	0	0	0	0	0	0	-711,352	41,616	-669,736
Balance at 31 Dec 2005	14,170,448	-4,670,280	28,993,129	3,592,196	2,300,000	53,979,823	14,280,823	1,243,852	561,602	114,451,593
Entry of net profit for the period	0	0	0	0	0	0	27,085,840	0	0	27,085,840
Formation of statutory reserves	0	0	0	0	500,000	0	-500,000	0	0	0
Formation of other revenue reserves under the resolution of the Management and the Supervisory Board	0	0	0	0	0	4,800,000	-4,800,000	0	0	0
Transfer of previous period's net profit to retained earnings	0	0	0	0	0	0	-14,280,823	14,280,823	0	0
Transfer to other revenue reserves under the resolution of the Annual Meeting	0	0	0	0	0	7,312,001	0	-7,312,001	0	0
Dividends paid	0	0	0	0	0	0	0	-5,631,286	0	-5,631,286
Recognised income and expenses	0	0	0	0	0	0	0	396,650	272,336	668,986
Balance at 31 Dec 2006	14,170,448	-4,670,280	28,993,129	3,592,196	2,800,000	66,091,824	21,785,840	2,978,038	833,938	136,575,133

Cash Flow Statement

in thousand SIT	Notes	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit for the period		27,085,840	22,459,190
Adjustments for:		16,398,326	15,927,547
– amortisation /depreciation		8,673,366	8,378,685
– foreign exchange gain		-361,039	-1,523,964
– foreign exchange loss		1,145,677	842,959
– investment income		-2,788,654	-6,219
– investment expense		713,646	1,150,399
– financial income		0	-70,253
– financial expense		747,438	1,180,260
– income taxes and other taxes not included in operating expenses		8,201,153	5,890,302
– other		66,739	85,378
Operating profit before changes in net operating current assets and provisions		43,484,166	38,386,737
Change in trade receivables		-4,813,688	-7,785,501
Change in inventories		3,043,741	-8,399,959
Change in operating debts (liabilities)		-376,424	2,504,351
Change in other current liabilities and provisions		4,342,526	3,387,544
Income taxes paid		-15,138,201	-4,085,332
Cash generated from operations		30,542,120	24,007,840
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest received		215,829	92,450
Proceeds from sale of investments		243,050	64,744
Dividends received		48,200	25,886
Proportionate profit of subsidiaries		485,751	0
Proceeds from sale of property, plant and equipment		281,907	150,165
Purchase of intangible assets	14	-1,547,755	-1,853,563
Purchase of property, plant and equipment	13	-19,138,163	-12,164,575
Payments related to subsidiaries – capital increase and loss coverage	15	-1,557,816	-2,434,057
Proceeds/payments in connection with long-term loans	16	21,533	56,891
Payments in connection with other non-current assets	18	-33,727	-1,529
Acquisition of current investments		-3,210,646	-2,257,560
Acquisition of derivative financial instruments		435,486	-334,251
Net cash used in investing activities		-23,756,351	-18,655,399
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from an increase in short-term financial liabilities		2,764,802	3,993,805
Interest paid		-721,549	-625,317
Payment of long-term financial liabilities		-2,797,968	-4,264,238
Dividends paid		-5,623,905	-4,809,077
Net cash used in financing activities		-6,378,620	-5,704,827
Net increase in cash and cash equivalents		407,148	-352,386
Cash and cash equivalents at beginning of period		758,768	1,100,954
Effect of exchange rate fluctuations on cash held		-87,942	10,200
Net cash and cash equivalents at end of period		1,077,974	758,768

Notes to the financial statements

Summary of significant accounting policies

Krka, d. d., Novo mesto (hereinafter "Company") is the parent company in the Krka Group with its registered seat at Šmarješka cesta 6, 8501 Novo mesto, Slovenia.

1. Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the EU.

The financial statements of the Company were authorised for issue by the Management Board on 15 March 2007.

2. Basis of preparation

These financial statements are presented in Slovene tolar (SIT), which is the Company's functional currency. All financial information presented in SIT has been rounded to the nearest thousand.

The financial statements have been prepared on the historical cost basis. The fair value has been taken into account with derivative financial instruments, financial instruments held for trading, and financial instruments available for sale.

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in the following notes:

- Note 26 – measurement of defined benefit obligations,
- Note 26 – provisions for lawsuits,
- Note 31 – valuation of financial instruments.

3. Significant accounting policies

The Company applies the same accounting policies in all periods, presented in the accompanying financial statements.

The Company established in 2006 that an error occurred upon the transition to the International Financial Reporting Standards in connection with the impairment of a loan granted to a subsidiary. Pursuant to IAS 8, an adjustment of the opening balance of the comparable period was made (refer to Note 16). The effect of the adjustment was recorded in retained earnings as at 1 January 2005.

The comparable data are in accordance with the information referring to the current financial year. Where necessary, they were adjusted so as to comply with the information referring to the current financial year.

4. Foreign currency

Foreign currency transactions
Transactions in foreign currencies are translated to Slovenian tolar (i.e. the Company's functional currency) at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to tolar at the exchange rate at that date. The foreign currency gain or loss on monetary items is recognised in profit or loss. Non-monetary assets and liabilities initially denominated in foreign currencies are retranslated

to tolar at the exchange rate effective at the date of transaction. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

5. Financial instruments

Non-derivative financial instruments
Non-derivative financial instruments comprise investments in equity and debt securities, trade and other receivables, cash and cash equivalents, loans and borrowings, and trade and other payables.

Non-derivative financial instruments are recognised initially at fair value plus (for instruments not recognised at fair value through profit or loss) any directly attributable transaction costs, except as described below. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

A financial instrument is recognised if the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Company's contractual rights to the cash flows from the financial assets expire or if the Company transfers the financial asset to another party without retaining control or substantially all risks and rewards of the asset. Regular way purchases and sales of financial assets are accounted for at trade date, i.e., the date that the Company commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Company's obligations specified in the contract expire or are discharged or cancelled.

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Accounting for financial income and expense is discussed in note 11.

Available-for-sale financial assets
The Company's investments in equity securities and certain debt securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value. Changes in fair value are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss. Impairment losses and foreign exchange gains and losses on available-for-sale monetary items are recognised directly in profit or loss.

Investments at fair value through profit or loss
An instrument is classified as at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value. Upon initial recognition, attributable transaction costs are recognised in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

Other
Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

Derivative financial instruments
The Company holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in profit or loss when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Cash flow hedges
Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

Investments in subsidiaries
Non-current investments made in equity of subsidiaries or associates included in consolidated financial statements are valued at cost. Participation in the profit of subsidiary is recognised in the income statement of the controlling company when the latter retains the right to profit distribution. If the investment is required to be impaired due to subsidiary's loss, the amount of loss due to impairment is measured as a difference between the carrying amount and the present value of expected future cash flows.

Share capital
Repurchase of share capital
When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity.

Dividends
Dividends are recognised as a liability in the period in which they are declared by the annual meeting.

6. Property, plant and equipment

Items of property, plant and equipment are measured at cost less accumulated depreciation and impairment losses (see accounting policy "Impairment"). The cost of property, plant and equipment as at 1 January 2004, the date of transition to IFRS, is determined by reference to its fair value at that date.

Cost includes expenditures that are directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials and direct labour, any other costs, and (if applicable) costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Subsequent costs
The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Company and its cost can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

Depreciation
Depreciation is recognised in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated.

The estimated useful lives are as follows:

• land	3 - 60 years
• plant and equipment	5-20 years
• furniture	5 years
• computer equipment	4-6 years
• means of transportation	5-15 years

7. Intangible assets

Research and development
As for the research and development function, the item of intangible assets comprise the purchase of the registration documentation. All other costs referring to the research development work within the Company are recognised in the income statement as expense upon their accrual.

Other intangible assets
Other intangible assets that are acquired by the Company, which have finite useful lives, are measured at cost less accumulated amortisa-

tion and accumulated impairment losses (see accounting policy "Impairment").

Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

Subsequent expenditure
Subsequent expenditure is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is recognised in profit or loss when incurred.

Amortisation
Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use.

The estimated useful lives are as follows:

• recognised development costs	5 years
• software	2–10 years
• other intangible assets	5–10 years

8. Inventories

An inventory unit of raw materials and materials, as well as supporting and packaging materials is valued at cost including all direct cost of purchase. Inventories of material are carried at moving average prices. Inventories of finished products and work in progress are valued at fixed prices, which in addition to direct cost of material include also cost of production (direct labour, direct cost of depreciation, direct cost of services and indirect cost of production such as energy, maintenance, quality management, etc.). Inventories of work in progress and finished products are carried at fixed prices. An inventory unit of merchandise is valued at cost including cost of purchase, import duties and all costs directly attributable to the acquisition, decreased by discounts. Inventories of merchandise are carried at moving average prices.

Inventories of materials and merchandise are stated at the lower of cost and net realisable value, whereas inventories of finished products at the lower of fixed price and net realisable value.

9. Impairment

Financial assets
A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss in respect of an available-for-sale financial asset is calculated by reference to its current fair value.

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss. Any cumulative loss in respect of an available-for-sale financial asset recognised previously in equity is transferred profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost and available-for-sale financial assets that are debt securities, the reversal is recognised in profit or loss. For available-for-sale financial assets that are equity securities, the reversal is recognised directly in equity.

Non-financial assets
The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised in the previous periods.

10. Provisions

A provision is recognised if, as a result of a past event, the Company has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Provisions for lawsuits
The Company discloses provisions for lawsuits related to alleged patent infringements. Provisions entirely refer to drugs for heart and cardiovascular diseases. Each year the Company verifies the justification of the formed provisions with a view to the litigation status and the prospects for a favourable or unfavourable lawsuit outcome. The amounts of provisions are defined on the basis of the noted amount of the indemnification claim, or on the basis of anticipated potential amount, if the indemnification claim is not yet disclosed.

Provisions for termination pay and anniversary bonuses
Pursuant to the local legislation, the Company is liable to pay to its employees anniversary bonuses and termination pay upon retirement. For these obligations, long-term provisions are formed. There is no other obligation in respect of pension.

Provisions are determined by discounting, at the balance sheet date, the estimated future benefits in respect of termination pays and anniversary bonuses paid to employees in those countries, where this legal obligation exists. The obligation is calculated by estimating the costs of termination pay upon retirement and the costs of all expected anniversary bonuses until retirement. The selected annual discount rate is set at 4.75% and represents the return rate on long-term government bonds. The calculation is performed by a certified actuary. Actuarial gains and losses are recognised in the income statement.

Provisions for ecological improvements and provisions for grants were both already used up and decreased by the depreciation amount.

11. Sales revenues

Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. Transfers of risks and rewards vary depending on the individual terms of the sales contract. Revenue from services rendered is recognised in the income statement in proportion to the stage of completion of the transaction at the balance sheet date. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due, associated costs or the possible return of goods, also continuing managerial involvement with the goods. Revenues from the sale of goods and services rendered are measured at selling prices stated in invoices or other documents, reduced by discounts and rebates approved either when the sale is made or subsequently, including those granted for early payment.

Government grants
Government grants are recognised initially as deferred income when there is reasonable assurance that they will be received and that the Company will comply with the conditions associated with

the grant. Grants that compensate the Company for expenses incurred are recognised in profit or loss on a systematic basis in the same periods in which the expenses are recognised. Grants that compensate the Company for the cost of an asset are recognised in profit or loss on a systematic basis over the useful life of the asset.

12. Financial income and financial expenses

Financial income comprises interest income on funds invested, dividend income, gains on the disposal of available-for-sale financial assets, changes in the fair value of financial assets at fair value through profit or loss, foreign currency gains, and gains on hedging instruments that are recognised in profit or loss. Interest income is recognised as it accrues, using the effective interest method. Dividend income is recognised on the date that the Company's right to receive payment is established, which in the case of quoted securities is the ex-dividend date.

Financial expenses comprise interest expense on borrowings, foreign currency losses, changes in the fair value of financial assets at fair value through profit or loss, impairment losses recognised on financial assets, and losses on hedging instruments that are recognised in profit or loss. All borrowing costs are recognised in profit or loss using the effective interest method.

13. Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity. Also deferred tax on these items is recorded within equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the temporary differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which temporary difference can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

14. Earnings per share (EPS)

The Company presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period. The diluted EPS is not determined, as the Company issued solely ordinary shares.

15. Segment reporting

With respect to the strategic direction of its operations and criteria for the formation of business segments (common therapeutic characteristics of products, marketing and advertising methods and level of risk) the Company distinguishes between following three segments: human health products (prescription pharmaceuticals, OTC products and cosmetics), animal health products and health-resort and tourist services.

Geographical segments, within which we find geographically related countries with a similar level of economic development and purchasing power, as well as similar economic and political characteristics are as follows: the European Union, South-East Europe, Eastern Europe, Central Europe and the remaining Western Europe and overseas markets.

The Company's basic form of reporting bases on geographical segments, which reflect the Company's internal organisation. Certain business functions are entirely or mostly carried out by the parent company that holds the controlling share in terms of sale as well as asset value. The Company boasts of an own strong sales marketing network, with the emphasis on five key markets i.e. Slovenia, the Russian Federation, Croatia, Poland and the Western Europe. Each of these markets is involved in one of the five geographical regions that are specified as geographical segments. In the light thereof the geographical segments are given priority during reporting. Operating results, assets and liabilities by geographical segments include items that may directly be attributable to the segment, as well as items that may reasonably be allocated to the segment.

As for business segments the Company reports solely on the revenue. Within the structure of business segments, the share of human health products represents more than 90% of the Company's sale in terms of value.

16. New standards and interpretations not yet adopted

The list below presents the new standards, amendments to standards and interpretations that are not yet effective for the year ended 31 December 2006, and have thus not been applied in preparing the financial statements:

IFRS 7 Financial Instruments: Disclosures and the Amendment to IAS 1 Presentation of Financial Statements: Capital Disclosures
The standard requires extensive disclosures about the significance of financial instruments for an entity's financial position and performance, and qualitative and quantitative disclosures on the nature and extent of risks. IFRS 7 and amended IAS 1, which become mandatory for the Company's 2007 financial statements, will require extensive additional disclosures with respect to Company's financial instruments and share capital.

IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
addresses the application of IAS 29 when an economy first becomes hyperinflationary and in particular the accounting for deferred tax. IFRIC 7, which becomes mandatory for the Company's 2007 financial statements, is not expected to have any impact on the financial statements.

IFRIC 8 Scope of IFRS 2 Share-based Payment
addresses the accounting for share-based payment transactions in which some or all of goods or services received cannot be specifically identified. IFRIC 8 will become mandatory for the Company's 2007 financial statements, with retrospective application required. The Company has not yet determined the potential effect of the interpretation.

IFRIC 9 Reassessment of Embedded Derivatives
requires that a reassessment of whether embedded derivative should be separated from the underlying host contract should be made only when there are changes to the contract. IFRIC 9, which becomes mandatory for the Company's 2007 financial statements, is not expected to have any impact on the financial statements.

IFRIC 10 Interim Financial Reporting and Impairment
prohibits the reversal of an impairment loss recognised in a previous interim period in respect of goodwill, an investment in an equity instrument or a financial asset carried at cost. IFRIC 10 will become mandatory for the Company's 2007 financial statements, and will apply to goodwill, investments in equity instruments, and financial assets carried at cost prospectively from the date that the Company first applied the measurement criteria of IAS 36 and IAS 39 respectively (i.e., 1 January 2004). The adoption of IFRIC 10 will result in a decrease in deferred tax.

17. Determination of fair values

A number of the Company's accounting policies and disclosures require the determination of fair value, for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the following methods. Where applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

Investments in equity and debt securities
The fair value of financial assets at fair value through profit or loss, held-to-maturity investments and available-for-sale financial assets is determined by reference to their close price as regards foreign securities, or to the average price per share for investments in Slovenian companies, effective at the reporting date.

Trade and other receivables
The fair value of trade and other receivables, excluding construction work in progress, is estimated as the present value of future cash flows, discounted at the market rate of interest at the reporting date.

Derivatives
The fair value of forward exchange contracts is based on their listed market price, if available. If a listed market price is not available, then fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using a risk-free interest rate (based on government bonds).

The fair value of interest rate swaps equals the market price recorded as at the balance sheet date.

Non-derivative financial liabilities
Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

18. Cash flow statement

The cash flow statement has been prepared under the indirect method based upon items from the balance sheet as at 31 December 2006 and 31 December 2005, the income statement for the year that ended 31 December 2006, as well as additional data required for the adjustment of inflows and outflows.

1. Geographical and business segments

Segment information is presented in respect of the Company's business and geographical segments. The primary reporting format is geographical segments, whereby these are presented both by location of customers and by location of assets. A considerable portion of immovable and movable property is located at the Company's headquarters in Slovenia. It must be taken into consideration that the major part of the assets held by the Company in Slovenia are also used for business activities (production, storage, quality control etc.) referring to other geographical segments.

Those items of revenue, expenses, assets, and liabilities that are not directly attributable to reportable segments or cannot be reliably allocated to reportable segments by the application of certain criteria are presented under the item "Unallocated".

Sales revenues by business segments

in thousand SIT	2006	2005
Human health products	134,970,288	111,762,137
– prescription pharmaceuticals	115,667,492	95,973,901
– self-medication products	17,082,484	13,825,788
– cosmetic products	2,220,312	1,962,448
Animal health products	5,323,106	4,602,791
Other	160,152	205,404
Total sales revenues	140,453,546	116,570,332
– thereof sales revenues of services	1,075,694	590,151

Geographical segment reporting

	European Union		South-East Europe		Eastern Europe		The remaining western Europe and overseas markets		Total	
in thousand SIT	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
Sales revenues	71,274,360	62,420,646	23,374,599	20,027,693	42,504,776	31,500,901	3,299,811	2,621,092	140,453,546	116,570,332
Segment's results from operations	20,128,771	16,682,177	7,549,308	6,441,520	11,340,607	5,718,501	755,712	581,135	39,774,398	29,423,333
Other operating income									479,384	11,880,171
Unallocated costs									-5,035,000	-12,502,563
Operating profit									35,218,782	28,800,941
Net financial income/ expenses									68,211	-451,449
Income tax expense									-8,201,153	-5,890,302
Profit for the period									27,085,840	22,459,190
Segment's assets	110,750,230	101,883,833	17,108,507	20,102,116	24,181,182	16,547,055	1,067,290	987,789	153,107,209	139,520,793
Unallocated assets									51,613,954	42,729,772
Total assets									204,721,163	182,250,565
Investments	21,269,176	16,886,249	0	0	15,156	0	0	0	21,284,332	16,886,249
Impairment of receivables and inventories									1,077,227	925,677
Total liabilities									68,146,030	67,798,972

2. Other operating income

in thousand SIT	2006	2005
Reversal of non-current provisions	53,633	11,498,778
Reversal of allowances for receivables	13,661	106,998
Profit from the sale of fixed assets	139,126	106,926
Other operating income	272,964	167,469
Total other operating income	479,384	11,880,171

Utilized non-current provisions for ecological improvements in the amount of 40,543 thousand SIT represent the major item within reversal of non-current provisions, and subsidies granted by the European Bank for Reconstruction and Development (EBRD) for ecological improvements in the amount of 98,837 thousand SIT represent the major item of other operating income.

3. Production cost of goods sold

In 2006, production cost of goods sold indicated an increase of 13.4% compared to the previous year's figures. As for their share among the sales revenues, the production costs decreased from 38.7% in 2005 to 36.4% in 2006. The decrease is a result of a more favourable product mix of goods sold as well as stronger cost efficiency due to the better productivity (contemporary technological procedures, an improved utilisation level of production capacities).

4. Sales and marketing

Sales and marketing expenses comprise the costs of the domestic and foreign marketing sales network, as well as provisions formed for lawsuits, which has caused an irregular increase of these costs in individual periods. In the reporting period, the sales and marketing expenses were lower by 8.4% than in 2005. The decrease was due to the fact that the 2005 figures included 12,502,563 thousand SIT of newly formed provisions for the lawsuit relating to drugs for heart and cardiovascular diseases, whereas the total amount of provisions formed for lawsuits in 2006 was 5,035,000 thousand SIT. Sales and marketing expenses have increased 20%, provided that provisions are not taken into account.

5. R&D costs

All R&D costs recorded are charged against the income statement of 2006, since research and development costs are not capitalised. Compared to 2005, the relevant costs increased by 30.8% and accounted for 8.8% of the total sales revenues.

6. Administrative expenses

Compared to 2005, administrative expenses increased by 0.6%, and its share in the structure of sales revenues implies a decrease from 8.6% in 2005 to 7.2% in 2006. The item of administrative expenses encompasses also other operating expenses (refer to Note 9).

7. Costs in terms of type

in thousand SIT	2006	2005
Cost of goods and materials	33,694,542	33,574,525
Cost of services	23,850,222	18,599,374
Employee benefits expense	30,347,888	28,097,832
Depreciation	8,673,366	8,378,686
Provisions formed for lawsuits	5,035,000	12,502,563
Provisions formed for termination pay and anniversary bonuses	867,544	559,364
Other operating expenses	2,868,525	2,743,836
Total costs in terms of type	105,337,087	104,456,180
Changes in the value of inventories	-377,061	4,806,618
Total	105,714,148	99,649,562

8. Employee benefits cost

in thousand SIT	2006	2005
Gross wages and salaries and continued pay	23,855,480	21,541,753
Social security contributions and payroll tax	5,215,368	5,333,490
Other employee benefits cost	1,277,040	1,222,589
Total	30,347,888	28,097,832

Other employee benefits cost in the reporting period include the vacation bonus, travel allowances, meal allowance and some other repayments to employees.

Compulsory pension and disability insurance (comprising both the employee's and the employer's contribution) payable in 2006 amounted to 5,725,315 thousand SIT and additional pension insurance amounted to 698,548 thousand SIT.

9. Other operating expenses

in thousand SIT	2006	2005
Grants, assistance	497,991	491,257
Environmental levies	316,000	306,305
Fiscal charges irrespective of operating results	344,505	258,283
Loss in the sale of fixed assets	220,158	198,452
Impairments and inventory write-offs	919,056	537,672
Impairments and receivable write-offs	158,171	388,005
Other costs	412,644	563,862
Total	2,868,525	2,743,836

10. Financial income and financial expenses

in thousand SIT	2006	2005
Exchange differences	1,034,720	3,011,958
Interest income	215,661	133,707
Change in fair value of investments (through profit or loss)	396,828	19,159
Gain on the sale of securities	259,212	64,744
Income from derivative financial instruments	1,101,095	27,726
Dividend income	533,951	25,886
Total financial income	3,541,467	3,283,180
Exchange differences	2,397,369	1,240,989
Interest paid	728,166	634,050
Impairments due to remeasurement of investments at fair value	131,779	39,748
Loss recorded in subsidiaries and covering of loss from previous periods	0	1,150,399
Expense from derivative financial instruments	180,508	589,690
Other expenses	35,434	79,753
Total financial expenses	3,473,256	3,734,629
Net financial income / expenses	68,211	-451,449

11. Income tax expense

in thousand SIT	2006	2005
Actual income tax	9,764,717	9,315,564
Deferred tax	-1,563,564	-3,425,262
Total	8,201,153	5,890,302
Profit before tax	35,286,993	28,349,492
Income tax calculated using the 25-percent tax rate	8,821,748	7,087,373
Non-deductible expenses	795,971	1,227,238
Tax incentives	-1,308,985	-1,140,676
Tax exempt revenues	-185,322	-750,533
Other items	77,741	-533,100
Total	8,201,153	5,890,302

12. Deferred tax assets and deferred tax liabilities

	Assets		Liabilities		Assets – Liabilities	
in thousand SIT	2006	2005	2006	2005	2006	2005
Investments	39,522	66,818	249,098	265,879	-209,576	-199,061
Receivables	95,815	96,275	0	0	95,815	96,275
Inventories	143,297	117,661	0	0	143,297	117,661
Provisions for lawsuits	4,033,639	3,125,641	0	0	4,033,639	3,125,641
Provisions for termination pay	2,313,196	326,466	0	0	2,313,196	326,466
Tax effects of the transition and adjustment to IFRS	0	0	698,367	0	-698,367	0
Total	6,625,469	3,732,861	947,465	265,879	5,678,004	3,466,982

in thousand SIT	Assets – Liabilities		Through profit and loss		Through equity	
	2006	2005	2006	2005	2006	2005
Investments	-209,576	-199,061	39,521	79,125	-249,097	-278,186
Receivables	95,815	96,275	23,161	96,275	72,654	319,906
Inventories	143,297	117,661	143,297	117,661	0	0
Provisions for lawsuits	4,033,639	3,125,641	1,158,050	3,125,641	2,875,589	0
Provisions for termination pay	2,313,196	326,466	199,535	6,560	2,113,661	0
Tax effects of the transition and adjustment to IFRS	-698,367	0	0	0	-698,367	0
Total	5,678,004	3,466,982	1,563,564	3,425,262	4,114,440	41,720

13. Property, plant and equipment

in thousand SIT	31 Dec 2006	31 Dec 2005
Property	3,151,927	2,908,502
Plant	40,447,172	33,547,973
Equipment	33,892,425	27,204,490
PPE under construction	12,958,723	14,442,886
- advances for PPE	1,188,372	594,677
Total property, plant and equipment	90,450,247	78,103,851

Movements of property, plant and equipment in 2006

in thousand SIT	Property	Plant	Equipment	PPE under construction	Advances for PPE	Total
Cost at 01 Jan 2006	2,908,502	59,066,622	76,133,775	13,848,209	594,677	152,551,785
Additions	0	0	0	19,736,577	593,695	20,330,272
Capitalisation - transfer from PPE under construction	257,111	9,515,690	12,015,620	-21,788,421	0	0
Disposals, deficits, surpluses	-13,686	-300,362	-1,954,050	0	0	-2,268,098
Transfer to intangible assets	0	-45,201	43,096	0	0	-2,105
Cost at 31 Dec 2006	3,151,927	68,236,749	86,238,441	11,796,365	1,188,372	170,611,854
Accumulated depreciation at 01 Jan 2006	0	25,518,649	48,929,285	0	0	74,447,934
Depreciation	0	2,504,271	5,132,261	0	0	7,636,532
Capitalisation - prolongation of useful life	0	0	-26,014	26,014	0	0
Disposals, deficits, surpluses	0	-232,910	-1,687,844	0	0	-1,920,754
Transfer to intangible assets	0	-433	-1,672	0	0	-2,105
Accumulated depreciation at 31 Dec 2006	0	27,789,577	52,346,016	26,014	0	80,161,607
Carrying amount at 01 Jan 2006	2,908,502	33,547,973	27,204,490	13,848,209	594,677	78,103,851
Carrying amount at 31 Dec 2006	3,151,927	40,447,172	33,892,425	11,770,351	1,188,372	90,450,247

Movements of property, plant and equipment in 2005

in thousand SIT	Property	Plant	Equipment	PPE under construction	Advances for PPE	Total
Cost at 01 Jan 2005	2,775,096	58,334,764	72,501,301	6,563,124	1,356,002	141,530,287
Additions	0	0	0	15,032,686	-761,325	14,271,361
Capitalisation – transfer from PPE under construction	133,406	962,753	6,641,538	-7,737,697	0	0
Disposals, deficits, surpluses	0	-229,232	-3,015,715	-3,865	0	-3,248,812
Transfer to intangible assets	0	-1,663	6,651	0	0	4,988
Cost at 31 Dec 2005	2,908,502	59,066,622	76,133,775	13,854,248	594,677	152,557,824
Accumulated depreciation at 01 Jan 2005	0	23,168,361	46,834,163	0	0	70,002,524
Depreciation	0	2,430,101	5,055,406	0	0	7,485,507
Capitalisation – prolongation of useful life	0	0	-6,039	6,039	0	0
Disposals, deficits, surpluses	0	-79,054	-2,955,714	0	0	-3,034,768
Transfer to intangible assets	0	-759	1,469	0	0	710
Accumulated depreciation at 31 Dec 2005	0	25,518,649	48,929,285	6,039	0	74,453,973
Carrying amount at 01 Jan 2005	2,775,096	35,166,403	25,667,138	6,563,124	1,356,002	71,527,763
Carrying amount at 31 Dec 2005	2,908,502	33,547,973	27,204,490	13,848,209	594,677	78,103,851

Expenses for property, plant and equipment presented in the cash flow statement differ from those stated in the schedule of movement by the amount of difference that occurs between the opening and the closing balance of trade payables.

14. Intangible assets

in thousand SIT	31 Dec 2006	31 Dec 2005
R&D cost	627,239	530,924
Long-term property rights	3,769,563	3,532,260
Intangible assets under construction	971,190	834,560
Total intangible assets	5,367,992	4,897,744

The most significant share in the structure of the Company's intangible assets refers to the purchase of new software, namely for the Synthesis 4 (273,675 thousand SIT), for handling of registration documentation (121,389 thousand SIT) and the upgrading of the SAP software (84,557 thousand SIT).

Intangible assets under construction comprise payments for the registration documentation as regards new drugs.

Movements of intangible assets in 2006

in thousand SIT	R&D cost	Long-term property rights	IA under construction	Total
Cost at 01 Jan 2006	1,207,826	4,894,268	834,560	6,936,654
Additions	0	2	1,547,753	1,547,755
Transfer from IA under construction	417,108	994,015	-1,411,123	0
Disposals	-40,630	-43	0	-40,673
Transfers to property, plant and equipment	0	2,105	0	2,105
Cost at 31 Dec 2006	1,584,304	5,890,347	971,190	8,445,841
Accumulated amortisation at 01 Jan 2006	676,902	1,362,008	0	2,038,910
Amortisation	280,163	756,671	0	1,036,834
Transfers to property, plant and equipment	0	2,105	0	2,105
Accumulated amortisation at 31 Dec 2006	957,065	2,120,784	0	3,077,849
Carrying amount at 01 Jan 2006	530,924	3,532,260	834,560	4,897,744
Carrying amount at 31 Dec 2006	627,239	3,769,563	971,190	5,367,992

Movements of intangible assets in 2005

in thousand SIT	R&D cost	Long-term property rights	IA under construction	Total
Cost at 01 Jan 2005	1,021,035	3,756,181	350,297	5,127,513
Additions	0	67	1,853,496	1,853,563
Transfer from IA under construction	212,156	1,157,077	-1,369,233	0
Disposals	-25,365	-14,069	0	-39,434
Transfers to property, plant and equipment	0	-4,988	0	-4,988
Cost at 31 Dec 2005	1,207,826	4,894,268	834,560	6,936,654
Accumulated amortisation at 01 Jan 2005	507,706	672,221	0	1,179,927
Amortisation	194,561	698,618	0	893,179
Disposals	-25,365	-8,121	0	-33,486
Transfers to property, plant and equipment	0	-710	0	-710
Accumulated amortisation at 31 Dec 2005	676,902	1,362,008	0	2,038,910
Carrying amount at 01 Jan 2005	513,329	3,083,960	350,297	3,947,586
Carrying amount at 31 Dec 2005	530,924	3,532,260	834,560	4,897,744

15. Investments in subsidiaries

Movements of investments in subsidiaries in 2006

in thousand SIT	Investments in subsidiaries
Cost at 01 Jan 2006	27,561,602
Capital increase	1,557,817
Balance at 31 Dec 2006	29,119,419
Carrying amount at 01 Jan 2006	27,561,602
Carrying amount at 31 Dec 2006	29,119,419

Movements of investments in subsidiaries in 2005

in thousand SIT	Investments in subsidiaries
Cost at 01 Jan 2005	25,178,132
Capital increase, share purchase	2,383,470
Balance at 31 Dec 2005	27,561,602
Carrying amount at 01 Jan 2005	25,178,132
Carrying amount at 31 Dec 2005	27,561,602

Interests in subsidiaries

	Share in equity	Share capital	Value of share	
in thousand SIT	31 Dec 2006	31 Dec 2006	31 Dec 2006	31 Dec 2005
TERME KRKA, d. o. o., Novo mesto, Slovenia**	100%	3,535,466	10,881,283	10,881,283
"KRKA-FARMA" d. o. o. Novi Sad, Serbia	100%	363	10,069	10,069
KRKA-FARMA, d. o. o., Zagreb, Croatia	100%	4,668,036	4,729,973	3,614,230
KRKA-FARMA DOOEL, Skopje, Macedonia	100%	191,479	192,272	192,272
OOO "KRKA-RUS", Istra, Russian Federation	100%	7,677,155	7,912,581	7,912,087
OOO "KRKA FARMA", Sergiev Posad, Russian Federation	100%	26,766	117,806	118,300
KRKA-Polska, Sp. z o. o., Warsaw, Poland	100%	1,094,764	4,480,527	4,480,527
KRKA Magyarország Kft, Budapest, Hungary	100%	12,000	452,715	10,641
KRKA ČR, s. r. o., Prague, Czech Republic*	100%	872	826	826
KRKA Pharma Dublin Limited, Dublin, Ireland	100%	240	240	240
KRKA Sverige AB, Stockholm, Sweden	100%	3,975	198,283	198,283
KRKA Aussenhandels GmbH, Munich, Germany*	100%	61,263	96,719	96,719
HELVETIUS-S. R. L., Trieste, Italy***	80%	12,365	46,125	46,125
Total			29,119,419	27,561,602

* companies, where no operations are carried out
** inclusive of Terme Krka – Strunjan
*** company in the process of dissolution

In 2006, increase of capital stock was carried out in the following companies: Krka-Farma, Zagreb (1,115,743 thousand SIT) and Krka Magyarorszag, Budapest (442,073 thousand SIT).

16. Long-term loans

in thousand SIT	31 Dec 2006	31 Dec 2005
Long-term loans to subsidiaries	454,829	506,074
Long-term loans to other entities	820,931	858,695
Total long-term loans	1,275,760	1,364,769

Long-term loans granted to subsidiaries

The Company extended a loan (denominated in US Dollars) to the company Krka-Rus, Istra for resuming investment projects and for financing current operations. The repayment of the loan is to begin in 2008. The Company extended no new loans in the reporting period.

Long-term loans to other entities

In conformity with internal acts the Company extends long-term loans to its employees. These loans are mainly used for housing, scholarship, and for moving abroad. Loans bear the annual interest rate, which equals the contractually agreed rate set by the Minister of Finance in

Movements of long-term loans in 2006

in thousand SIT	Long-term loans to subsidiaries	Long-term loans to other entities	Total
Cost at 01 Jan 2006	506,074	872,709	1,378,783
New loans	0	373,013	373,013
Repayments	0	-413,819	-413,819
Exchange differences	-51,245	583	-50,662
Cost at 31 Dec 2006	454,829	832,486	1,287,315
Value adjustment at 01 Jan 2006	0	14,014	14,014
Decrease (write-off)	0	-2,459	-2,459
Value adjustment at 31 Dec 2006	0	11,555	11,555
Carrying amount at 01 Jan 2006	506,074	858,695	1,364,769
Carrying amount at 31 Dec 2006	454,829	820,931	1,275,760

Movements of long-term loans in 2005

in thousand SIT	Long-term loans to subsidiaries	Long-term loans to other entities	Total
Cost at 31 Dec 2004	129,424	915,676	1,045,100
Correction of an error upon transition to IFRS	310,966	0	310,966
Cost at 01 Jan 2005	440,390	915,676	1,356,066
New loans	198,938	289,678	488,616
Repayments	-199,122	-334,319	-533,441
Exchange differences	65,868	1,674	67,542
Cost at 31 Dec 2005	506,074	872,709	1,378,783
Value adjustment at 01 Jan 2005	0	16,884	16,884
Increase	0	91	91
Decrease (write-off)	0	-2,961	-2,961
Value adjustment at 31 Dec 2005	0	14,014	14,014
Carrying amount at 01 Jan 2005	440,390	898,792	1,339,182
Carrying amount at 31 Dec 2005	506,074	858,695	1,364,769

accordance with the Corporate Income Tax Act that defines the interest rate for related parties. In 2006, the interest rate ranged between 3.72% and 4.25%. The repayment period must not exceed 15 years.

Upon transition to IFRS, the Company started to apply the cost method for the valuation of investments in subsidiaries; previously, they had been accounted for using the equity method. An error occurred in the amount referring to the investment in Krka Pharma Dublin: by mistake, an impairment of a loan granted by the parent company to the subsidiary for the loss recorded in the periods until 2004 had been carried out. Pursuant to IAS 8, an adjustment of the opening balance of the comparable period was made (310,966 thousand SIT). The effect of the adjustment was recorded in retained earnings.

17. Other non-current investments

in thousand SIT	31 Dec 2006	31 Dec 2005
Financial assets available-for-sale	1,502,246	1,167,910
Other non-current investments	62,391	62,391
Total other non-current investments	1,564,637	1,230,301

Other non-current investments include items of historical and cultural value.

Movements of non-current investments in 2006

in thousand SIT	Financial assets available for sale	Other non-current investments	Total
Cost at 01 Jan 2006	1,175,612	62,391	1,238,003
Increase	313	0	313
Change in fair value	334,023	0	334,023
Balance at 31 Dec 2006	1,509,948	62,391	1,572,339
Value adjustment at 01 Jan 2006	7,702	0	7,702
Balance at 31 Dec 2006	7,702	0	7,702
Carrying amount at 01 Jan 2006	1,167,910	62,391	1,230,301
Carrying amount at 31 Dec 2006	1,502,246	62,391	1,564,637

Movements of non-current investments in 2005

in thousand SIT	Financial assets available for sale	Other non-current investments	Total
Cost at 01 Jan 2005	1,119,723	62,391	1,182,114
Purchase	313	0	313
Change in fair value	55,576	0	55,576
Balance at 31 Dec 2005	1,175,612	62,391	1,238,003
Value adjustment at 01 Jan 2005	7,595	0	7,595
Increase	107	0	107
Balance at 31 Dec 2005	7,702	0	7,702
Carrying amount at 01 Jan 2005	1,112,128	62,391	1,174,519
Carrying amount at 31 Dec 2005	1,167,910	62,391	1,230,301

18. Other non-current assets

Other non-current assets include collaterals given in connection with representations abroad (40,393 thousand SIT) and payments made for the reserve housing fund (2,162 thousand SIT).

19. Inventories

in thousand SIT	31 Dec 2006	31 Dec 2005
Material	7,540,200	9,510,900
Work in progress	6,097,503	4,929,239
Products	9,766,303	11,812,302
Merchandise	432,193	630,146
Advances	3,236	588
Total inventories	23,839,435	26,883,175

In the reporting period the Company carried out an impairment of inventories (152,325 thousand SIT) and a write-off of inventories amounting to 766,731 thousand SIT. In 2005 the impairment amounted to 67,028 thousand SIT whereas the write-off to 470,644 thousand SIT.

20. Receivables

in thousand SIT	31 Dec 2006	31 Dec 2005
Short-term receivables due from subsidiaries	20,196,443	15,314,474
Trade receivables	15,548,263	16,907,748
Receivables due from other entities	1,994,848	1,552,776
Total receivables	37,739,554	33,774,998

Short-term receivables due from subsidiaries

in thousand SIT	31 Dec 2006	31 Dec 2005
KRKA-FARMA d. o. o., Zagreb, Croatia	7,168,636	6,891,748
"KRKA-FARMA" d. o. o. Novi Sad, Serbia	739,863	607,187
KRKA-FARMA DOOEL, Skopje, Macedonia	504,906	1,281,080
OOO "KRKA-RUS", Istra, Russian Federation	2,105,807	248,094
OOO "KRKA FARMA", Sergiev posad, Russian Federation	3,956,068	1,348,038
KRKA-POLSKA, Sp. z o. o., Warsaw, Poland	5,225,712	4,488,802
KRKA Sverige AB, Stockholm, Sweden	491,214	442,509
Operating receivables due from other Group companies	4,237	7,015
Total short-term receivables due from subsidiaries	20,196,443	15,314,473

Trade receivables

in thousand SIT	Gross value	Allowances for doubtful and disputable receivables	Net value at 31 Dec 2006	Net value at 31 Dec 2005
Domestic customers	2,654,328	29,758	2,624,570	2,802,781
Foreign customers	13,427,976	504,283	12,923,693	14,104,967
Total trade receivables	16,082,304	534,041	15,548,263	16,907,748

Trade receivables are not secured. As at 31 December 2006 the ageing structure of trade receivables is as follows: 98% of receivables are past due by six months (including undue receivables), 0.2% of receivables are past due from six months to one year, and 1.8% of receivables are past due for over a year.

In 2006 allowances for receivables were charged against the income statement in the amount of 158,171 thousand SIT (2005: 388,005 thousand SIT).

Receivables due from other entities

Receivables due from other entities in the amount of 1,994,848 thousand SIT refer mostly to receivables arising from VAT refund.

21. Current investments

in thousand SIT	31 Dec 2006	31 Dec 2005
Current investments	5,420,099	3,068,998
– instruments held for trading	2,849,357	1,524,869
– Interest-bearing current investments	820,560	665,431
– other current investments	1,750,182	878,698
Short-term loans	2,198,023	864,670
– short-term loans to subsidiaries	1,952,500	672,111
– short-term loans to other entities	245,523	192,559
Total current investments	7,618,122	3,933,668

The major items of instruments held for trading refers to shares issued by foreign companies (2,200,563 thousand SIT), marketable shares (372,045 thousand SIT) and non-marketable shares (3,917 thousand SIT).

Interest-bearing current investments comprise government bonds (719,973 thousand SIT), and deposit certificates (100,587 thousand SIT). All interest-bearing current investments bear the fixed interest rate (2005: 83%) and none the variable interest rate (2005: 17%).

Most of other current investments refer to mutual funds (domestic and foreign) in the amount of 1,158,389 thousand SIT and managed funds in the amount of 216,902 thousand SIT.

Short-term loans to subsidiaries include a short-term loan to Terme Krka in the amount of 1,636,000 thousand SIT, a loan to the subsidiary Krka-Rus in the amount of 181,931 thousand SIT, as well as interest on loans to subsidiaries in the amount of 134,569 thousand SIT.

92% of short-term loans bear the fixed interest rate (2005: 100%) and 8% (2005: 0%) of short-term loans the variable interest rate.

22. Cash and cash equivalents

in thousand SIT	31 Dec 2006	31 Dec 2005
Cash in hand	16,695	11,352
Bank balances	1,061,278	747,416
Total cash and cah equivalents	1,077,973	758,768

23. Equity

in thousand SIT	31 Dec 2006	31 Dec 2005
Share capital	14,170,448	14,170,448
Own shares	-4,670,280	-4,670,280
Reserves	35,385,325	34,885,325
– share premium	28,993,129	28,993,129
– legal reserves	3,592,196	3,592,196
– statutory reserves	2,800,000	2,300,000
Retained earnings	90,855,702	69,504,498
Fair value reserves	833,938	561,602
Total equity	136,575,133	114,451,593

Share capital

Share capital of the Company consists of 3,542,612 ordinary registered shares at par value of 4,000 SIT. There is solely one class of shares, whereas the first and only issue of shares was carried out in 1995.

Own shares

As of the balance sheet date the Company recorded 162,662 own shares amounting to 650,648 thousand SIT, i.e. 4.6% of the share capital value. The number of shares in this reporting period remained unchanged if compared to 2005.

Reserves

The Company's reserves comprise the share premium, legal and statutory reserves. None of the aforesaid reserve may be used for payout of dividends and other equity interests. With respect to legal possibilities, the Company increased reserves in the reporting period by 500,000 thousand SIT of additionally formed statutory reserves.

Retained earnings

Retained earnings of the Company are increased by the profit for the period amounting to 27,085,840 thousand SIT and the net income recognised directly in equity (396,650 thousand SIT). The latter include the surplus of deferred tax assets over deferred tax liabilities (329,911 thousand SIT) as well as the refunded default interest that had been overcharged by the tax office (66,739 thousand SIT). The decrease, on the other hand, is a result of statutory reserves (500,000 thousand SIT) additionally formed pursuant to the resolution adopted by the Company's management, and the dividend payout (5,631,286 thousand SIT) as confirmed by the 11th annual meeting held on 6 July 2006. The amount of the dividend payout, shown in the cash flow statement, differs from the figure, confirmed by the annual meeting and included in the statement of changes in equity, by the amount of change between the opening and closing balance of liabilities for dividend payout.

Fair value reserves

Fair value reserves record an increase of 272,336 thousand SIT, i.e. amount of the revaluation of non-current investments to market price.

Statement of recognised income and expense

in thousand SIT	31 Dec 2006	31 Dec 2005
Deferred taxes	709,458	-799,015
Tax effects of the transition and adjustment to IFRS	-379,547	0
Refund of default interest paid in respect of taxes	66,739	87,663
Total recognised income and expense for the period	396,650	-711,352

Accumulated profit

in thousand SIT	2006	2005*
Compulsory appropriation of net profit		
Net profit for the period	27,085,840	21,580,823
– to cover the loss from previous periods	0	0
– allocation to legal reserves	0	0
– allocation to reserves for own shares	0	0
– allocation to statutory reserves	500,000	800,000
Net profit after compulsory appropriation	26,585,840	20,780,823
– formation of other income reserves pursuant to a decision adopted by the Management Board and Supervisory Board	4,800,000	6,500,000
Surplus of net profit	21,785,840	14,280,823
Identification of accumulated profit		
– surplus of net profit	21,785,840	14,280,823
– retained earnings from previous periods	2,978,037	5,974,464
Accumulated profit	24,763,877	20,255,287

* The accumulated profit for 2005, whose appropriation was decided upon at the annual meeting, was established on the basis of the financial statements prepared in compliance with Slovenian Accounting Standards.

24. Earnings per share

Earnings per share amount to 8,013.68 SIT and show an increase of 21% compared to the previous year's result (2005: 6,644.83 SIT). The calculation for both years bases upon the equity interest of the majority stockholder and 3,379,950 shares, whereas 162,662 own shares were not taken into account. All shares issued by the Company are ordinary shares, hence the diluted earnings per share ratio was not calculated.

25. Borrowings

in thousand SIT	31 Dec 2006	31 Dec 2005
Long-term borrowings	6,983,844	10,011,560
– borrowings from domestic banks	6,983,844	9,973,126
– borrowings from other entities	0	38,434
Short-term borrowings	11,120,221	8,352,968
– borrowings from domestic banks	5,602,783	4,846,617
– borrowings from foreign banks	2,817,265	979,945
– borrowings from other entities	2,700,173	2,526,406
Interest payable	167,947	142,062
Total borrowings	18,272,012	18,506,590

Movement of long-term borrowings

in thousand SIT	Long-term borrowings from banks	Long-term borrowings from other entities	Total
Balance at 01 Jan 2005	13,699,841	86,702	13,786,543
Repayments	-1,447,507	-49,745	-1,497,252
Balance of transfer at 01 Jan 2005	1,426,068	49,421	1,475,489
Transfer to current liabilities at 31 Dec 2005	-4,101,618	-50,938	-4,152,556
Exchange differences	396,342	2,994	399,336
Balance at 31 Dec 2005	9,973,126	38,434	10,011,560
Repayments	-4,043,925	-49,983	-4,093,908
Balance of transfer at 01 Jan 2006	4,101,618	50,938	4,152,556
Transfer to current liabilities at 31 Dec 2006	-2,817,265	-39,389	-2,856,654
Exchange differences	-229,710	0	-229,710
Balance at 31 Dec 2006	6,983,844	0	6,983,844

Long-term borrowings are denominated in euro and US dollar and were extended by three domestic banks for the period of up to 7 years. The borrowings were raised for financing the investments in current assets. The Company raised no new long-term borrowing in the reporting period.

Long-term borrowings obtained from banks are neither secured by mortgages nor by bank guarantees. The Company issued bills of exchange for the borrowings which are pursuant to IFRS 4 considered as Insurance Contracts and treated as contingent liabilities (refer to Note 30). The Company hedged three long-term borrowings that are considered to form the major part of the borrowed amount by using interest rate swaps.

Movement of short-term borrowings

in thousand SIT	Short-term borrowings from banks	Short-term borrowings from other entities	Total
Balance at 01 Jan 2005	1,426,068	3,009,395	4,435,463
New borrowings	21,655,761	2,838,964	24,494,725
Repayments	-21,356,885	-3,372,891	-24,729,776
Transfer from non-current liabilities	4,101,618	50,938	4,152,556
Balance at 31 Dec 2005	5,826,562	2,526,406	8,352,968
New borrowings	35,772,467	706,137	36,478,604
Repayments	-35,998,693	-571,759	-36,570,452
Transfer from non-current liabilities	2,817,265	39,389	2,856,654
Exchange differences	2,447	0	2,447
Balance at 31 Dec 2006	8,420,048	2,700,173	11,120,221

The balance of short-term borrowings include repayments of a long-term bank loan which matured in 2006 (2,817,265 thousand SIT).

The short-term borrowings are denominated in Slovenian tolars for a period of one to six months; some of them were taken on for an indefinite period or at call. The borrowings are not secured.

26. Provisions

in thousand SIT	Balance at 31 Dec 2005	Formation	Utilisation and reversal	Balance at 31 Dec 2006
Provisions for termination pay and anniversary bonuses	9,752,747	867,544	562,916	10,057,375
Other provisions	12,940,163	5,035,002	41,138	17,934,027
- provisions for lawsuits	12,820,158	5,035,000	552	17,854,606
- provisions for ecological restoration	119,937	0	40,543	79,394
- other provisions	68	2	43	27
Total provisions	22,692,910	5,902,546	604,054	27,991,402

The amounts of provisions for lawsuits referring to intellectual property are defined on the basis of the noted amount of the indemnification claim, or on the basis of anticipated potential amount, if the indemnification claim is not yet disclosed. External advisors for litigations referring to intellectual property are engaged for defining the anticipated potential amounts. Furthermore, the management verifies the justification of the formed provisions with a view to the prospects for a favourable or unfavourable lawsuit outcome every year. The Company formed additional provisions for lawsuits in the amount of 5,035,000 thousand SIT which refers to the alleged patent infringements in connection with atorvastatin. As for the income statement, the newly formed and utilised provisions are included among other operating expenses or other operating income.

Provisions for payables to employees are based on a calculation performed by a certified actuary, whereby a discount rate of 4.75% p.a. (that grounds on the profitability of 10-year corporate bonds of high credit rating in the euro-zone), as well as certain estimates and assumptions were made regarding the amount of termination pay and anniversary bonuses, age structure of employees, employee turnover, etc. The estimates and the assumptions that have been applied are based on the actual state of affairs during the preparation of the calculation of the actuary. The calculation applied the projected unit method. No material discrepancies from the assumptions applied may be expected in the near future.

27. Grants received

in thousand SIT	Balance at 31 Dec 2005	Formation	Utilisation and reversal	Balance at 31 Dec 2006
Grants for the subsidiary Krka-Rus	4,572	0	2,285	2,287
Grants for the plant BETA in Šentjernej	83,033	0	10,600	72,433
Grants by the European Regional Development Fund	0	6,420	160	6,260
Free receipt of fixed assets	0	26,527	0	26,526
Total grants received	87,605	32,947	13,045	107,506

The recorded amounts of grants received are decreased by the proportionate share of depreciation of assets to which the grants refer to.

28. Trade payables

in thousand SIT	31 Dec 2006	31 Dec 2005
Payables to subsidiaries	401,955	157,079
Payables to domestic suppliers	7,826,024	6,593,827
Payables to foreign suppliers	5,185,963	5,508,753
Payables from advances	78,841	454,204
Total trade payables	13,492,783	12,713,863

PAYABLES TO SUBSIDIARIES

in thousand SIT	31 Dec 2006	31 Dec 2005
TERME KRKA, d. o. o., Novo mesto, Slovenia	20,324	25,899
KRKA-FARMA d. o. o., Zagreb, Croatia	65,028	0
"KRKA-FARMA" d. o. o. Novi Sad, Serbia	0	477
KRKA-POLSKA, Sp. z o. o., Warsaw, Poland	62,540	52,067
KRKA Magyarország Kft, Budapest, Hungary	123,985	0
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	129,762	79,735
KRKA Sverige AB, Stockholm, Sweden	316	176
Helvetius-S. R. L.,Trieste, Italy	0	-1,275
Total payables to subsidiaries	401,955	157,079

29. Other current liabilities

in thousand SIT	31 Dec 2006	31 Dec 2005
Accrued contractual discounts on products sold to subsidiaries	126,580	258,748
Accrued contractual discounts on products sold to other customers	1,777,280	3,307,117
Payables to employees – gross wages, other charges	3,667,675	3,027,437
Liabilities in connection with derivative financial instruments	0	234,840
Other	158,328	105,050
Total other current liabilities	5,729,863	6,933,192

30. Contingent liabilities

in thousand SIT	31 Dec 2006	31 Dec 2005
Bills issued in connection with loans	9,840,498	14,164,115
Guarantees issued to Group companies in connection with loans	14,824	1,917,521
Other guarantees issued	248,386	252,280
Other	539,289	362,579
Total contigent liabilites	10,642,997	16,696,495

31. Financial instruments

Long-term stability of the Company's performance is managed by means of active risk management policies as presented in detail under 'Hedging'. Due to the high amount of international import and export business, the Company is primarily exposed to foreign exchange and interest rate risks, as well as to credit risks. Derivative financial instruments are used for hedging the Company's exposure against foreign exchange and interest rate risks.

Credit risk

Credit risk is hedged by the assessment of the customers' credit rating as well as by debt collection procedures. No major debt write-offs due to customers' failures of payments were recorded in 2006.

Interest rate risk

In 2004, three non-current loans (two of them denominated in US dollars, one in euros) were hedged by using interest rate swaps. No further hedging instruments were applied in 2005 and 2006. As at 31 December 2006, the contract value of the hedged item amounted to 9,389,169 thousand SIT, and the Company's interest rate swaps recorded at fair value amounted to 173,353 thousand SIT.

A detailed schedule of long-term and short-term borrowings is presented below.

Long-term borrowings

in thousand SIT	31 Dec 2006	31 Dec 2005
Long-term borrowings	9,840,498	14,164,116
– short-term portion of long-term borrowings	2,856,654	4,152,556
Average balance of long-term borrowings	12,002,307	14,713,074
Interest paid (financial year)	437,641	464,981
Other cost of long-term borrowings	0	0
Average cost of long-term borrowings (financial year)	3.6%	3.2%
Contracted to mature in three years or less	20%	69%
Contracted to mature in more than three years	80%	31%
Currency structure of long-term borrowings:		
– US dollar	16%	21%
– Euro	84%	78%
– Slovenian tolar	0%	1%
Structure of long-term borrowings in terms of interest rates:		
– Variable interest rate	100%	100%
– Fixed interest rate	0%	0%

Short-term borrowings

in thousand SIT	31 Dec 2006	31 Dec 2005
Short-term borrowings, including short-term portion of long-term loans, thereof:	11,120,221	8,352,968
- borrowings from banks	8,420,048	5,826,562
- borrowings from other entities	2,700,173	2,526,406
Short-term borrowings	8,263,567	4,342,474
Average balance of short-term borrowings	6,321,990	3,747,940
Interest paid (financial year)	288,995	169,069
Other costs of raising long-term borrowings	734	1,253
Average cost of short-term borrowings (financial year)	4.6%	4.5%
Currency structure of short-term borrowings:		
- Euro	67%	43%
- SIT	33%	57%
Interest rate structure of short-term borrowings		
- Variable interest rate	68%	41%
- Fixed interest rate	32%	59%

Foreign currency risk

Currency options (i.e. range forwards) and futures are used to hedge against foreign currency risks. The contract value of both derivative financial instruments as at 31 December 2006 amounted to 11,279,660 thousand SIT, and the fair value recorded in the Balance Sheet as at 31 December 2006 is 201,539 thousand SIT.

Liquidity risk

Due to an accurate planning of cash flows and short-term credit lines that were agreed with the banks in advance, the liquidity risk was low in 2006.

Sensitivity analysis

The lowering imbalances in currency positions resulting from the improved structure of the Company's import and export activities, the growing ratio of transactions performed in euros, as well as the hedging instruments have contributed to a lower impact of exchange currency changes upon the Company's financial results. We believe that any considerable future changes in exchange rates will not have a significant impact on the Company's financial results. Due to a relatively low indebtedness and hedging instruments enacted in the past, the same applies to any considerable changes in interest rates that may occur in the future.

Fair value

in thousand SIT	2006		2005	
	Carrying amount	Fair value	Carrying amount	Fair value
Non-current investments	2,840,397	2,840,397	2,595,070	2,595,070
– interests and shares	1,502,246	1,502,246	1,167,910	1,167,910
– other non-current investments	62,391	62,391	62,391	62,391
– long-term loans granted	1,275,760	1,275,760	1,364,769	1,364,769
Current investments	7,618,122	7,618,122	3,933,668	3,933,668
– instruments held for trading	2,849,357	2,849,357	1,524,869	1,524,869
– interest-bearing current investments	820,560	820,560	665,431	665,431
– other current investments	1,750,182	1,750,182	878,698	878,698
– short-term loans granted	2,198,023	2,198,023	864,670	864,670
Trade and other receivables	37,739,554	37,739,554	33,774,998	33,774,998
Cash and cash equivalents	1,077,973	1,077,973	758,768	758,768
Interest bearing derivatives	173,353	173,353	58,491	58,491
– assets	173,353	173,353	65,619	65,619
– liabilities	0	0	-7,128	-7,128
Embedded foreign currency derivatives	201,539	201,539	-168,699	-168,699
– assets	201,539	201,539	59,013	59,013
– liabilities	0	0	-227,712	-227,712
Borrowings	-18,272,012	-18,272,012	-18,506,590	-18,506,590
Trade and other payables	-13,492,783	-13,492,783	-12,713,863	-12,713,863
Total	17,886,143	17,886,143	9,731,843	9,731,843

Fair value measurement

The manner of the fair value measurement of the individual types of financial instruments is presented below.

Securities held for trading

The fair value is computed on the basis of the stock exchange quotation of the respective securities as at the balance sheet date, and it is not decreased by any costs that may arise upon the sale or purchase of securities.

Futures

The fair value of futures is recorded as the difference between the agreed spot rate upon closing a contract and the rate for futures of the same maturity as at the balance sheet date, multiplied by the value of the futures as at the last day of the Quarterly for the last entire financial year. The rate as at the balance sheet date is a sum of the current rate and the market points, reflecting the difference between the interest rates of the two currencies of the futures, under consideration of the maturity. The information on market points may be obtained from any of the Slovenian banks with which an ISDA Master Agreement was signed, or from the specific derivatives valuation models within Reuters information platform.

Options

The fair value of currency options is computed as at the last day of the Quarterly for the last entire financial year, by the use of specific derivatives valuation models available within Reuters information platform.

Interest rate swaps

The fair value of interest rate swaps is computed as at the last day of the Quarterly for the last entire financial year, by the use of specific derivatives valuation models available within Reuters information platform.

Financial assets available for sale

If the financial assets are listed on the stock exchange market, their fair value equals to the market value as at the balance sheet date, not decreased by any costs that may arise upon the sale or purchase of the said shares. Other financial assets available for sale are recorded at the net carrying amount as at the balance sheet date, representing the assessed fair value.

Interest bearing loans and borrowings

The fair value of loans and borrowings with a repayment period exceeding 5 years is recorded under consideration of the discounted cash flow of the principal and interest. A 4.00% discount rate was applied. It has been computed under consideration of yield to maturity for government bonds of the Republic of Slovenia, based on the information published by the Ljubljana Stock Exchange and/or the TUVL, authorised for secondary trading in government securities. In our opinion, the applied discount rate appropriately reflects the financial market situation in Slovenia as well as in other European financial markets.

Receivables and liabilities

Short-term receivables and payables are recorded at net carrying amount, which is considered to be their fair value.

32. Transactions with related parties

Intragroup transactions

Transactions with Group companies in 2006 are presented below.

in thousand SIT	Sales	Expenses	Borrowings	Loans
Terme Krka, d. o. o., Novo mesto, Slovenia*	44,610	217,719	0	3,067,000
KRKA-FARMA d. o. o., Zagreb, Croatia	6,978,747	422,955	0	0
"KRKA-FARMA" d. o. o. Novi Sad, Serbia	1,536,148	3,250	0	0
KRKA-FARMA DOOEL, Skopje, Macedonia	1,537,152	0	0	0
OOO "KRKA-RUS", Istra, Russian Federation	2,593,068	0	0	364,491
OOO "KRKA FARMA", Sergiev Posad, Russian Federation	4,335,505	0	0	0
KRKA-POLSKA, Sp. z o. o., Warsaw, Poland	13,996,820	152,742	0	0
KRKA Magyarország Kft, Budapest, Hungary	0	886,124	0	0
KRKA Pharma Dublin Limited, Dublin, Ireland	0	109,683	0	0
KRKA Sverige AB, Stockholm, Sweden	926,023	7,695	0	0
Total	31,948,073	1,800,168	0	3,431,491

* Including the subsidiaries Terme Krka – Strunjan, d. o. o. and Golf Grad Otočec, d. o. o.

The transactions between the parent and the above-mentioned Group companies were based on sales contracts, which included the rendering of products and services at market prices.

For intragroup receivables and liabilities, please refer to Notes 20 and 28.

Related parties as shareholders

As at the year-end, the members of the Management Board of the Krka Company held 5,693 of shares in the Krka Company, representing 0.16% of the total equity, and the Managing Directors of subsidiaries held 2,514 of shares or 0.07% of the total equity. A questionnaire on related entities is filled in by the members of the Management Board and other management staff on a yearly basis, which is afterwards used by the Company to check the occurrence of any other business relations between the Company and the employees. No such business relations were recorded in 2006.

As at the year-end, the members of the Supervisory Board held 888 of shares in the Krka Company, representing 0.03% of the total equity.

Shares of members of the Management Board and the Supervisory Board in the Krka Company

	2006		2005	
	Number of shares	Share (in %)	Number of shares	Share (in %)
Management Board members				
Jože Colarič	2,100	0.0593	1,700	0.0480
Janez Poljanec	2,206	0.0623	2,206	0.0623
Aleš Rotar	1,277	0.0361	1,157	0.0327
Zvezdana Bajc	110	0.0031	110	0.0031
Danica Novak Malnar	0	0.0000	0	0.0000
Total Management Board	5,693	0.1607	5,173	0.1460
Supervisory Board members				
Gregor Gomišček	12	0.0003	12	0.0003
Marko Kranjec	101	0.0029	101	0.0029
Mateja Božič	0	0.0000	0	0.0000
Anton Rous	0	0.0000	0	0.0000
Draško Veselinovič	0	0.0000	0	0.0000
Alojz Zupančič	514	0.0145	514	0.0145
Sonja Kermc	211	0.0060	211	0.0060
Tomaž Sever	50	0.0014	50	0.0014
Mateja Vrečer	0	0.0000	0	0.0000
Total Supervisory Board	888	0.0251	888	0.0251

Emoluments of groups of persons in 2006

in thousand SIT	Total emoluments	Hereof participation in profit according to the annual meeting
Members of the Management Board	463,285	0
Members of the Supervisory Board	104,570	51,291
Persons employed under individual employment contracts	4,157,476	0
Other employees	21,104,124	0
Total emoluments of groups of persons	25,829,455	51,291

Emoluments of the Management Board members represent salaries and wages, fringe benefits and any other receipts.

Emoluments of the Management Board members in 2006

in thousand SIT	Gross remuneration – fixed portion	Gross remuneration – variable	Fringe benefits and other receipts	Total emoluments
Jože Colarič	63,918	65,632	2,481	132,031
Janez Poljanec	52,917	54,339	3,011	110,267
Aleš Rotar	49,915	51,265	4,193	105,373
Zvezdana Bajc	42,098	42,726	2,998	87,822
Danica Novak Malnar	26,243	0	1,549	27,792
Total emoluments of the Management Board	235,091	213,962	14,232	463,285

Emoluments of the employees also represent salaries and wages, fringe benefits, vacation bonus and any other receipts (tenure awards, etc.).

Emoluments of the Supervisory Board members represent remuneration for the tasks performed within the Supervisory Board.

The 12 members that performed their tasks in the Supervisory Board until 21 June 2005 were paid out dividends in 2006 pursuant to a resolution adopted at the annual meeting of shareholders, for the work performed as members of the Supervisory Board in the first half of 2005.

The 9 members that performed their tasks in the Supervisory Board from 22 June 2005 on were paid out dividends in 2006 pursuant to a resolution adopted at the annual meeting of shareholders, for the work performed as members of the Supervisory Board in the second half of 2005. In compliance with the resolution adopted at the annual meeting on 6 July 2006, the members of the Supervisory Board from 1 January 2006 shall receive a fixed monthly amount for the tasks performed in the Supervisory Board. Attendance fee is paid to the members of the Supervisory Board, Audit Committee and Nomination and Remuneration Committee for attending the meetings. New amounts of attendance fees were approved at the annual meeting, effective as of the date when the annual meeting took place.

Emoluments of the Supervisory Board members in 2006

in thousand SIT	Monthly remuneration	Attendance fees	Participation in profit	Total
Supervisory Board until 21 June 2005 (12 members)				
Janez Prijatelj, President	0	0	4,460	4,460
Janko Kastelic, Deputy President	0	0	2,230	2,230
Bojan Dejak	0	0	2,230	2,230
Borut Jamnik	0	0	2,230	2,230
Sonja Kermc	0	0	2,230	2,230
Mihaela Korent	0	0	2,230	2,230
Miroslav Kramarič	0	0	2,230	2,230
Darinka Kure	0	0	2,230	2,230
Mojca Osolnik	0	0	2,230	2,230
Boris Petančič	0	0	2,230	2,230
Božena Šuštar	0	0	2,230	2,230
Stanislav Valant	0	0	2,230	2,230
Total	0	0	28,990	28,990
Supervisory Board since 22 June 2005 (9 members)				
Gregor Gomišček, President	6,060	1,316	4,460	11,836
Marko Kranjec, Deputy President	5,799	774	2,230	8,803
Mateja Božič	4,744	542	2,230	7,516
Sonja Kermc	4,744	697	2,230	7,671
Anton Rous	4,744	697	2,230	7,671
Tomaž Sever	4,744	774	2,230	7,748
Draško Veselinovič	5,270	852	2,230	8,352
Mateja Vrečer	4,744	774	2,230	7,748
Alojz Zupančič	5,270	735	2,230	8,235
Total	46,119	7,161	22,300	75,580
GRAND TOTAL	46,119	7,161	51,290	104,570

LOANS GRANTED TO GROUPS OF PERSONS

in thousand SIT	Loan balance as at 31 Dec 2006	Repayments in 2006
Members of the Management Board	2,886	654
Members of the Supervisory Board in the parent company (employee representatives)	362	155
Persons employed under individual employment contracts	84,559	18,923
Other employees	1,251,944	147,204
Total loans to groups of persons	1,339,751	166,936

The loans granted to the above-mentioned persons were used for housing purposes.

33. Educational structure of employees

	2006		2005	
	Headcount	Share (in %)	Headcount	Share (in %)
PhD	50	1.2	44	1.1
MSc	135	3.3	127	3.3
University education	1612	39.2	1363	35.5
Higher professional education	183	4.4	145	3.8
Vocational college education	142	3.5	139	3.6
Secondary school education	833	20.2	818	21.3
Skilled workers	990	24.0	1022	26.6
Unskilled workers	173	4.2	186	4.8
Total (average for the period)	4118	100	3844	100

34. Transactions with the audit firm

The annual service fee for audit services performed by the audit company KPMG Slovenija, d. o. o. amounted to 23,964 thousand SIT. KPMG poslovno svetovanje d.o.o., on the other hand, provided tax advisory services in the value of 3,185 thousand SIT.

35. Events after the balance sheet date

At the beginning of 2007, initial capital was paid in for two new companies incorporated in Portugal and USA by the parent company Krka, d. d., Novo mesto: KRKA FARMACÊUTICA, LDA, Estoril, Portugal and KRKA USA, LLC, Delaware, USA. Krka, d. d., Novo mesto is the sole shareholder of the two companies.

Auditor's report

KPMG

Independent Auditor's Report

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

We have audited the accompanying financial statements of the company KRKA, d.d., Novo mesto which comprise the balance sheet as at 31 December 2006, the income statement, the statement of changes in equity, the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

We also read the Management Report.

Management's responsibility for the financial statements

Management is responsible for the preparation and fair presentation of these financial statements prepared in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with relevant ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free of material misstatements.

An audit involves procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of misstatements of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting principles used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the company KRKA, d.d., Novo mesto as at 31 December 2006, and the result of its operations and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as endorsed by the European Union.

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

KPMG SLOVENIJA,
podjetje za revidiranje, d.o.o.

Marjan Mahnič, B.Sc.Ec.
Certified Auditor
Partner

Andrej Korinšek, B.Sc.Ec.
Certified Auditor
Partner

Ljubljana, 15 March 2007

KPMG Slovenija, d.o.o.

Appendix: Financial statements of the Krka Group and Krka, d. d., Novo mesto, presented in euros

The translation of SIT to EUR was conducted in accordance with Note 1 to the Introduction to the Slovenian Accounting Standards (2006) – Change in the presentation currency, approved by the Professional Council of the Slovene Institute of Auditors at its 80th session. Accordingly, all items presented in the financial statements are translated to euro by the use of the official exchange rate of the Bank of Slovenia effective at the last day of the comparable period i.e. 1 EUR=239.6400 SIT for 2006 and 1 EUR=239.5756 SIT for 2005.

Consolidated Balance Sheet

in thousands of euros	31 Dec 2006	31 Dec 2005
Assets		
Property, plant and equipment	506,821	451,487
Intangible assets	23,608	21,114
Investments in associates	2,024	1,130
Long-term loans	3,564	3,714
Other investments	6,737	5,343
Deferred tax assets	31,840	19,945
Other non-current assets	253	51
Non-current assets	574,847	502,785
Inventories	115,926	120,908
Trade and other receivables	153,890	137,780
Current investments	24,067	14,154
Cash and cash equivalents	10,399	12,638
Current assets	304,282	285,480
Total assets	879,128	788,265
Equity		
Share capital	59,132	59,148
Own shares	-19,489	-19,494
Reserves	147,660	145,613
Retained earnings	372,060	284,385
Reserves for fair value	3,480	2,344
Translation reserves	154	19
Equity holders of the parent	562,998	472,015
Minority interest	7,907	7,570
Total equity	570,905	479,585
Liabilities		
Borrowings	34,584	48,709
Provisions	122,554	100,043
Grants received	2,777	1,861
Deferred tax liabilities	4,025	1,190
Total non-current liabilities	163,940	151,803
Trade payables	60,889	58,619
Borrowings	48,769	38,070
Income tax liabilities	7,020	27,922
Other liabilities	27,605	32,266
Total current liabilities	144,283	156,877
Total liabilities	308,223	308,680
Total equity and liabilities	879,128	788,265

Consolidated Income Statement

in thousands of euros	2006	2005
Sales revenues	667,955	554,137
Production cost of goods sold	248,985	216,415
Gross operating yield	418,969	337,722
Sales and marketing	165,844	173,681
R&D costs	52,650	40,120
Administrative expenses	53,544	55,876
Other operating income	3,564	51,012
Operating profit	150,495	119,057
Financial income	15,500	16,652
Financial expenses	17,239	12,450
Net financial expenses / income	-1,739	4,202
Profit before tax	148,756	123,260
Income tax expense	36,669	25,924
Profit for the period	112,086	97,335
Equity holders of the parent	111,682	97,208
Minority interest	405	128
Earnings per share (in EUR)	33	29

Consolidated Statement of Changes in Equity

in thousands of euros	Called capital	Own shares	Reserves			Retained earnings			Fair value reserves	Minority interest	Total equity
			Share premium	Legal reserves	Statutory reserves	Profit reserves	Net profit for the period	Net profit carried forward			
Balance at 01 Jan 2005	59,148	-19,494	121,019	14,994	6,261	189,785	44,403	-20,724	2,421	7,595	405,407
Entry of net profit for the period	0	0	0	0	0	0	97,208	0	0	128	97,335
Formation of statutory reserves	0	0	0	0	3,339	0	-3,339	0	0	0	0
Formation of other revenue reserves under the resolution of the Management and the Supervisory Board of the Krka Company	0	0	0	0	0	27,131	-27,131	0	0	0	0
Transfer of previous period's net profit to retained earnings	0	0	0	0	0	0	-44,403	44,403	0	0	0
Transfer to other revenue reserves under the resolution of the Annual Meeting	0	0	0	0	0	24,572	0	-24,572	0	0	0
Dividends paid	0	0	0	0	0	-16,174	0	-3,804	0	-133	-20,111
Recognised income and expenses	0	0	0	0	0	0	0	-2,969	-57	-19	-3,046
Balance at 31 Dec 2005	59,148	-19,494	121,019	14,994	9,600	225,314	66,737	-7,667	2,364	7,570	479,585
Balance at 1 Jan 2006	59,132	-19,489	120,986	14,990	9,579	225,253	66,719	-7,665	2,364	7,568	479,456
Entry of net profit for the period	0	0	0	0	0	0	111,682	0	0	405	112,086
Formation of statutory reserves	0	0	0	0	2,086	0	-2,086	0	0	0	0
Formation of other revenue reserves under the resolution of the Management and the Supervisory Board of the Krka Company	0	0	0	0	0	20,030	-20,030	0	0	0	0
Transfer of previous period's net profit to retained earnings	0	0	0	0	0	0	-66,719	66,719	0	0	0
Transfer to other revenue reserves under the resolution of the Annual Meeting	0	0	0	0	0	30,512	0	-30,512	0	0	0
Dividends paid	0	0	0	0	0	0	0	-23,499	0	-65	-23,564
Recognised income and expenses	0	0	0	0	0	0	0	1,655	1,271	0	2,926
Balance at 31 Dec 2006	59,132	-19,489	120,986	14,990	11,684	275,796	89,565	6,698	3,634	7,907	570,905

Consolidated Cash Flow Statement

in thousands of euros	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit for the period	112,086	97,335
Adjustments for:	85,623	76,939
– Amortisation /Depreciation	47,704	45,792
– Foreign exchange gain	-1,962	-2,389
– Foreign exchange loss	4,147	3,493
– Investment income	-9,831	-40
– Financial income	3,636	-293
– Financial expenses	4,980	4,225
– Income taxes and other taxes not included in operating expenses	36,669	25,924
– Other	278	229
Operating profit before changes in net operating current assets and provisions	197,710	174,275
Change in trade receivables	-18,880	-37,375
Change in inventories	4,950	-37,281
Change in operating debts (liabilities)	-1,101	13,583
Change in other current liabilities and provisions	19,751	15,288
Income taxes paid	-65,512	-18,901
Cash generated from operations	136,918	109,590
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	768	485
Proceeds from sale of investments	1,014	270
Dividends received	201	169
Proceeds from sale of property, plant and equipment	1,565	1,526
Purchase of intangible assets	-7,298	-7,713
Purchase of property, plant and equipment	-96,910	-75,209
Proceeds/payments in connection with long-term loans	-25	360
Proceeds/payments in connection with other non-current assets	-1,150	-6
Acquisition of current investments	-7,802	-7,600
Acquisition of derivative financial instruments	1,817	-1,395
Net cash used in investing activities	-107,820	-89,114
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from an increase in short-term financial liabilities	10,492	16,552
Interest paid	-4,764	-2,286
Payment of long-term financial liabilities	-13,162	-13,931
Dividends paid	-23,534	-20,073
Net cash used in financing activities	-30,967	-19,739
Net increase in cash and cash equivalents	-1,869	737
Cash and cash equivalents at beginning of period	12,635	11,859
Effect of exchange rate fluctuations on cash held	-367	43
Net cash and cash equivalents at end of period	10,399	12,638

Balance Sheet of the Krka company

in thousands of euros	31 Dec 2006	31 Dec 2005
Assets		
Property, plant and equipment	377,442	326,009
Intangible assets	22,400	20,443
Investments in subsidiaries	121,513	115,043
Long-term loans	5,324	5,697
Other investments	6,529	5,135
Deferred tax assets	27,648	15,581
Other non-current assets	178	37
Non-current assets	561,034	487,946
Inventories	99,480	112,212
Trade and other receivables	157,484	140,978
Current investments	31,790	16,419
Cash and cash equivalents	4,498	3,167
Current assets	293,253	272,777
Total assets	854,286	760,723
Equity		
Share capital	59,132	59,148
Own shares	-19,489	-19,494
Reserves	147,660	145,613
Retained earnings	379,134	290,115
Reserves for fair value	3,480	2,344
Total equity	569,918	477,726
Liabilities		
Borrowings	29,143	41,789
Provisions	116,806	94,721
Grants received	449	366
Deferred tax liabilities	3,954	1,110
Total non-current liabilities	150,351	137,985
Trade payables	56,304	53,068
Borrowings	47,105	35,459
Income tax liabilities	6,698	27,544
Provisions and other liabilities	23,910	28,939
Total current liabilities	134,017	145,011
Total liabilities	284,368	282,996
Total equity and liabilities	854,286	760,723

Income Statement of the Krka company

in thousands of euros	2006	2005
Sales revenues	586,102	486,570
Production cost of goods sold	213,248	188,063
Gross operating yield	372,854	298,507
Sales and marketing	133,943	146,326
R&D costs	51,764	39,601
Administrative expenses	42,182	41,952
Other operating income	2,000	49,588
Operating profit	146,965	120,217
Financial income	14,778	13,704
Financial expenses	14,494	15,589
Net financial income / expenses	285	-1,884
Profit before tax	147,250	118,332
Income tax expense	34,223	24,586
Profit for the period	113,027	93,746
Earnings per share (in EUR)	33	28

Statement of changes in equity of the Krka company

	Called capital	Own shares	Reserves			Retained earnings			Fair value reserves	Total equity
in thousands of euros			Share premium	Legal reserves	Statutory reserves	Profit reserves	Net profit for the period	Net profit carried forward		
Balance at 31 Dec 2004	59,148	-19,494	121,019	14,994	6,261	189,785	43,033	-11,460	2,170	405,456
Correction	0	0	0	0	0	0	0	1,298	0	1,298
Balance at 01 Jan 2005	59,148	-19,494	121,019	14,994	6,261	189,785	43,033	-10,162	2,170	406,754
Entry of net profit for the period	0	0	0	0	0	0	93,746	0	0	93,746
Formation of statutory reserves	0	0	0	0	3,339	0	-3,339	0	0	0
Formation of other revenue reserves under the resolution of the Management and the Supervisory Board	0	0	0	0	0	27,131	-27,131	0	0	0
Transfer of previous period's net profit to retained earnings	0	0	0	0	0	0	-46,699	46,699	0	0
Transfer to other revenue reserves under the resolution of the Annual Meeting	0	0	0	0	0	24,572	0	-24,572	0	0
Dividends paid	0	0	0	0	0	-16,174	0	-3,804	0	-19,987
Recognised income and expenses	0	0	0	0	0	0	0	-2,969	174	-2,796
Balance at 31 Dec 2005	59,148	-19,494	121,019	14,994	9,600	225,314	59,609	5,192	2,344	477,726
Balance at 1 Jan 2006	59,132	-19,489	120,986	14,990	9,598	225,254	59,593	5,191	2,343	477,598
Entry of net profit for the period	0	0	0	0	0	0	113,027	0	0	113,027
Formation of statutory reserves	0	0	0	0	2,086	0	-2,086	0	0	0
Formation of other revenue reserves under the resolution of the Management and the Supervisory Board	0	0	0	0	0	20,030	-20,030	0	0	0
Transfer of previous period's net profit to retained earnings	0	0	0	0	0	0	-59,593	59,593	0	0
Transfer to other revenue reserves under the resolution of the Annual Meeting	0	0	0	0	0	30,512	0	-30,512	0	0
Dividends paid	0	0	0	0	0	0	0	-23,499	0	-23,499
Recognised income and expenses	0	0	0	0	0	0	0	1,655	1,136	2,792
Balance at 31 Dec 2006	59,132	-19,489	120,986	14,990	11,684	275,796	90,911	12,427	3,480	569,918

Cash Flow Statement of the Krka company

in thousands of euros	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Profit for the period	113,027	93,746
Adjustments for:	68,429	66,482
– amortisation /depreciation	36,193	34,973
– foreign exchange gain	-1,507	-6,361
– foreign exchange loss	4,781	3,519
– investment income	-11,637	-26
– investment expense	2,978	4,802
– financial income	0	-293
– financial expense	3,119	4,926
– income taxes and other taxes not included in operating expenses	34,223	24,586
– other	278	356
Operating profit before changes in net operating current assets and provisions	181,456	160,228
Change in trade receivables	-20,087	-32,497
Change in inventories	12,701	-35,062
Change in operating debts (liabilities)	-1,571	10,453
Change in other current liabilities and provisions	18,121	14,140
Income taxes paid	-63,171	-17,052
Cash generated from operations	127,450	100,210
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	901	386
Proceeds from sale of investments	1,014	270
Dividends received	201	108
Proportionate profit of subsidiaries	2,027	0
Proceeds from sale of property, plant and equipment	1,176	627
Purchase of intangible assets	-6,459	-7,737
Purchase of property, plant and equipment	-79,862	-50,776
Payments related to subsidiaries – capital increase and loss coverage	-6,501	-10,160
Proceeds/payments in connection with long-term loans	90	237
Payments in connection with other non-current assets	-141	-6
Acquisition of current investments	-13,398	-9,423
Acquisition of derivative financial instruments	1,817	-1,395
Net cash used in investing activities	-99,133	-77,869
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from an increase in short-term financial liabilities	11,537	16,670
Interest paid	-3,011	-2,610
Payment of long-term financial liabilities	-11,676	-17,799
Dividends paid	-23,468	-20,073
Net cash used in financing activities	-26,618	-23,812
Net increase in cash and cash equivalents	1,699	-1,471
Cash and cash equivalents at beginning of period	3,166	4,595
Effect of exchange rate fluctuations on cash held	-367	43
Net cash and cash equivalents at end of period	4,498	3,167

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