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

Living a healthy life.

Financial statements

Contents

1 Introductory explanations to the financial statements

The Accounting Report consists of three separate sections.

The accounting policies, the financial statements and notes to the financial statements of Krka, d. d., Novo mesto (hereinafter: the Company), representing Part 1 of the Accounting Report, have been prepared in compliance with the Slovenian Accounting Standards (hereinafter SAS).

The consolidated financial statements and notes to the consolidated financial statements of the Krka Group represent Part 2 of the Accounting Report and have been prepared in compliance with the International Financial Reporting Standards (hereinafter: IFRS). A separate chapter provides a presentation of the transfer to the IFRS as well as of the effects of the transfer to the IFRS in terms of values. The financial statements of the Krka Group were prepared only in accordance with the IFRS.

The financial statements and notes to the financial statements of Krka, d. d., Novo mesto as presented in Part 3 were presented in compliance with the IFRS. A separate chapter is included here as well, providing a presentation of the transfer to the IFRS as well as of the effects of the transfer to the IFRS in terms of values.

The auditing firm KPMG SLOVENIJA, podjetje za revidiranje, d. o. o., performed an audit of every section of the Accounting Report. Therefore, three Auditor's Reports were issued, to be included at the beginning of the financial statements to which they refer, respectively.

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

2 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 as of 31 December 2005.
The Management 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 for the Company have been prepared in compliance with the effective legislation, the SAS and in addition with the IFRS;
– the financial statements and the notes thereto both for the Company and the Group have been prepared in accordance with the IFRS.

The Company's Management 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.

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

Novo mesto, March 2006

3 Financial statements of Krka, d. d., Novo mesto prepared in accordance with Slovenian Accounting Standards

3.1 Balance sheet

In thousand SIT	Notes	31 Dec 2005	31 Dec 2004
Assets		**182,826,120**	**151,080,787**
Fixed assets		**114,012,826**	**103,768,324**
Intangible fixed assets	3.7.1.1	5,240,167	4,337,508
Tangible fixed assets	3.7.1.2	73,440,344	67,607,520
Long-term investments	3.7.1.3	35,332,315	31,823,296
Current assets		**68,731,246**	**47,176,096**
Inventories	3.7.1.4	26,926,295	18,538,074
Operating receivables	3.7.1.5	37,182,590	25,617,311
Short-term investments	3.7.1.6	3,863,593	1,919,757
Cash in bank, cheques and cash in hand	3.7.1.7	758,768	1,100,954
Deferred costs (expenses) and accrued revenues		**82,048**	**136,367**
OFF BALANCE SHEET ASSETS	3.7.1.13	19,352,546	18,599,067
Liabilities		**182,826,120**	**151,080,787**
Capital	3.7.1.8	**125,045,773**	**106,711,173**
Called-up capital		14,170,448	14,170,448
Capital reserves		2,598,736	2,598,736
Revenue reserves		64,542,300	55,230,357
Net profit from previous periods		5,974,464	3,583,658
Net profit for the financial year		14,280,823	9,101,384
Capital revaluation adjustment		23,479,002	22,026,590
Provisions	3.7.1.9	**13,027,768**	**12,025,182**
Financial and operating liabilities		**40,918,261**	**30,972,198**
Long-term financial and operating liabilities	3.7.1.10	10,011,560	13,786,543
Short-term financial and operating liabilities	3.7.1.11	30,906,701	17,185,655
Accrued costs (expenses) and deferred revenues	3.7.1.12	**3,834,318**	**1,372,234**
Off balance sheet liabilities	3.7.1.13	19,352,546	18,599,067

3.2 Income statement

In thousand SIT	Notes	2005	2004
Net sales	3.7.2.1	116,570,332	97,977,511
– on domestic market		18,336,745	18,474,969
– on foreign market		98,233,587	79,502,542
Change in inventories		4,794,880	–1,074,999
Capitalised own products and services		19,143	44,949
Other operating revenues	3.7.2.2	11,796,305	4,098,175
Cost of goods, materials and services	3.7.2.3	–52,173,899	–43,518,841
Labour cost	3.7.2.4	–28,657,196	–26,359,527
Amortisation/depreciation expense	3.7.2.5	–10,252,992	–9,750,662
– amortisation/depreciation expense, and operating expenses from revaluation of intangible and tangible fixed		–9,327,315	–8,604,262
– operating expenses from revaluation of current assets		–925,677	–1,146,400
Other operating expenses	3.7.2.6	–13,908,010	–3,832,049
Financial revenues from shares	3.7.2.7	1,019,272	1,545,028
Financial revenues from long-term receivables	3.7.2.7	146,652	404,541
Financial revenues from short-term receivables	3.7.2.7	1,996,463	1,599,680
Financial expenses for long- and short-term investment write-offs	3.7.2.8	–2,095,761	–1,816,727
Interest expenses and financial expenses for other liabilities	3.7.2.8	–1,879,116	–2,353,173
Profit from ordinary activities		**27,376,073**	**16,963,906**
Extraordinary revenues		64,723	112,051
Extraordinary expenses		–25,220	–10,799
Profit from extraordinary activities		**39,503**	**101,252**
Profit before tax		**27,415,576**	**17,065,158**
Income tax	3.7.2.9	–5,834,753	–2,963,774
Net profit for the financial year	3.7.2.10	**21,580,823**	**14,101,384**

3.3 Cash flow statement

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

* The balance in 2005 also includes cash equivalents: securities and options to the value of 3,042,133 thousand SIT. The balance of cash and cash equivalents at the end of 2004 totalled 1,162,791 thousand SIT.

3.4 Statement of changes in equity for the period from 31 December 2004 to 31 December 2005

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

3.5 Statement of changes in equity for the period from 31 December 2003 to 31 December 2004

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

3.6 Accumulated profit

In thousand SIT	2005	2004
Compulsory appropriation of net profit		
Net profit for the financial year	**21,580,823**	**14,101,384**
– 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	800,000	500,000
Net profit after compulsory appropriation	**20,780,823**	**13,601,384**
– formation of other revenue reserves (decision adopted by the Management and Supervisory Board)	6,500,000	4,500,000
Surplus of net profit	**14,280,823**	**9,101,384**
Identification of accumulated profit		
Surplus of net profit	14,280,823	9,101,384
+ profit from previous periods	5,974,464	3,583,658
+ decrease in revenue reserves	0	3,874,858
Accumulated profit	**20,255,287**	**16,559,900**

In thousand SIT	2005	2004
Appropriation of accumulated profit		
– to dividends		4,731,930
– to other revenue reserves		5,886,801
– to carry forward into the next period		5,886,801
– for other purposes (Supervisory Board's participation in profit)		54,368

3.7 Notes to financial statements

Basis for the preparation of the financial statements

The financial statements of Krka, d. d., Novo mesto, and the consolidated financial statements of the Krka Group with notes thereto have been prepared in accordance with the Slovenian Accounting Standards and in compliance with the Companies Act. The fundamental accounting assumptions underlying the preparation of financial statements are: accrual, going concern, and true and fair presentation under a fluctuating value of the Euro and individual prices.

Financial statements are prepared in Slovenian tolars, rounded to thousands (hereafter: thousand SIT).

Foreign exchange rate and translation into local currency

Items in financial statements, denominated in foreign currencies are translated into the local currency in the balance sheet and the income statement, using the middle exchange rate of the Bank of Slovenia. Foreign currency translation gains or losses are recognized in the income statement under financial revenues or expenses, respectively.

Reporting by business and geographical segments (Segment reporting)

In compliance with strategic operations guidelines and with the factors to be considered in determining business segments (mutual therapeutic characteristics of products, the marketing and advertising characteristics, and the risk level), four business segments have been identified within the Company, as follows: prescription pharmaceuticals, self-medication products, animal health products, cosmetic products and others.

There are five geographical segments, each consisting of geographically connected countries that share a similar level of economic development, purchasing power, and similar economic and political conditions: Slovenia, South-East Europe, East Europe, Central Europe, West Europe and Overseas Markets.

The segment reporting of the Company includes reporting of net sales that could be directly assigned to the reporting segments.

Accounting policies

The items in the balance sheet, income statement and/or other statements are recorded and valued in compliance with the provisions of SAS, except for those items that may be, in accordance with the respective standards, accounted for at freely selected methods. The following policies have been applied by the Company with these items:

Intangible fixed assets

Intangible fixed assets comprise investments in long-term industrial property rights (licences, computer software), long-term deferred costs, and other intangible fixed assets.

An item of intangible fixed assets is initially recognised at cost. In addition to its purchase price, the cost of an intangible fixed asset comprises import duties and non-refundable purchase taxes.

Intangible fixed assets are not revalued due to value increase.

Tangible fixed assets

Tangible fixed assets are initially recognised at cost, less accumulated depreciation computed on the straight-line basis.

It comprises its purchase price, including import duties and non-refundable purchase taxes, as well as directly attributable costs of bringing the asset to working condition for its intended use, especially the costs of delivery and installation costs. Only under specific circumstances, when the cost of purchase of an item of tangible fixed assets is high and the individual constituent parts of such item may be considered as individual items of fixed assets, then every such part may be recorded as an individual item of fixed assets. Recognition of an item of tangible fixed assets in the bookkeeping records and the balance sheet is reversed when an asset has been disposed or it has been permanently put out of use and no economic benefits may be expected from its disposal. Gains on disposal of an asset are recorded under operating revenues from revaluation; the carrying amount of the asset is recorded under operating expenses from revaluation.

Subsequent expenditure on an item of tangible fixed assets increases its cost when it increases its future economic benefits in excess of the originally assessed future economic benefits. The subsequent expenditure enabling extension of the useful life of the asset initially reduces the accumulated depreciation.

Expenditure on repair or maintenance of tangible fixed assets is made to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of the asset. As such, it is recognised as an expense when incurred.

Amortisation/depreciation

The carrying amount of an item of tangible fixed assets and intangible fixed assets is reduced through depreciation or amortisation, respectively.

The depreciation of an item of tangible fixed assets begins on the first day of the month following the beginning of the activity for which it is intended. The amortisation of an item of intangible fixed assets begins when the asset is available for use.

Intangible fixed assets are amortised by the use of the straight-line method of amortisation (single-asset amortisation). Tangible fixed assets are depreciated by the use of the straight-line method of depreciation (single-asset depreciation). Land is not depreciated.

The following useful lives are applied in the Company for depreciation of tangible fixed assets:

Intangible fixed assets	2–10 years
Long-term operating lease	5–10 years
Buildings	20–30 years
Computer equipment	4–6 years
Transport equipment	8–10 years
Production equipment	5–20 years
Other equipment and low value assets	5 years

Investments

Investments of all categories are initially recognized at cost. Long- and short-term investments are recorded separately.

Long-term investments in subsidiaries and associated companies that have been included in the consolidated financial statements are accounted for using the equity method. Under the equity method, the carrying amount of investments in subsidiaries is increased to recognise the controlling company's share of net profit of the subsidiary. It is accounted for as an increase in specific capital revaluation adjustment, whereas until (including) 2004, it was accounted as an increase in financial revenues of the controlling company. The Management's decision to apply the above-mentioned change in the accounting policy was due to the fact that profit in subsidiaries abroad was increasingly generated by the sale of their own product lines and not only by the distribution of the controlling company's products. In 2005, net profits of subsidiaries totalled 1,509,832 thousand SIT.

Long-term investments in the form of long-term loans are increased by accrued interest or reduced by repaid amounts and by the amounts transferred to short-term investments payable within one year or less. Short-term investments in equity securities of other companies or in debt securities of other companies or the government are initially recognised and measured at cost.

Only the investments in shares of listed companies were verified for their fair market value, whereas the Company did not opt for any value increases.

As the Company considers the information on the interest rates of borrowings is business secret, the interest rates of borrowings have not been disclosed in the Notes to Financial Statements.

Derivative financial instruments

Derivative financial instruments are recognised at cost (fair value) in the balance sheet as at transaction day. The manner of disclosure of subsequent changes in fair value depends on whether a derivative financial instrument meets the conditions for the so-called special hedge accounting.

With those derivative financial instruments that meet the above-mentioned criteria, the portion of the gain or loss that is determined to be an effective hedge is recognised directly in equity through a change in the specific capital revaluation adjustment, and the ineffective portion is reported in the income statement.

In the other case, the subsequent changes in fair value are disclosed within capital revaluation adjustments. Any negative values of capital revaluation adjustment whose total value should exceed the previously formed positive changes are directly accounted for in the income statement.

Receivables

Receivables of all categories are initially recognised at amounts recorded in the relevant documents under the assumption that the amounts owed will also be collected. Receivables denominated in foreign currencies are translated into the local currency at the balance sheet date, using the middle exchange rate of the Bank of Slovenia. Exchange differences are recognized under financial revenues or expenses, respectively.

Any subsequent increases or decreases in receivables result in an increase or decrease in financial revenues or expenses, respectively. Any increases and decreases must be justified by the relevant supporting documents.

As a rule, allowances for disputable receivables due from domestic customers were formed in the amounts corresponding to 70 % of the total receivables, and allowances for bad receivables due from other customers were formed in the amounts corresponding to 90 % of the total receivables or in accordance with the expected collectability of individual receivables.

The methods in place for forming allowances for the remaining receivables are verified twice a year; based on these methods, allowances are formed for individual customers, whereby the share of overdue receivables in the total receivables due from the individual customers as well as the customers' credit ratings are taken into account. Credit ratings include the past transactions with the customers, analyses of the customers' financial statements, qualitative estimates based on the data from the questionnaires provided by individual customers, and the estimated country risks.

No allowances are formed for receivables due from subsidiaries. Other methods for forming allowances for bad receivables were applied by some Group companies, due to differences in the estimates referring to the risk levels of individual markets and customers.

Deferred tax assets

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

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 materials are carried at moving-average prices.

Inventory units of work in process, semi-finished products and products are valued at cost of production (direct cost of materials, direct labour cost, direct depreciation cost, direct cost of services, and indirect production cost - energy, maintenance, quality management, etc.). Inventories of work in process, semi-finished products and products are carried at fixed prices. Inventory units of merchandise are valued at cost, comprising the purchase price, import duties, and other directly attributable costs of acquisition, less trade discounts. Inventories of merchandise are carried at moving-average prices.

Allowances for inventories are formed for inventories ranked as questionable items, and for expired sell-by date or perishable goods.

Inventories are revalued to account for their impairment when their carrying amount, including the amount established using the latest actual purchase prices or acquisition cost, exceeds their sales value, which is to be determined at least at the end of the financial year.

Cash

Cash consists of cash on hand, cash in banks (deposits), and cash in transit. Cash on hand includes banknotes, coins, cheques received, and securities with immediate liquidity. Deposits comprise cash in banks and other financial institutions, which are readily available for payments. Cash in transit denotes cash transferred from the safe deposit box to the account with bank or other financial institution, and which is not recorded as cash in bank on the same day.

Cash in local currency is stated at face value. Foreign currencies are translated into local currency at the exchange rate ruling at the date of receipt thereof. Foreign currency gains or losses are recorded as financial revenues or financial expenses.

Within the item "Closing balance of cash and cash equivalents" in the cash flow statement, the Company includes securities available-for-sale and currency options as derivative financial instruments.

Capital

The total capital consists of called-up capital, capital reserves, revenue reserves, retained net profit or loss from previous periods, capital revaluation adjustments, and undistributed net profit or loss for the financial year. Share capital is recorded in local currency.

Long-term provisions

Long-term provisions are formed when the Company has a present obligation as a result of a past event, and when it can be estimated that the settlement of a liability will decrease the Company's assets. In addition to the provisions for ecological improvements and provisions for grants received in 2003, which have both been actually used up already, and are decreased by the depreciation amount, the Company records provisions for lawsuits related to alleged patent infringement. Every 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.

Liabilities

Liabilities may be either financial or operating liabilities, short-term or long-term. An item of short-term and long-term liabilities is initially recognised at the amount arising from the relevant documents, provided that its settlement is required by the creditor.

Long-term liabilities are increased by accrued return (interest, other compensation), if an agreement to that effect has been concluded with the creditor. Interest arising from long-term liabilities is accounted for under financial expenses. Long-term liabilities are decreased by amounts paid and potential other settlements, if an agreement to that effect has been concluded with the creditor. Furthermore, they are decreased by the amounts that are transferred to short-term liabilities as they are payable within a year.

Long-term liabilities due to legal entities and natural persons abroad are translated into local currency at the date of transaction. An exchange difference resulting from a change in the exchange rate between the transaction date and the balance sheet date is recorded as an item of financial revenues or financial expenses.

Short-term liabilities may be subsequently increased or decreased, directly or irrespective of amounts paid, by the amount agreed with the creditors. Subsequent increases and decreases of short-term liabilities are accounted for as an increase in the relevant operating and financial expenses (costs).

The Company does not disclose the value of interest for loans given, since it considers this a business secret and since this is also requested by the creditors.

Short-term accrued and deferred items

Short-term deferred costs (expenses) and accrued revenues include short-term deferred costs and accrued revenues. Short-term deferred costs include amounts incurred but not charged against an activity that the enterprise undertakes. Accrued revenues arise when payments have not been received and invoices could not have been issued, but where an enterprise has good reasons to include the revenues in its profit or loss.

Accrued costs (expenses) and deferred revenues include accrued costs and short-term deferred revenues. Accrued costs include costs expected to be incurred and relate to the accounting period for which the results are to be determined. Deferred revenues appear when a company has invoiced or even received payments for services it has agreed to render in the future. Revenues may also be deferred when eligibility to recognize revenues in the profit or loss is doubtful at the moment of sale.

Recognition of revenues

Revenues are recognised if an increase in economic benefits during the accounting period is related to an increase in assets or a decrease in liabilities, and the increase can be measured reliably.

Revenues are recognised when it is probable that cash receipts will flow from them, unless they were achieved on origin.

Operating revenues

Revenues from the sale of products, merchandise and material are recognised at selling prices stated in invoices or other documents, less discounts and rebates approved either when the sale is made or subsequently, including those granted for early payment.

Revenues from the rendering of services, except of services from which financial revenues are earned, are recognised at selling prices of services completed, or at selling prices of services not yet completed in proportion to the stage of completion.

Operating revenues from revaluation arise upon the disposal of tangible and intangible fixed assets, taking into account a previous capital revaluation adjustment due to an increase in value of assets.

Financial revenues

Financial revenues are revenues generated from investment activities. They arise in association with long-term and short-term investments, as well as in association with receivables.

Financial revenues are recognised when statements of account are prepared, regardless of cash receipts associated with them, unless there exists a significant uncertainty as to their amount, maturity date, and collectability.

Interest is accounted for on a time proportion basis, taking account of the principal outstanding and the applicable interest rate.

Financial revenues from revaluation arise upon the disposal of long-term and short-term investments, taking into account a previous capital revaluation adjustment due to an increase in value of investments.

Extraordinary revenues

Extraordinary revenues include extraordinary items. They are recorded at actual amounts.

Recognition of expenses

Expenses are recognised when the outflow of economic benefits in the accounting period is related to decrease in assets or increase in liabilities, and when the amount of expenses can be measured reliably.

Operating expenses

Operating expenses are recognised when expenses are no longer comprised in the value of inventories of products and work in process, and/or when merchandise is sold.

Operating expenses are in principle equal to costs accrued in the accounting period, increased by costs held in the opening balance of inventories of products and work in process and decreased by costs held in the closing balance of inventories of products and work in process. Operating expenses also include cost of merchandise and materials sold.

Operating expenses from revaluation are recognised when the revaluation is performed, irrespective of their effects upon the profit and loss.

Revaluation of costs of depreciation, materials, services and labour costs is recorded as an item of increase in operating expenses from revaluation.

Operating expenses from revaluation are incurred in connection with the impairment of tangible fixed assets, intangible fixed assets, and operating current assets.

Financial expenses

Financial expenses include expenses incurred in connection with financing and investing.

Financial expenses are recognised when accrued, irrespective of related payments.

Financial expenses from revaluation are incurred in connection with the impairment of long-term and short-term investments, and the increase in value of long-term and short-term liabilities.

Extraordinary expenses

Extraordinary expenses include extraordinary items, which are recorded at actual amount.

Extraordinary expenses also include profit and loss revaluation adjustment, which is formed to maintain the purchasing power of capital measured in Euro, in compliance with the financial concept of equity capital.

Cash Flow Statement

The cash flow statement has been prepared using the indirect method on the basis of the items in the balance sheet as at 31 December 2005, the balance sheet as at 31 December 2004, the income statement for the year ended 31 December 2005, and the additional data required for the adjustment of inflows and outflows and for the itemisation of significant items.

The revaluation adjustment of economic categories is not stated in the cash flow statement for 2005, since it is not related to receipts and disbursements.

Notes to the financial statements

3.7.1 Balance sheet

3.7.1.1 Intangible fixed assets

In thousand SIT	31 Dec 2005	31 Dec 2004
Deferred operating cost	530,924	513,329
Concessions, patents, licences, trademarks, and similar rights and assets	4,709,243	3,824,179
Total	**5,240,167**	**4,337,508**

In 2005, the Company acquired intangible fixed assets in the amount of 1,912,408 thousand SIT. Investments in concessions, patents, licences, trademarks, and similar rights and assets amounted to 1,215,922 thousand SIT, of which 740,592 thousand SIT refers to the upgrading of the software SAP and WERUM. Intangible fixed assets being acquired encompass predominantly registration documents for new drugs.

The item of intangible fixed assets includes also 67,391 emission coupons which the Company received for the period from 2005 to 2007 from the government based on the Environment Protection Act (i.e. 23,694 coupons for 2005, 22,464 for 2006 and 21,233 coupons for 2007). Taking into account the actual emission of greenhouse gases in the reporting period, the Company shall be obliged to present 21,880 coupons by 30 April 2006. The respective coupons are valued at the amount of 1 Tolar per coupon and are recorded among long-term provisions.

Movement of intangible fixed assets

		Concessions, patents, licences, trademarks, and similar rights and assets					
In thousand SIT	Deferred opearting cost	Licences	Long-term operating leases	Investments in foreign fixed assets	Other intangible fixed assets	Intangible fixed assets being acquired	Total
Cost							
Balance as at 31 Dec 2004	**1,021,035**	**3,756,181**	**99,004**	**594,051**	**0**	**350,297**	**5,820,568**
Additions, capitalisations	0	0	0	0	67	1,912,341	1,912,408
Transfer from assets being acquired	212,156	1,157,077	0	58,845	0	–1,428,078	0
Disposals, write-offs	–25,365	–14,069	–99,004	–6,385	0	0	–144,823
Transfers	0	–4,988	0	0	0	0	–4,988
Balance as at 31 Dec 2005	**1,207,826**	**4,894,201**	**0**	**646,511**	**67**	**834,560**	**7,583,165**
Accumulated amortisation							
Balance as at 31 Dec 2004	**507,706**	**672,221**	**58,418**	**244,715**	**0**	**0**	**1,483,060**
Transfer from equipment	0	–710	0	0	0	0	–710
Disposals, write-offs, other	–25,365	–8,121	–59,389	–5,550	0	0	–98,425
Amortisation	194,561	698,618	971	64,923	0	0	959,073
Balance as at 31 Dec 2005	**676,902**	**1,362,008**	**0**	**304,088**	**0**	**0**	**2,342,998**
Carrying amount as at 31 Dec 2004	**513,329**	**3,083,960**	**40,586**	**349,336**	**0**	**350,297**	**4,337,508**
Carrying amount as at 31 Dec 2005	**530,924**	**3,532,193**	**0**	**342,423**	**67**	**834,560**	**5,240,167**

3.7.1.2 Tangible fixed assets

In thousand SIT	31 Dec 2005	31 Dec 2004
Land	2,908,502	2,775,096
Buildings	32,952,235	35,163,053
Equipment	23,136,721	21,750,245
Tangible fixed assets being acquired	13,848,209	6,563,124
Advances for fixed assets	594,677	1,356,002
Total	**73,440,344**	**67,607,520**

In 2005, the Company's investments in tangible fixed assets amounted to 14,973,841 thousand SIT and include the biggest investment in Krka's history namely the construction of a new plant for the production of pharmaceutical active substances called Synthesis 4 that is expected to be concluded by this year's autumn. Further investments were made in the construction of a new warehouse for liquid raw materials, investments made for increasing the production capacities of the Specifika plant and doubling the capacities of the warehouse of finished products, all referring to sites in Novo mesto.

Movement of tangible fixed assets

In thousand SIT	Land	Buildings	Equipment	Tangible fixed assets being	Advances	Total
Cost						
Balance as at 31 Dec 2004	**2,775,096**	**58,068,332**	**71,478,568**	**6,563,124**	**1,356,002**	**140,241,122**
Additions	0	0	0	14,973,841	–761,325	14,212,516
Capitalisations	133,406	962,753	6,582,693	–7,684,891	0	-6,093
Inventory surplus	0	0	91,682	0	0	91,682
Disposals, write-offs	0	–229,232	–3,101,012	–3,865	0	–3,334,109
Transfers	0	–1,663	6,651	0	0	4,988
Balance as at 31 Dec 2005	**2,908,502**	**58,800,190**	**75,058,582**	**13,848,209**	**594,677**	**151,210,160**
Accumulated depreciation						
Balance as at 31 Dec 2004	**0**	**22,905,279**	**49,728,323**	**0**	**0**	**72,633,602**
Capitalisation, extension of the useful live	0	0	–6,039	0	0	–6,039
Disposals, write-offs	0	–79,054	–3,040,302	0	0	–3,119,356
Depreciation	0	3,022,489	5,147,300	0	0	8,169,789
Inventory surplus	0	0	91,615	0	0	91,615
Transfers	0	–759	964	0	0	205
Balance as at 31 Dec 2005	**0**	**25,847,955**	**51,921,861**	**0**	**0**	**77,769,816**
Carrying amount as at 31 Dec 2004	**2,775,096**	**35,163,053**	**21,750,245**	**6,563,124**	**1,356,002**	**67,607,520**
Carrying amount as at 31 Dec 2005	**2,908,502**	**32,952,235**	**23,136,721**	**13,848,209**	**594,677**	**73,440,344**

3.7.1.3 Long-term investments

In thousand SIT	31 Dec 2005	31 Dec 2004
Interests in Group companies	28,815,352	25,332,414
Long-term receivables from investments in Group companies	506,074	440,607
Other long-term shares	481,914	481,203
Other long-term receivables from investments	858,695	898,792
Own shares	4,670,280	4,670,280
Total	**35,332,315**	**31,823,296**

Movement of long-term investments

In thousand SIT	Interests in Group companies	Long-term receivables from investments in Group companies	Other long-term shares	Other long-term receivables from	Own shares	Total
Gross value						
Balance as at 31 Dec 2004	**25,332,414**	**440,607**	**488,797**	**915,676**	**4,670,280**	**31,847,774**
Increase	2,793,178	198,938	313	289,678	0	3,282,107
Decrease	297,666	199,122	0	334,319	0	831,107
Revaluation	987,426	65,651	505	1,674	0	1,055,256
Balance as at 31 Dec 2005	**28,815,352**	**506,074**	**489,615**	**872,709**	**4,670,280**	**35,354,030**
Value adjustment						
Balance as at 31 Dec 2004	**0**	**0**	**7,594**	**16,884**	**0**	**24,478**
Increase	0	0	107	91	0	198
Decrease	0	0	0	2,961	0	2,961
Balance as at 31 Dec 2005	**0**	**0**	**7,701**	**14,014**	**0**	**21,715**
Carrying amount as at 31 Dec 2004	**25,332,414**	**440,607**	**481,203**	**898,792**	**4,670,280**	**31,823,296**
Carrying amount as at 31 Dec 2005	**28,815,352**	**506,074**	**481,914**	**858,695**	**4,670,280**	**35,332,315**

The structure of interests in subsidiaries is as follows:

In thousand SIT	Owner-ship share (in %)	Share capital (in thousand)	Value of interests in Group companies (in thousand SIT)	
	31 Dec 2005	31 Dec 2005	31 Dec 2005	31 Dec 2004
KRKA ZDRAVILIŠČA, d. o. o., Novo mesto	100 %	3,535,466	11,366,377	11,582,889
KRKA-FARMA d. o. o., Zagreb, Croatia	100 %	3,541,914	3,767,154	2,473,082
KRKA-FARMA DOOEL, Skopje, Macedonia	100 %	191,297	217,094	191,900
KRKA-POLSKA Sp. z o. o., Warsaw, Poland	100 %	1,085,819	5,542,787	4,751,526
KRKA Aussenhandels GmbH, Munich, Germany	100 %	61,247	102,381	99,943
OOO “KRKA-RUS”, Istra, Russian Federation	100 %	7,848,306	7,213,227	6,045,446
OOO “KRKA FARMA”, Sergiev Posad, Russian Federation	100 %	27,363	214,447	103,562
KRKA ČR, s. r. o., Prague, Czech Republic	100 %	826	826	788
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	100 %	240	207,034	15,819
KRKA Sverige AB, Stockholm, Sweden	100 %	3,826	121,304	3,996
KRKA Magyarország Kft, Budapest, Hungary	100 %	11,952	10,125	10,317
HELVETIUS-S.R.L., Trieste, Italy	80 %	12,362	42,163	46,370
“KRKA-FARMA”, d. o. o., Novi Sad, Serbia and Montenegro	100 %	307	10,433	6,776
Total			**28,815,352**	**25,332,414**

Hereinafter shortened corporate names are applied.

In 2005, the Company purchased a share of 1% in its subsidiary Krka Magyarorszàg, Budapest in the amount of 103 thousand SIT, as well as a 40% share in Krka-Farma, Novi Sad amounting to 4,311 thousand SIT. Consequently Krka is now the sole owner of both companies.

An increase of capital stock was carried out in following companies: Krka Farma, Sergijev Posad (by 25,764 thousand SIT), Krka Farma, Zagreb (by 1,054,629 thousand SIT) and Krka Sverige AB, Stockholm (by 198,850 thousand SIT). Investments in Group companies were increased by the accrued profit of the Group companies in the total amount of 1,509,832 thousand SIT and decreased by accrued loss of the Group companies in the total amount of 297,666 thousand SIT. Pursuant to the first paragraph of Art. 57 of the Companies Act, profits of individual subsidiaries are not disclosed.

• Long-term receivables from investments in Group companies

In thousand SIT	31 Dec 2005	31 Dec 2004
OOO “KRKA-RUS”, Istra, Russian Federation	506,074	440,607
Total	**506,074**	**440,607**

The Company extended a loan (denominated in US Dollars) to the company Krka-Rus, Istra for resuming investment projects and for financing current operations. As of the balance sheet date the loan is recorded at 506,074 thousand SIT. The repayment of the loan was deferred for two years (repayment is to begin in 2008).

In 2005, Krka-Farma, Zagreb repaid its long-term loan. The Company extended no new loans in the reporting period.

• Other long-term receivables from investments

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term loans granted to employees	858,695	898,792
Total	**858,695**	**898,792**

In conformity with internal acts Krka grants long-term loans to its employees. The extended loans are mainly used for housing, scholarship, and for moving abroad. Loans are denominated in Euros, bearing an annual interest-rate that is valid during the conclusion of the loan contract.

• Own shares

As of the balance sheet date, the item includes 162,662 own shares in the total amount of 4,670,280 thousand SIT. As for further notes regarding to own shares, refer to the section on capital - reserves for own shares.

3.7.1.4 Inventories

In thousand SIT	31 Dec 2005	31 Dec 2004
Raw materials and other material	9,510,900	5,746,953
Work-in-progress	4,929,239	3,937,437
Products	11,855,422	8,425,425
Merchandise	630,146	428,259
Advances for inventories	588	0
Total	**26,926,295**	**18,538,074**

Within the structure of inventories, raw materials and other material represent 35%, work-in-progress 18%, and products and merchandise represent 47%. Inventories show an increase of 45% compared to the previous year's figures. Higher balances of inventories are influenced by the wider scope of sale, greater range of products, increasing number of markets with more and more specific requirements by individual customers, as well as the Company's policy of having safety stocks in order to ensure flexible and reliable delivery of its core products.

3.7.1.5 Operating receivables

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term operating receivables	3,489,639	6,829
– long-term operating receivables due from Group companies	7,299	6,089
– long-term operating receivables due from other entities	3,482,340	740
Short-term operating receivables	33,692,951	25,610,482
– short-term operating receivables due from Group companies	15,314,474	13,571,146
– short-term trade receivables	16,907,748	11,001,850
– short-term operating receivables due from other entities	1,470,729	1,037,486
Total	**37,182,590**	**25,617,311**

Compared to the previous year's results, the balance of operating receivables increased by 45% which is a result of increased sales, as well as the dynamics used in sales to markets of the Western Europe and the Russian Federation in the last quarter of 2005. Longer repayment periods for government procurements in the Russian Federation contributed to this increase as well.

This year's item of long-term operating receivables encompasses also deferred tax receivables in the amount of 3,480,811 thousand SIT.

• **Short-term operating receivables due from Group companies**

In thousand SIT	31 Dec 2005	31 Dec 2004
KRKA Polska Sp. z o. o., Warsaw, Poland	4,488,802	4,360,100
KRKA FARMA d. o. o., Zagreb, Croatia	6,891,748	6,309,727
KRKA-FARMA DOOEL, Skopje, Macedonia	1,281,080	1,299,836
OOO KRKA FARMA, Sergiev Posad, Russian Federation	1,348,038	589,732
OOO KRKA-RUS, Istra, Russian Federation	248,094	495,171
KRKA-FARMA, d. o. o., Novi Sad, Serbia and Montenegro	607,187	463,957
KRKA Sverige AB, Stockholm, Sweden	442,509	0
Operating receivables due from other Group companies	7,015	52,623
Total	**15,314,474**	**13,571,146**

• **Short-term trade receivables**

In thousand SIT	Gross amount	Allowances	Net amount 31 Dec 2005	Net amount 31 Dec 2004
Short-term trade receivables – domestic customers	2,835,208	32,427	2,802,781	3,359,821
Short-term trade receivables – foreign customers	14,588,332	483,365	14,104,967	7,642,029
Total	**17,423,540**	**515,792**	**16,907,748**	**11,001,850**

The Company forms allowances for receivables in conformity with criteria indicated in the chapter about accounting policies and based on the risk of individual markets and customers as well as the actual repayability of receivables in the past.

Short-term trade receivables are not secured. According to the ageing structure of short-term trade receivables as at 31 December 2005, 98% of receivables are past due by six months (including undue receivables), 1% of receivables are past due from six months to one year, and 1% of receivables are past due for over a year.

• **Short-term operating receivables due from other entities**

The major part of short-term operating receivables due from other entities refers to the Company's receivables arising from VAT refund in the amount of 1,470,729 thousand SIT.

3.7.1.6 Short-term investments

Short-term investments in the amount of 3,863,593 thousand SIT comprise 672,111 thousand SIT of short-term loans to Group companies and 3,191,482 thousand SIT of short-term investments in other entities.

• **Short-term loans to Group companies**

The item of short-term loans to Group companies includes the short-term loan extended to Krka Zdravilišča in the amount of 546,000 thousand SIT and related loan interest amounting to 126,111 thousand SIT.

•Short-term investments in other entities

In thousand SIT	Gross amount	Allowances	Net amount 31 Dec 2005	Net amount 31 Dec 2004
Other shares, available-for-sale	1,521,814	43,210	1,478,604	769,490
Short-term loans granted	213,840	30,650	183,190	237,466
Other securities, available-for-sale	1,520,320	0	1,520,320	375,928
Interest on short-term loans	9,368	0	9,368	1,387
Total	**3,265,342**	**73,860**	**3,191,482**	**1,384,271**

3.7.1.7 Cash in bank, cheques and cash in hand

In thousand SIT	31 Dec 2005	31 Dec 2004
Cash in hand and cheques received	11,352	7,970
Cash in bank	747,416	1,092,984
Total	**758,768**	**1,100,954**

3.7.1.8 Capital

In thousand SIT	31 Dec 2005	31 Dec 2004
I. Called-up capital	14,170,448	14,170,448
1. Share capital	14,170,448	14,170,448
II. Capital reserves	2,598,736	2,598,736
III. Revenue reserves	64,542,300	55,230,357
1. Legal reserves	3,592,196	3,592,196
2. Reserves for own shares	4,670,280	4,670,280
3. Statutory reserves	2,300,000	1,500,000
4. Other revenue reserves	53,979,824	45,467,881
IV. Net profit or loss from previous periods	5,974,464	3,583,658
V. Net profit or loss for the financial year	14,280,823	9,101,384
VI. Capital revaluation adjustments	23,479,002	22,026,590
1. General capital revaluation adjustment	21,724,113	21,724,113
2. Specific capital revaluation adjustment	1,754,889	302,477
Total	**125,045,773**	**106,711,173**

The value of capital increased to 125,045,773 thousand SIT in the reporting period. The increase is a result of the net profit for 2005 in the amount of 21,580,823 thousand SIT, the subsequently enforced decrease in corporate income tax amounting to 87,663 thousand SIT (interest paid back by the Tax Administration of the Republic of Slovenia), and of the increase in the capital revaluation adjustment amounting to 1,509,832 thousand SIT - profits of subsidiaries. The decrease was due to dividends payout, payments made in accordance with the resolution adopted by the shareholders on 17 June 2005 at the 10th Annual Meeting amounting to 4,786,298 thousand SIT, as well as other decreases in capital components in the amount of 57,420 thousand SIT.

Transfers within capital result from the allocation of net profit or loss from previous periods and net profit or loss for the financial year to other revenue reserves in the amount of 6,500,000 thousand SIT and from forming additional statutory reserves in the amount of 800,000 thousand SIT.

• **Share capital**

Share capital of the Company consists of 3,542,612 ordinary registered shares at par value of 4,000 SIT. One class of shares is considered, hence this represents also the weighted average number of ordinary shares. The first and only issue of shares was carried out in 1995.

Net profit per share amounts to 6,092 SIT. The calculation takes into account the total number of shares issued by the Company.

• **Revenue reserves**

Legal reserves
The Company formed legal provisions in the amount of 10% of its share capital. As at the year-end, the value of reserves together with their revaluation amounted to 3,592,196 thousand SIT.

Reserves for own shares
As of the balance sheet date, the item of own shares includes 162,662 of Krka's own shares. The own shares' par value as at 31 December 2005 was recorded at 650,648 thousand SIT or 4.6% of the share capital's value.

The revaluation of own shares in the reporting period took into account the market value as at 29 December 2001, namely 28,711.56 SIT. On the last trading day of 30 December 2005, the quotation per share amounted to 102,342.30 SIT, which is 190% higher from the carrying value (35,297.60 SIT). Accordingly the fair value of own shares amounts to 16,647,203 thousand SIT.

Other revenues reserves
Part of the accumulated profit of 2004 amounting to 5,886,801 thousand SIT was allocated to other revenue reserves, in compliance with a resolution of the Annual Meeting adopted on 17 June 2005.

• **Net profit from previous periods**

Net profit from previous periods recorded in the amount of 5,974,644 thousand SIT represents a part of accumulated profit pursuant to the Annual Meeting's resolution in 2004.

• **Net profit for the financial year**

In 2005 Krka generated a profit in the amount of 21,580,823 thousand SIT. In conformity with legal provisions on the obligatory use of the net profit and in conformity with the statutory provisions, 800,000 thousand SIT were allocated to additional statutory reserves. In accordance with the resolution of the Management and the Supervisory Board, part of the net profit in the amount of 6,500,000 thousand SIT was allocated to other revenue reserves, whereas the amount of 14,280,823 thousand SIT was included in the item of net profit for the financial year.

• **Capital revaluation adjustments**

The general capital revaluation adjustment refers to previous periods (revaluation adjustment of share capital).
As at the balance sheet date, the specific capital revaluation adjustment is recorded at 1,754,889 thousand SIT and refers mainly to the profits of subsidiaries (1,509,518 thousand SIT) and the revaluation of derivative financial instruments.

3.7.1.9 Provisions

In thousand SIT	Balance as at 31 Dec 2004	Formation	Utilisation and reversal	Balance as at 31 Dec 2005
Other provisions				
– for lawsuits	11,763,665	12,502,655	11,446,162	12,820,158
– for ecological restoration	161,025	0	41,088	119,937
– from donations received	100,492	0	12,887	87,605
– emission coupons	0	68	0	68
Total	**12,025,182**	**12,502,723**	**11,500,137**	**13,027,768**

The major part of provisions refers to lawsuits, which have recorded an increase by 1,056,493 thousand SIT. The increase comprises also the formation of new provisions (12,502,563 thousand SIT) for an outstanding lawsuit relating to the alleged patent infringements in connection with atorvastatin. Furthermore, the Company reversed provisions in the amount of 11,444,803 thousand SIT referring to the lawsuit of alleged infringement of the patent that protects the drug simvastatin, since the claim was rejected. Newly formed and reversed provisions are included among other operating expenses or other operating revenues in the income statement.

Other changes in the balance of provisions refer to a decrease in provisions for ecological restoration and provisions from donations received in 2004 from the Ministry of the Economy for the investment in the Šentjernej plant and in the distribution centre in the Russian Federation. Provisions are decreased by accumulated depreciation of fixed assets, for which they were formed. The depreciation amount of 12,887 thousand SIT is recorded under the item of utilisation.

3.7.1.10 Long-term financial and operating liabilities

Compared to 2004, the structure of financial and operating liabilities changed significantly, as the Company raised long-term instead of short-term loans. Hence, the share of long-term liabilities within total liabilities decreased substantially (from 9.1% to 5.5%) and short-term financial liabilities increased (from 11.4% to 16.9%).

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term financial liabilities to banks	9,973,126	13,699,841
Long-term financial liabilities to other entities	38,434	86,702
Total	**10,011,560**	**13,786,543**

The portion of long-term loans payable within the next financial year in the total amount of 4,101,618 thousand SIT is recorded among short-term financial liabilities; 3,121,673 thousand SIT refers to local banks and the amount of 979,945 thousand SIT to foreign banks.

• Long-term financial liabilities to banks

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term loans raised at domestic banks	9,973,126	11,397,392
Long-term loans raised at foreign banks	0	2,302,449
Total	**9,973,126**	**13,699,841**

Long-term financial liabilities have decreased mostly due to a regular repayment of long-term loans extended by domestic banks. Loans are denominated in EUR and USD and were extended for a period of seven years and for financing investments in current assets. The Company raised no new long-term loan in the reporting period.

Long-term loans obtained from banks are neither secured by mortgages nor by bank guarantees. The Company issued bills of exchange for the loans and they are recorded among off balance sheet items.

The Company hedged three long-term loans that are considered to form the major part of the borrowed amount by using interest rate swaps.

3.7.1.11 Short-term financial and operating liabilities

In thousand SIT	31 Dec 2005	31 Dec 2004
Short-term financial liabilities to banks	5,959,778	1,601,791
Short-term operating liabilities from advances	454,205	503,246
Short-term trade payables	11,834,127	6,075,658
Short-term financial and operating liabilities to Group companies	157,079	1,710,155
Short-term financial and operating liabilities to other entities	12,501,512	7,294,805
Total	**30,906,701**	**17,185,655**

• Short-term financial liabilities to banks

In thousand SIT	31 Dec 2005	31 Dec 2004
Short-term loans from domestic banks	4,846,617	897,340
Short-term loans from foreign banks	979,945	528,728
Interest payable	133,216	175,723
Total	**5,959,778**	**1,601,791**

The balance of raised short-term loans at end-year is higher by 272% from the balance recorded at the beginning of the financial year. The increase is mostly attributable to the raising of additional short-term loans and repaying the long-term loan in the amount of 4,101,618 thousand SIT, which is due in 2006.

• Short-term trade payables

In thousand SIT	31 Dec 2005	31 Dec 2004
Payables to domestic suppliers	6,555,357	4,265,694
Payables to foreign suppliers	5,278,771	1,809,964
Total	**11,834,127**	**6,075,658**

• Short-term financial and operating liabilities to Group companies

In thousand SIT	31 Dec 2005	31 Dec 2004
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	79,735	2,877
KRKA-POLSKA, Sp. z o. o., Warsaw, Poland	52,067	27,539
KRKA ZDRAVILIŠČA, d. o. o., Novo mesto	25,899	15,507
"KRKA-FARMA", d. o. o., Novi Sad, Serbia and Montenegro	477	0
KRKA Sverige AB, Stockholm, Sweden	176	0
HELVETIUS-S. R. L.,Trieste, Italy	–1,275	1,605,798
KRKA-FARMA d. o. o., Zagreb, Croatia	0	58,434
Total	**157,079**	**1,710,155**

• **Short-term financial and operating liabilities to other entities**

In thousand SIT	31 Dec 2005	31 Dec 2004
Short-term financial liabilities due to other entities	2,770,091	3,154,657
Short-term operating liabilities:	9,731,421	4,140,148
– short-term operating liabilities to the state	7,103,157	1,854,637
– payables to employees	2,527,508	2,159,970
– short-term operating liabilities related to profit appropriation	88,405	111,183
– other short-term operating liabilities	12,351	14,358
Total	**12,501,512**	**7,294,805**

Short-term operating liabilities to the state mainly refer to the payment of corporate income tax amounting to 6,598,934 thousand SIT.

Short-term financial liabilities to other entities include short-term loans obtained from domestic companies in the amount of 2,475,469 thousand SIT and related interest in the amount of 8,730 thousand SIT. The loans were raised in Tolars for the period of one to six months, some for an indefinite period, or as money at call. Loans are not secured.

3.7.1.12 Accrued costs (expenses) and deferred revenues

In thousand SIT	Balance as at 31 Dec 2004	Utilisation	Formation	Balance as at 31 Dec 2005
Short-term deferred revenues – subsidiaries	153,527	–153,527	258,748	258,748
Short-term deferred revenues – other entities	926,357	–926,357	3,309,804	3,309,804
Short-term accrued costs (expenses) – other entities	292,350	–290,397	263,813	265,766
Total	**1,372,234**	**–1,370,281**	**3,832,365**	**3,834,318**

Short-term deferred revenues incurred in connection with subsidiaries includes 258,748 thousand SIT of contractually based discounts that shall be granted on products sold to subsidiaries in 2005.

Other short-term deferred revenues comprise 3,028,686 thousand SIT of contractually based discounts that shall be granted on products sold to other entities in 2005.

3.7.1.13 Off balance sheet items

In thousand SIT	31 Dec 2005	31 Dec 2004
Bills of exchange issued as collateral for loans raised	14,164,115	13,453,199
Guarantees given to Group companies for loans raised	1,917,521	2,727,688
Other guarantees given	252,280	377,479
Other	3,018,630	2,040,701
Total	**19,352,546**	**18,599,067**

3.7.2 Income statement

The income statement has been prepared in terms of type of revenues and expenses. Additionally, cost items are also presented in terms of operating units based on cost accounting data.

Cost in terms of operating units

In thousand SIT	2005	2004
Production cost of goods sold	45,415,353	44,047,215
Development cost	9,556,081	8,372,923
Selling expense	35,104,584	22,067,586
General and administrative expense	10,121,199	10,048,354
Total	**100,197,217**	**84,536,078**

• Production costs of goods sold

In 2005 the production costs of goods sold were recorded at 45,415,353 thousand SIT indicating an increase of 3% compared to the previous year's results. As for their share among the net sales, the production costs decreased from 45% in 2004 to 39% in 2005. The relevant decrease is a result of a more favourable structure of goods sold, as well as stronger cost effectiveness due to the better productivity (contemporary technological procedures, an improved utilisation level of production capacities).

• Development cost

As for the development research activity, the Company incurred costs amounting to 9,556,081 thousand SIT. All costs recorded are charged against the income statement of 2005, since development and research costs are not capitalised. Compared to 2004 the relevant costs increased by 14%, whereas its share among the net sales was 8.2%.

• Selling expense

The selling expense comprises 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 the reporting period the selling expense amounted to 35,104,584 thousand SIT or 59% more than in 2004. The increase was influenced by the newly formed provisions (12,502,655 thousand SIT) for the lawsuit relating to drugs for heart and cardiovascular diseases. The amount of provisions formed in 2004 was 2,471,663 thousand SIT and increased the selling expense.

• General and administrative expense

Compared to the previous year's figures, the general and administrative expense increased by 1% and amounted to 10,121,199 thousand SIT. Its share in the structure of net sales implies a decrease from 11.9% to 8.7%. The item of general and administrative expense encompasses also other operating expenses.

3.7.2.1 Net sales

In thousand SIT	2005	2004
Revenues from the sale of products and services in Slovenia	**17,458,589**	**17,825,424**
– to Group companies	51,669	16,344
– to others	17,406,920	17,809,080
Revenues from the sale of products and services abroad	**96,663,870**	**76,698,886**
– to Group companies	23,099,235	17,102,250
– to others	73,564,635	59,596,636
Revenues from the sale of goods and material in Slovenia	**878,156**	**649,545**
– to Group companies	19	0
– to others	878,137	649,545
Revenues from the sale of goods and material abroad	**1,569,717**	**2,803,656**
– to Group companies	566,358	867,598
– to others	1,003,359	1,936,058
Total	**116,570,332**	**97,977,511**

Net sales by business segments

In thousand SIT	2005	2004
Human health products	111,762,137	93,946,353
– prescription pharmaceuticals	95,973,901	79,847,605
– self-medication products	13,825,788	11,362,910
– cosmetic products	1,962,448	2,735,838
Animal health products	4,602,791	3,884,460
Other	205,404	146,698
Total	**116,570,332**	**97,977,511**

Net sales by geographical segments

In thousand SIT	2005	2004
Slovenia	18,336,745	18,474,969
South-East Europe	20,027,693	16,797,813
East Europe	31,500,900	22,134,771
Central Europe	26,708,314	19,380,057
West Europe and Overseas Markets	19,996,680	21,189,901
Total	**116,570,332**	**97,977,511**

3.7.2.2 Other operating revenues

In thousand SIT	2005	2004
Utilisation and reversal of long-term provisions (Note 3.7.1.9)	11,498,778	3,788,275
Other income-related revenues	83,603	185,825
Operating revenues from revaluation	213,924	124,075
Total	**11,796,305**	**4,098,175**

3.7.2.3 Cost of goods, materials and services

In thousand SIT	2005	2004
Cost of goods and materials sold and cost of materials used	33,574,525	27,372,515
Cost of services	18,599,374	16,146,326
Total	**52,173,899**	**43,518,841**

The cost of goods, materials and services increased by 19% compared to the previous year's results.

• Cost of goods and materials sold and cost of materials used

In thousand SIT	2005	2004
Cost of basic materials and cost of goods sold	29,521,036	23,556,602
Cost of energy supply	2,161,531	1,825,206
Other cost of materials	1,891,958	1,990,707
Total	**33,574,525**	**27,372,515**

Other cost of materials comprise cost of spare parts and materials for maintenance of fixed assets, cost of office stationary and trade magazines, the write-off of low value items and other cost of materials.

• Cost of services

In thousand SIT	2005	2004
Costs of fairs, advertising and promotion	6,573,631	5,546,732
Costs of professional services	4,669,260	3,332,996
Cost of maintenance	1,485,380	1,531,072
Cost of transport services	1,498,193	1,252,784
Refund of work-related expenses	728,267	893,422
Cost of services performed by natural persons that do not perform a registered business activity, including the associated cost	1,036,053	940,883
Other cost of services	2,608,590	2,648,437
Total	**18,599,374**	**16,146,326**

The item of other cost of services is inclusive of cost of funds transfer and bank services as well as insurance premiums in the amount of 799,781 thousand SIT, rentals in the amount of 561,144 thousand SIT, dealer's commissions in the amount of 323.523 thousand SIT, and costs of other services in the amount of 924,142 thousand SIT.

3.7.2.4 Labour cost

In thousand SIT	2005	2004
Gross salaries, wages and continued pay	21,541,753	19,031,365
Social security contributions and payroll tax	5,333,490	4,911,068
Other labour cost	1,781,953	2,417,094
Total	**28,657,196**	**26,359,527**

Other labour cost incurred in 2005 includes the vacation bonus, travel allowances, termination pays, tenure awards, and some other repayments to employees.

The contribution for compulsory pension and disability insurance amounted to 5,367,737 thousand SIT (comprising employer's as well as employee's contributions), and for additional pension insurance to 691,628 thousand SIT.

3.7.2.5 Amortisation/depreciation expense

Amortisation/depreciation expense consists of 9,327,315 thousand SIT of amortisation/depreciation expense and operating expenses from revaluation of tangible fixed assets and 925,677 thousand SIT of operating expenses from revaluation of operating current assets.

- **Amortisation/depreciation expense, and operating expenses from revaluation**

In thousand SIT	2005	2004
Amortisation of intangible fixed assets	959,073	524,717
Depreciation of tangible fixed assets	8,169,789	7,725,946
Operating expenses from revaluation of tangible fixed assets	198,452	353,599
Total	**9,327,315**	**8,604,262**

- **Operating expenses from revaluation of operating current assets**

Allowances for inventories of materials, goods, products and work-in-progress are formed for the inventories ranked as questionable items, non-moving, expired sell-by date or perishable goods. Operating expenses from revaluation of operating current assets include allowances for inventories in the amount of 537,672 thousand SIT and allowances for receivables in the amount of 388,005 thousand SIT.

3.7.2.6 Other operating expenses

In thousand SIT	2005	2004
Environmental levies	306,305	260,494
Donations, aids, co-financing	491,257	464,132
Scholarships and rewards to pupils and students	25,784	28,500
Fiscal charges irrespective of operating results	258,283	311,802
Formation of provisions	12,502,563	2,471,633
Other costs	323,818	295,488
Total	**13,908,010**	**3,832,049**

3.7.2.7 Financial revenues

In thousand SIT	2005	2004
Financial revenues from shares	**1,019,272**	**1,545,028**
– financial revenues from shares in Group companies (revaluation of investments)	993,386	1,521,560
– financial revenues from shares in associates	0	11,128
– other financial revenues from shares	25,886	12,340
Financial revenues from long-term receivables	**146,652**	**404,541**
– financial revenues from long-term receivables due from Group companies (interest revenues from long-term loans)	106,678	74,384
– financial revenues from long-term receivables due from associates	0	6,685
– other financial revenues from long-term receivables	39,974	323,472
Financial revenues from short-term receivables	**1,996,463**	**1,599,680**
– financial revenues from short-term receivables due from Group companies	251,366	505,860
– other financial revenues from short-term receivables	1,745,097	1,093,820
Total	**3,162,387**	**3,549,249**

As for the reporting period, the item of other financial revenues refers to exchange gains from payments and revaluation of long-term extended and raised loans in the amount of 10,525 thousand SIT as well as revenues from the interest on extended long-term loans in the amount of 29,449 thousand SIT.

Financial revenues from short-term receivables due from Group companies include 233,385 thousand SIT of exchange differences arising from import and export.

Other significant items within other financial revenues from short-term receivables include exchange gains in the amount of 1,582,802 thousand SIT and revenues from the sale of short-term investments amounting to 64,744 thousand SIT.

3.7.2.8 Financial expenses

In thousand SIT	2005	2004
Financial expenses for long- and short-term investment write-offs	**2,095,761**	**1,816,727**
– financial expenses for revaluation of investments in Group companies	1,454,167	1,394,176
– other financial expenses for revaluation	641,594	422,551
Interest expenses and financial expenses for other liabilities	**1,879,116**	**2,353,173**
– interest expenses and financial expenses for other liabilities to Group companies	127,758	288,729
– other interest expenses and financial expenses for other liabilities	1,751,358	2,064,444
Total	**3,974,877**	**4,169,900**

Financial expenses from revaluation of investments in Group companies represent current losses of these companies in the amount of 297,666 thousand SIT and the coverage of loss from previous years generated by Krka-Rus in the amount of 1,150,399 thousand SIT, exchange losses from revaluation of investments in accordance with changes of the exchange rates of foreign currencies in which individual investments are denominated, as well as exchange losses arising from revaluation of a long-term loan extended to Krka-Rus, Istra.

Interest expenses and financial expenses for other liabilities to Group companies comprise exchange gains and losses arising from export payments and revaluation of export receivables due from Group companies in the amount of 288,729 thousand SIT.

Other interest expenses and financial expenses for other liabilities include mostly negative exchange differences in the total amount of 1,226,685 thousand SIT, incurred in connection with receivables and liabilities, both upon payments and upon revaluation as at the balance sheet date, mainly related to the drop of dollar exchange rate, and interest expenses from short-term and long-term loans in the amount of 634,050 thousand SIT. The rest mainly relates to commissions.

3.7.2.9 Income tax

Income is taxed at 25%. The tax base was determined by taking into account tax additions and tax deductions. Considering the new legislation applied for tax deduction, the income tax was recorded at 9,315,564 thousand SIT and represents 34% in the total profit structure. The receivable for deferred taxes amounts to 3,480,811 thousand SIT, thus the effective rate is 21.3% of the total profit (2004: 17.4%).

3.7.2.10 Net profit for the financial year

In thousand SIT	2005	2004
Profit from ordinary activities	27,376,073	16,963,906
Profit from extraordinary activities	38,503	101,252
Net profit for the financial year	**21,580,823**	**14,101,384**

The operating profit generated by the Company in 2005 amounted to 28,188,563 thousand SIT indicating an increase of 60.3% compared to 2004.

Net profit for 2005 amounted to 21,580,823 thousand SIT and represents an increase of 53% over the previous year's figure.

If capital had been revalued by the growth rate of the euro exchange rate (0.07%), profit or loss for the period would have been higher by 74,213 thousand SIT. If capital had been revalued by the cost of living index (102.3%), profit or loss for the period would have been lower by 2,418,083 thousand SIT.

3.7.3 General information and other disclosures

Company profile

Krka, d. d., Novo mesto
Šmarješka cesta 6
8501 Novo mesto
Slovenia

Objects of the Company

Business operations of the Company are mainly centred upon pharmaceutical and chemical activities, which, in addition to the production and sale of prescription pharmaceuticals and self-medication products, also include the production and sale of animal health products and cosmetic products. The registered activities of the Company are listed in the Articles of Association.

Data on the controlling company

Krka, tovarna zdravil, d. d., Novo mesto, Šmarješka cesta 6, 8501 Novo mesto is the controlling company within the Krka Group. The Annual Report of Krka, d. d., Novo mesto and the Consolidated Annual Report of the Krka Group are available for review at the Company's registered seat and on the web-site www.krka.si.

Employees

As at the balance sheet date, the Company employed 3,978 staff; 2,954 of those in Slovenia and 1,024 in representative offices abroad.

Average number and breakdown of employees by educational levels in 2005 compared to 2004:

	Krka, d. d., Novo mesto			
	2005		2004	
Educational level	Headcount	Share (in %)	Headcount	Share (in %)
PhD	44	1.1	42	1.2
MSc	127	3.3	113	3.1
University education	1,363	35.5	1,113	30.9
Higher professional education	145	3.8	106	3.0
Vocational college education	139	3.6	149	4.1
Secondary school education	818	21.3	816	22.6
Skilled workers	1,022	26.6	1,058	29.3
Unskilled workers	186	4.8	208	5.8
Total (average for the period)	**3,844**	**100.0**	**3,605**	**100.0**

Total amount of receipts that groups of persons received in the financial year 2005 for performing their functions or duties in conformity with Article 253 of the Companies Act:

Groups of persons as per the Companies Act (In thousand SIT)	Total receipts	Hareof participation in profit according to the annual meeting resolution
Members of the Management Board	365,145	0
Members of the Supervisory Board	63,066	51,291
– supervisory board prior to 21 June 2005 (12 members)	59,899	51,291
– supervisory board after 22 June 2005 (9 members)	3,167	0
Persons employed under individual employment contracts	3,812,416	0
Total	**4,240,627**	**51,291**

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

The fixed part of the salary is defined in individual employment contracts concluded between members of the Management Board and the Supervisory Board. The variable part of the salary is considered part of the gross salary and is accounted for in compliance with provisions of Rules on Bonuses Granted to the Management Board, adopted by the Company's Supervisory Board. The Management does not participate in the profit. The receipts of Ms Zvezdana Bajc refer to the period after 1 April 2005 when she was appointed member of the Management Board.

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

Receipts of persons employed under individual employment contracts include salaries and wages, fringe benefits, holiday allowance, any other receipts (tenure awards), and refund of expenses

Data on loans extended by the Company to groups of persons in conformity with Article 253 of the Companies Act

Groups of persons as per the Companies Act In thousand SIT	Loan balance as at 31 Dec 2005	Repayements in 2005
Members of the Management Board	3,539	770
Members of the Supervisory Board (employees' representatives)	517	173
Persons employed under individual employment contracts	98,152	22,124
Total	**102,208**	**23,067**

3.7.4 Ratios

	2005	2004
1. Equity financing rate: equity / liabilities (in broader sense)	0.684	0.706
2. Long-term financing rate: equity + provisions + long-term liabilities / liabilities (in broader sense)	0.810	0.877
3. Operating fixed assets rate: fixed assets (at carrying amount) / assets	0.402	0.447
4. Long-term investment rate: fixed assets (at carrying amount) + long-term investments + long-term operating receivables / assets	0.614	0.658
5. Equity to operating fixed assets: equity / fixed operating assets (at carrying amount)	1.703	1.578
6. Acid test ratio: short-term investments + cash / short-term liabilities	0.150	0.176
7. Quick ratio: short-term investments + cash + short-term receivables / short-term liabilities	1.240	1.666
8. Current ratio: inventories + short-term investments + cash + short-term receivables / short-term liabilities	2.111	2.745
9. Operating efficiency ratio: operating revenues / operating expenses	1.281	1.208
10. Net return on equity ratio: net profit for the financial year / average equity (less net operating result for the reporting year)	0.205	0.149
11. Dividends to share capital ratio: total dividends paid in the financial year / average share capital	0.350	0.290

3.8 Auditor's Report

KPMG

Auditor's Report

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

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

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

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

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

KPMG SLOVENIJA,

podjetje za revidiranje, d.o.o.

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

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

Ljubljana, March 23, 2006

KPMG Slovenija, d.o.o.
4

4 Financial statements of the Krka Group prepared in accordance with the International Financial Reporting Standards

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

4.1 Consolidated balance sheet

In thousand SIT	Notes	31 Dec 2005	31 Dec 2004
Assets			
Property, plant and equipment	4.5.1.1	108,165,231	98,539,914
Intangible assets	4.5.1.2	5,058,450	4,151,803
Investments in associates	4.5.1.3	270,761	119,871
Deferred tax assets	4.5.2.12	4,778,324	1,913,542
Other non-current assets	4.5.1.4	2,182,301	2,207,730
Non-current assets		**120,455,067**	**106,932,860**
Inventories	4.5.1.5	28,966,629	20,035,072
Trade and other receivables	4.5.1.6	33,008,703	23,910,769
Current investments	4.5.1.7	3,391,005	1,875,683
Cash and cash equivalents	4.5.1.8	3,027,752	2,841,099
Current assets		**68,394,089**	**48,662,623**
Total assets		**188,849,156**	**155,595,483**
Off balance sheet items		20,201,775	19,271,908
Equity	4.5.1.9		
Share capital		14,170,448	14,170,448
Own shares		–4,670,280	–4,670,280
Reserves		34,885,325	34,085,325
Retained earnings		68,131,642	51,140,710
Reserves for fair value		561,602	519,987
Translation reserves		4,648	59,959
Equity holders of the parent		**113,083,385**	**95,306,149**
Minority interest		1,813,556	1,819,476
Total equity		**114,896,941**	**97,125,625**
Liabilities			
Borrowings	4.5.1.11	11,669,435	14,596,143
Provisions	4.5.1.12	23,647,648	22,416,952
Grants received	4.5.1.13	445,849	209,898
Deferred tax liabilities	4.5.2.12	285,236	248,948
Total non-current liabilities	4.5.1.10	**36,048,168**	**37,471,941**
Trade payables	4.5.1.14	14,043,571	9,073,437
Borrowings	4.5.1.11	9,120,664	5,282,943
Income tax liabilities		6,689,431	1,490,963
Provisions and other liabilities		8,050,381	5,150,574
Total current liabilities		**37,904,047**	**20,997,917**
Total liabilities		**73,952,215**	**58,469,858**
Total equity and liabilities		**188,849,156**	**155,595,483**
Off balance sheet items		20,201,775	19,271,908

4.2 Consolidated income statement

In thousand SIT	Notes	2005	2004
Net sales	4.5.2.1	132,757,626	113,317,141
Production cost of goods sold	4.5.2.3	51,847,673	51,676,455
Gross operating yield		**80,909,953**	**61,640,686**
Sales and marketing	4.5.2.4	41,609,639	26,869,490
R&D costs	4.5.2.5	9,611,856	8,313,591
Administrative expenses	4.5.2.6	13,386,461	13,031,883
Other operating revenues	4.5.2.2	12,221,261	4,524,293
Operating profit		**28,523,258**	**17,950,015**
Financial income	4.5.2.10	3,989,327	3,545,539
Financial expenses	4.5.2.10	2,982,607	3,195,485
Net financial expenses		**1,006,720**	**350,054**
Profit before tax		**29,529,978**	**18,300,069**
Income tax expense	4.5.2.11	6,210,850	2,639,051
Profit for the period		**23,319,128**	**15,661,018**
Equity holders of the parent		**23,288,582**	**15,637,826**
Minority interest		**30,546**	**23,192**
Earnings per share		6,890	4,627

4.3 Consolidated cash flow statement

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

4.4 Consolidated statement of recognised income and expenses

In thousand SIT	2005	2004
Translation reserve	–59,927	47,378
Revaluation of long-term investments to market price	55,071	653,843
Deferred taxes	–812,470	–354,318
Subsequent decrease in income tax	0	73,925
Refund of default interest paid in respect of taxes	87,663	0
Net income and expense recognised directly in equity	**–729,663**	**420,828**
Profit for the period	**23,319,128**	**15,661,018**
Total recognised income and expense for the period	**22,589,465**	**16,081,846**

4.5 Notes to the financial statements

Group profile

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

In the reporting period, the Group generated net sales amounting to 132,757,626 thousand SIT, of which 18% on the domestic market and 82% on the foreign market. Most of the Group companies abroad represent a part of the distribution network, through which Krka sells its products. Krka-Polska and Krka-Farma Zagreb are both production as well as selling companies, whereas Krka-Rus is solely a production company. In 2005, the Group recorded a 122% increase in sale of products from own production capacities abroad.

In the structure of the Group's net sales, 95.6% refers to the sale of human health products, cosmetic products and animal health products (126.9 billion SIT) and the remaining 4.4% or 5.8 billion SIT to the sale of health resorts and tourist services by Krka Zdravilišča (together with Krka Strunjan).

	2005	Growth 2005/2004 (in %)
Net sales in thousand SIT	132,757,626	17
Net profit in thousand SIT	23,319,128	47
Asset value in thousand SIT (at 31 December)	188,849,156	22
Number of staff (at 31 December)	5,224	9

Krka is the controlling company of the Krka Group, which encompasses following subsidiaries:

	Ownership share 31 Dec 2005 (in %)	Share capital	Currency
KRKA ZDRAVILIŠČA, d. o. o., Novo mesto	100	3,535,466,000	SIT
KRKA- FARMA d. o. o., Zagreb, Croatia	100	76,369,900	HRK
KRKA-FARMA DOOEL, Skopje, Macedonia	100	49,060,618	MKD
KRKA-POLSKA Sp. z o. o., Warsaw, Poland	100	17,490,000	PLZ
KRKA Aussenhandels GmbH, Munich, Germany*	100	255,646	EUR
OOO "KRKA-RUS", Istra, Russian Federation	100	1,111,374,765	RUB
OOO "KRKA FARMA", Sergiev Posad, Russian Federation	100	130,000	RUB
KRKA ČR, s. r. o., Prague, Czech Republic*	100	100,000	CZK
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	100	1,000	EUR
KRKA Sverige AB, Stockholm, Sweden	100	150,000	SEK
KRKA Magyarorszàg Kft, Budapest, Hungary	99	12,600,000	HUF
HELVETIUS-S.R.L., Trieste, Italy**	80	51,600	EUR
"KRKA-FARMA", d. o. o., Novi Sad, Serbia and Montenegro	60	119,745	CSD

* Companies where no operations were carried out
** Company in the proscess of dissolution

The subsidiary Krka Zdravilišča, d. o. o., Novo mesto has interests in following companies:

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

The Group's associated company Dawa in Kenya has been sold in the reporting period.

The consolidated (Group) Annual Report 2005 is available for review at the registered office of the controlling company and the web site www.krka.si.

Bodies of the Group companies

Since 1 January 2005 the Management Board is chaired by its President and Chief Executive Mr Jože Colarič and made up of following members: Mr Janez Poljanec as Director of Product Supply, Mr Aleš Rotar as Director of Research and Development, Ms Danica Novak Malnar as Worker Director and Ms Zvezdana Bajc (since 1 April 2005) as Director of Economics and Information Processing.

Up till Krka's Annual Meeting that was held on 17 June 2005 the Supervisory Board consisted of following shareholders' representatives: Mr Janez Prijatelj as President, Mr Bojan Dejak, Mr Borut Jamnik, Mr Janko Kastelic, Ms Mojca Osolnik Videmšek and Mr Stanislav Valant, as well as six employees' representatives: Ms Sonja Kermc, Ms Mihaela Korent, Mr Miroslav Kramarič, Ms Darinka Kure, Mr Boris Petančič and Ms Božena Šuštar.

A new Supervisory Board was elected for a four-year mandate as at 21 June 2005 comprising six shareholders' representatives: Mr Gregor Gomišček as President, Mr Marko Kranjec as Deputy President, Ms Mateja Božič, Mr Draško Veselinovič, Mr Anton Rous and Mr Alojz Zupančič, as well as three employees' representatives according to Company's modified articles of association: Ms Sonja Kermc, Ms Mateja Vrečer and Mr Tomaž Sever.

In 2005 subsidiaries were managed by following directors:

Group companies	Director
KRKA ZDRAVILIŠČA, d. o. o., Novo mesto	Vladimir Petrovič
KRKA-FARMA d. o. o., Zagreb, Croatia	Mladen Pavletić (till 30 June 2005)
	Hrvoje Hudiček (since 1 July 2005)
KRKA-FARMA DOOEL, Skopje, Macedonia	Svetlana Stanoevska
KRKA-POLSKA Sp. z o. o., Warsaw, Poland	Jožef Kolarič
KRKA Aussenhandels GmbH, Munich, Germany	Irena Bostič
OOO "KRKA-RUS", Istra, Russian Federation	Boris Veselič
OOO "KRKA FARMA", Sergiev Posad, Russian Federation	Aleš Cuderman
KRKA ČR, s. r. o., Prague, Czech Republic	Andrej Dobovišek
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	Viktor Kozjan
KRKA Magyarorszàg Kft, Budapest, Hungary	Tomaž Sever (till 31 December 2005)
	Katalin Hubay (since 1 January 2006)
HELVETIUS-S.R.L., Trieste, Italy	Tanja Šega
"KRKA-FARMA", d. o. o., Novi Sad, Serbia and Montenegro	Adam Frenc
KRKA Sverige AB, Stockholm, Sweden	Jan-Christer Tjernström

Number of employees in Group companies

Group companies	31 Dec 2005	31 Dec 2004
KRKA, d. d., Novo mesto	3,978	3,648
KRKA ZDRAVILIŠČA, d. o. o., Novo mesto*	626	594
KRKA-FARMA d. o. o., Zagreb, Croatia	105	89
KRKA-FARMA DOOEL, Skopje, Macedonia	22	23
KRKA-POLSKA Sp. z o. o., Warsaw, Poland	410	347
KRKA Aussenhandels GmbH, Munich, Germany	0	1
OOO "KRKA-RUS", Istra, Russian Federation	53	50
OOO "KRKA FARMA", Sergiev Posad, Russian Federation	15	16
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	0	1
HELVETIUS-S.R.L., Trieste, Italy	2	5
"KRKA-FARMA", d. o. o., Novi Sad, Serbia and Montenegro	9	7
KRKA Sverige AB, Stockholm, Sweden	4	0
Total	**5,224**	**4,781**

* including Zdravilišče Strunjan

Summary of significant accounting policies

Krka, d. d., Novo mesto (hereinafter: the Company) is the controlling company of the Krka Group with its registered seat at Šmarješka cesta 6, 8501 Novo mesto in Slovenia. The consolidated financial statements of the Krka Group for the year ended 31 December 2005 comprise the Company, its subsidiaries in Slovenia and abroad (hereinafter: the Group) as well as Group's interests in associated companies.
The audited consolidated financial statements were authorised for issue by the Management Board on 23 March 2006.

1. Statement of compliance

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

Clarification on the transition to IFRS and its impact on the Group's financial position, financial performance and the financial result is presented in a separate section.

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

IFRS 6 *Exploration for and Evaluation of Mineral Resources* (effective from 1 January 2006)
The Standard includes a requirement to distinguish between tangible and intangible assets that are used in the exploration for and evaluation of mineral resources, and specifies the level at which impairment testing should be carried out. The Group does not include companies whose operations would be affected by the new standard.

IFRS 7 *Financial Instruments: Disclosures* (effective from 1 January 2007)
The Standard will require increased disclosure in respect of the Group's financial instruments. It supersedes IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and is applicable to all entities that prepare financial statements in accordance with IFRS. Significant additional disclosures required will relate to the Group's financial risk management objectives, policies and processes.

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards and IFRS 6 Exploration for and Evaluation of Mineral Resources* (effective from 1 January 2006)
The amendment clarifies that a first-time adopter of IFRS for a period beginning before 1 January 2006 that applies IFRS 6 voluntarily need not apply the disclosure, recognition and measurement requirements of IFRS 6 to the comparative information included in its first IFRS financial statements. The Group does not include companies whose operations would be affected by this amendment.

Amendment to IAS 1 *Presentation of Financial Statements - Capital Disclosures* (effective from 1 January 2007)
As a complimentary amendment, the standard will require increased disclosure in respect of the Group's as well as the Company's capital.

Amendment to IAS 19 *Employee Benefits - Actuarial Gains and Losses, Group Plans and Disclosures* (effective from 1 January 2006)
The amendment includes an option for actuarial gains and losses to be recognised in full as they arise, outside of the income statement in a statement of recognised income and expense. The Group has not yet determined whether it will elect to apply the allowed option. Currently the Group recognizes actuarial gains and losses in full in the year that they arise.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement - Cash Flow Hedge Accounting of Forecast Intragroup Transactions* (effective from 1 January 2006)
The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item if certain criteria are met. This amendment is not relevant to the Group's operations, as the Group does not have any intragroup transactions that would qualify as a hedged item in the consolidated financial statements.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement - The Fair Value Option* (effective from 1 January 2006)
The amendment restricts the designation of financial instruments as "at fair value" through profit or loss. The Group believes that this amendment should not have a significant impact on the classification of financial instruments, as the Group should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit or loss.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts - Financial Guarantee Contracts* (effective from 1 January 2006)
The amendment requires guarantees that are not insurance contracts to be measured at fair value upon initial recognition. Where the Company issues financial

guarantees to guarantee the indebtedness of other Group entities, the Company considers these to be insurance arrangements and accounts for them as such. The Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee. As at 31 December 2005 the impact on the consolidated financial statements amounted to 1,917,521 thousand SIT.

Amendment to IAS 21 *The Effects of Changes in Foreign Exchange Rates - Net Investment in a Foreign Operation* (effective from 1 January 2006)
The amendment clarifies in which circumstances a loan may form part of a reporting entity's net investment in a foreign operation, and the currency in which such an item may be denominated. The Group currently has no items comprising net investments in foreign operations that will be affected by the amendment.

IFRIC 4 *Determining whether an Arrangement contains a Lease* (effective from 1 January 2006)
The Interpretation requires certain arrangements to be accounted for in compliance with IAS 17 Leases, even if they are not in the legal form of a lease. The Group has not yet completed its analysis of the impact of the new Interpretation.

IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (effective from 1 January 2006)
The Interpretation deals with funds created for the purpose of settling decommissioning and similar expenses. The respective Interpretation is not relevant to the Group companies.

IFRIC 6 *Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment* (effective from 1 December 2005)
The Interpretation deals with obligations arising from the European Union Directive regulating the collection, treatment, recovery and environmentally sound disposal of waste equipment. The respective Interpretation is not relevant to the Group companies.

IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies.* (effective from 1 March 2006)
The Interpretation contains guidance on how an entity would restate its financial statements pursuant to IAS 29 in the first year it identifies the existence of hyperinflation in the economy of its functional currency. The Interpretation is not relevant to the Group companies as they do not operate in hyperinflation environment.

IFRIC 8 *Scope of IFRS 2* (effective from 1 May 2006)
The Interpretation clarifies that the accounting standard IFRS 2 Share-based Payment applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. The Interpretation is not relevant to the Group as it has not entered into any share-based payments arrangements for apparently nil or inadequate consideration.

IFRIC 9 *Reassessment of Embedded Derivatives* (effective from 1 June 2006)
The treatment of an embedded derivative is assessed by the entity when the entity first becomes a party to the contract, and that reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract. The Interpretation is not relevant to the Group as it has no embedded financial instruments.

2. Basis of preparation

The financial statements are presented in Slovene tolar (SIT), rounded to the nearest thousand. They are prepared on the historical cost basis, while derivative financial instruments, financial instruments held for trading, and financial instruments classified as available-for-sale are stated at their fair value.

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and 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.

The 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 if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The Group applies the same accounting policies in its opening balance sheet as at 1 January 2004 pursuant to IFRS and all periods, presented in the accompanying consolidated financial statements.

The Group companies apply uniform accounting policies.

3. Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the controlling company. Control exists when the controlling company has the power, directly or indirectly, 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 of the Company. 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 associates are eliminated to the extent of the Group's interest in the entity. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment

4. Foreign currency

Foreign currency transactions

Transactions and balances in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Slovenian tolars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Slovenian tolars at foreign exchange rates ruling at the dates the fair value was determined.

Financial statements of foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to Slovenian tolars at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated to Slovenian tolars at the average annual rate that most suits the rate ruling at the date of the transactions. Foreign exchange differences arising on retranslation are recognised directly in a separate component of equity.

5. Derivative financial instruments and hedging

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its treasury policy, the Group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The recognition of subsequent changes to the fair value depends upon whether a certain derivative financial instrument qualifies for hedge accounting:

- At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk.
- The hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship.
- For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss.
- The effectiveness of the hedge can be reliably measured i.e. the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured.

The derivative financial instrument is recorded differently in respect to its purpose in case of a specific hedge accounting.

Changes to fair values of derivative financial instruments earmarked for hedging the fair value of assets or liabilities are disclosed in the income statement. The income statement includes also changed values of assets or liabilities to which the derivative financial instruments refer.

Hedging of net investments in foreign operations is disclosed in the same manner as cash flow hedging. Exchange differences arising on this transaction are included in equity under joint exchange difference.

Changes to fair values of derivative financial instruments earmarked for hedging in various economic sense but not meeting the stated criteria, are recorded and subsequently valued as each other asset or liability. Gains and losses that occurred due to the changed fair value are disclosed in the income statement.

6. Property, plant and equipment

Items of property, plant and equipment are stated at cost as deemed cost less accumulated depreciation and impairment losses (see accounting policy 'Impairment'). The cost of self-constructed assets includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads.

Certain items of property, plant and equipment that had been revalued to fair value on or prior to 1 January 2004, the date of transition to IFRS, are measured on the basis of deemed cost, being the revalued amount at the date of that revaluation. Where 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 subsequent cost of an item of property, plant and equipment is recognised in the carrying amount when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group. All other subsequent costs are recognised in the income statement as an expense as incurred.

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The depreciation rates are determined on the basis of the estimated useful lives. Land is not depreciated.

The estimated useful lives are as follows:

• buildings	8–40 years
• plant and equipment	5–20 years
• furniture	5 years
• computer equipment	4–6 years
• means of transportation	5–15 years

The residual value, if not insignificant, is reassessed annually.

7. Intangible assets

Research and development

As for the research and development activity, 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 are stated at cost less accumulated amortisation and 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 on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets and starts, when the asset is available for its intended use. The estimated useful lives are as follows:

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

8. Investments

Investments in debt and equity securities

Financial instruments held for trading are classified as current assets and are stated at fair value, with any resultant gain or loss recognised in the income statement.

Other financial instruments held by the Group are classified as being available-for-sale and are stated at fair value. Any resultant gain or loss is recognised directly in equity, except for impairment losses and, in the case of monetary items such as debt securities, foreign exchange gains and losses. When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in profit or loss. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss.

The fair value of financial instruments classified as held for trading and available-for-sale is their quoted bid price at the balance sheet date.

Financial instruments classified as held for trading or available-for-sale investments are recognised/derecognised by the Group on the date it commits to purchase/sell the investments. Securities held-to-naturity are recognised/derecognised on the day they are transferred by the Group.

9. Trade and other receivables

Trade and other receivables are stated at their cost less impairment losses (see accounting policy 'Impairment').

10. 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 average cost of purchase. 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 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.

11. Cash and cash equivalents

Cash and cash equivalents comprises 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.

12. Impairment

The carrying amounts of the Group's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement. The recoverable amount is calculated as the present value of estimated future cash flows. Short-term receivables are not discounted.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in profit or loss even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

Calculation of recoverable amount

The recoverable amount of the Group's investments in held-to-maturity securities and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e., the effective interest rate computed at initial recognition of these financial assets). Short-term receivables are not discounted.

The recoverable amount of other assets is the greater of their net selling price and value in use. 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. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Reversal of impairment

An impairment loss in respect of a held-to-maturity security or receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available for sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss shall be reversed, with the amount of the reversal recognised in profit or loss.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, 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.

13. Equity

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 change in equity. Repurchased shares are classified as treasury shares and presented as a deduction from total equity.

Dividends

Dividends are recognised in the consolidated financial statements in the period, in which the annual meeting adopted the resolution on dividend payout.

14. Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

15. Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

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 it 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 in countries where the controlling company and its subsidiaries are located, 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.

The Group has formed provisions as at 1 January 2004 i.e. date of the opening balance sheet prepared according to IFRS, except for those companies for which the obligation already existed pursuant to the local legislation. 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 discount rate is 2.75% p.a.. 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.

16. Trade and other payables

Trade and other payables are stated at historical cost, indicated in relevant documents.

17. Net sales

Net sales or 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. 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.

18. Net financing costs

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method, interest receivable on funds invested, dividend income, foreign exchange gains and losses, and gains and losses on hedging instruments that are recognised in the income statement and valued at market value.

Interest income is recognised in the income statement as it accrues, using the effective interest method. Dividend income is recognised in the income statement on the date the entity's right to receive payments is established.

19. 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.

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

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences are not provided for investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

20. 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 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 controlling 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 net sales. 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.

21. Cash Flow Statement

The cash flow statement has been prepared under the direct method based upon items from the balance sheet as at 31 December 2005 and 31 December 2004, the income statement for the year that ended 31 December 2005, as well as additional data required for the adjustment of inflows and outflows.

Notes to the financial statements

4.5.1 Consolidated balance sheet

4.5.1.1 Property, plant and equipment

In thousand SIT	31 Dec 2005	31 Dec 2004
Property	5,168,315	5,064,126
Plant	52,732,547	53,110,476
Equipment	33,583,618	30,835,770
PPE under construction	16,680,751	9,529,542
– advances for PPE	996,748	1,384,168
Total	**108,165,231**	**98,539,914**

In 2005, the Krka Group invested 19,623,009 thousand SIT in property, plant and equipment. The controlling company's investments in property, plant and equipment were recorded at 15,032,686 thousand SIT, whereas investments made in subsidiaries in Slovenia and abroad amounted to 4,590,323 thousand SIT.

Krka's biggest investment in terms of value is the construction of a new plant for the production of pharmaceutical active substances and a new warehouse for liquid raw materials, as well as the investment in increasing the production capacities of the Specifika plant and doubling the capacities of the warehouse of finished products. The co-financing of the purifying plant in Ljutomer was concluded, whereas in Novo mesto a technical upgrading of the existent purifying plant was carried out. The construction of the production and distribution centre in Croatia was also concluded and all necessary permits for the production of solid pharmaceutical forms obtained. The subsidiary Krka Zdravilišča invested mostly in improving the health resort and tourist centre in Zdravilišče Šmarješke Toplice.

Movements of property, plant and equipment in 2005

In thousand SIT	Property	Plant	Equipment	PPE under construction	Advances for PPE	Total
Cost at 31 Dec 2004	**5,064,126**	**86,664,134**	**82,253,631**	**8,145,374**	**1,384,168**	**183,511,433**
Additions	0	0	0	19,623,009	–385,972	19,237,037
Capitalisations	311,176	3,639,160	9,577,256	–12,080,515	–1,448	1,445,629
Disposals, write-offs	–206,987	–418,888	–3,558,802	–3,865	0	–4,188,542
Cost at 31 Dec 2005	**5,168,315**	**89,884,406**	**88,272,085**	**15,684,003**	**996,748**	**200,005,557**
Accumulated depreciation at 01 Jan 2005	**0**	**33,553,658**	**51,417,861**	**0**	**0**	**84,971,519**
Depreciation	0	3,614,385	6,402,707	0	0	10,017,092
Capitalisations	0	4,424	85,070	0	0	89,494
Disposals, write-offs	0	–20,608	–3,217,171	0	0	–3,237,779
Accumulated depreciation at 31 Dec 2005	**0**	**37,151,859**	**54,688,467**	**0**	**0**	**91,840,326**
Carrying amount at 31 Dec 2004	**5,064,126**	**53,110,476**	**30,835,770**	**8,145,374**	**1,384,168**	**98,539,914**
Carrying amount at 31 Dec 2005	**5,168,315**	**52,732,547**	**33,583,618**	**15,684,003**	**996,748**	**108,165,231**

Movements of property, plant and equipment in 2004

In thousand SIT	Property	Plant	Equipment	PPE under construction	Advances for PPE	Total
Cost at 31 Dec 2003	**4,820,028**	**83,101,023**	**71,577,568**	**7,128,933**	**226,871**	**166,854,423**
Additions	0	0	0	19,514,691	1,169,571	20,684,262
Capitalisations	248,862	4,720,316	12,769,599	–18,226,087	0	–487,310
Disposals, write-offs	–4,764	–1,157,205	–2,093,536	–272,163	–12,274	–3,539,942
Cost at 31 Dec 2004	**5,064,126**	**86,664,134**	**82,253,631**	**8,145,374**	**1,384,168**	**183,511,433**
Accumulated depreciation at 01 Jan 2003	**0**	**31,010,759**	**46,900,193**	**0**	**0**	**77,910,952**
Depreciation	0	3,582,613	6,309,198	0	0	9,891,811
Capitalisations	0	–373,231	197,397	0	0	–175,834
Disposals, write-offs	0	–666,483	–1,988,927	0	0	–2,655,410
Accumulated depreciation at 31 Dec 2004	**0**	**33,553,658**	**51,417,861**	**0**	**0**	**84,971,519**
Carrying amount at 31 Dec 2003	**4,820,028**	**52,090,264**	**24,677,375**	**7,128,933**	**226,871**	**88,943,471**
Carrying amount at 31 Dec 2004	**5,064,126**	**53,110,476**	**30,835,770**	**8,145,374**	**1,384,168**	**98,539,914**

4.5.1.2 Intangible assets

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term deferred R&D cost	603,482	594,559
Long-term property rights	3,611,856	3,198,700
Intangible assets under construction	843,112	358,544
Total	5,058,450	4,151,803

The most significant share in the structure of the Group's intangible assets refers to property rights i.e. 71%. Additions to intangible assets are recorded in the amount of 1,877,196 thousand SIT, of which the major part represents property rights namely the upgrading of the SAP and WERUM software in the amount of 740,592 thousand SIT. Intangible assets under construction comprise payments for the registration documentation as regards new drugs.

Movements of intangible assets in 2005

In thousand SIT	Long-term deferred R&D	Long-term property	IA under construction	Total
Cost at 31 Dec 2004	**1,160,561**	**4,049,427**	**358,544**	**5,568,532**
Additions, capitalisations	222,508	1,170,120	484,568	1,877,196
Disposals, write-offs	–44,456	–21,616	0	–66,072
Cost at 31 Dec 2005	**1,338,613**	**5,197,931**	**843,112**	**7,379,656**
Accumulated amortisation at 31 Dec 2004	**566,002**	**850,727**	**0**	**1,416,729**
Amortisation	211,576	741,905	0	953,481
Disposals, write-offs	–42,447	–6,557	0	–49,004
Accumulated amortisation at 31 Dec 2005	**735,131**	**1,586,075**	**0**	**2,321,206**
Carrying amount at 31 Dec 2004	**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**

Movements of intangible assets in 2004

In thousand SIT	Long-term deferred R&D	Long-term property	IA under construction	Total
Cost at 31 Dec 2003	**1,077,020**	**1,341,677**	**736,043**	**3,154,740**
Additions, capitalisations	125,053	2,663,651	–377,499	2,411,205
Disposals, write-offs	–41,512	44,099	0	2,587
Cost at 31 Dec 2004	**1,160,561**	**4,049,427**	**358,544**	**5,568,532**
Accumulated amortisation at 31 Dec 2003	**390,734**	**511,000**	**0**	**901,734**
Amortisation	182,645	323,068	0	505,713
Disposals, write-offs	–7,377	16,659	0	9,282
Accumulated amortisation at 31 Dec 2004	**566,002**	**850,727**	**0**	**1,416,729**
Carrying amount at 31 Dec 2003	**686,286**	**830,677**	**736,043**	**2,253,006**
Carrying amount at 31 Dec 2004	**594,559**	**3,198,700**	**358,544**	**4,151,803**

4.5.1.3 Investments in associates

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

4.5.1.4 Other non-current assets

In thousand SIT	31 Dec 2005	31 Dec 2004
Investments	2,169,989	2,163,395
– equity shares available-for-sale	1,217,773	1,168,774
– other investments	62,391	62,391
– loans to other entities	889,825	932,230
Trade receivables	12,312	44,335
Total	**2,182,301**	**2,207,730**

Long-term loans include loans granted by the controlling company and some subsidiaries to employees in compliance with internal acts. Loans bear interest at the rate that is in force during the conclusion of the loan agreement.

Movements of other non-current investments in 2005

In thousand SIT	Equity shares	Other investments	Loans to other entities	Total
Gross value				
Balance at 31 Dec 2004	**1,176,369**	**62,391**	**949,114**	**2,187,874**
Increase	313	0	294,028	294,341
Decrease	–6,783	0	–335,458	–342,241
Revaluation to fair value	55,576	0	1,652	57,228
Transfer to short-term loans	0	0	–5,497	–5,497
Balance at 31 Dec 2005	**1,225,475**	**62,391**	**903,839**	**2,191,705**
Value adjustment				
Balance at 31 Dec 2004	**7,595**	**0**	**16,884**	**24,479**
Increase	107	0	91	198
Decrease	0	0	–2,961	–2,961
Balance at 31 Dec 2005	**7,702**	**0**	**14,014**	**21,716**
Carrying amount at 31 Dec 2004	**1,168,774**	**62,391**	**932,230**	**2,163,395**
Carrying amount at 31 Dec 2005	**1,217,773**	**62,391**	**889,825**	**2,169,989**

Movements in long-term investments in 2004

In thousand SIT	Equity shares	Other long-term investments	Loans to other entities	Total
Gross value				
Balance at 31 Dec 2003	**517,782**	**213,859**	**902,393**	**1,634,034**
Increase	1,087	0	186,662	187,749
Decrease	0	–151,468	–153,394	–304,862
Revaluation to fair value	657,500	0	13,453	670,953
Balance at 31 Dec 2004	**1,176,369**	**62,391**	**949,114**	**2,187,874**
Value adjustment				
Balance at 31 Dec 2003	**7,339**	**0**	**5,576**	**12,915**
Increase	256	0	14,569	14,825
Decrease	0	0	–3,261	–3,261
Balance at 31 Dec 2004	**7,595**	**0**	**16,884**	**24,479**
Carrying amount at 31 Dec 2003	**510,443**	**213,859**	**896,817**	**1,621,119**
Carrying amount at 31 Dec 2004	**1,168,774**	**62,391**	**932,230**	**2,163,395**

4.5.1.5 Inventories

In thousand SIT	31 Dec 2005	31 Dec 2004
Material	9,900,962	6,233,168
Work in progress	4,986,820	3,760,315
Products	13,440,723	9,582,844
Merchandise	630,146	428,259
Advances	7,978	30,486
Total	**28,966,629**	**20,035,072**

Compared to the previous year's results inventories of Krka Group increased by 45% and as at the balance sheet date amount to 28,966,629 thousand SIT. In addition to the larger scope of production, preparation of inventories for sales in the first quarter of 2006, the increase is attributable also to the formation of safety stocks, mostly for the most significant products. Higher balances of inventories were also a result of the price cut for drugs on most of the markets causing a constant increase in the scope of production and sales. As for the structure of the Group's inventories, 34% refers to material, 17% to work in progress and 49% to finished products and merchandise.

In 2005, impairment amounted to 549,916 thousand SIT (2004: 575,828 thousand SIT).

4.5.1.6 Trade and other receivables

In thousand SIT	31 Dec 2005	31 Dec 2004
Trade receivables	30,255,828	22,190,529
Other receivables	2,752,875	1,720,240
Total	**33,008,703**	**23,910,769**

Receivables record an increase by 38%. The increase is due to the high sale in the last quarter of 2005 as well as the dynamics used in sales to markets of the Western Europe and the Russian Federation. Longer repayment periods for government procurements in the Russian Federation contributed to this increase as well. Most of receivables are not yet due.

- **Trade receivables**

In thousand SIT	Gross value	Adjustment	Net value at 31 Dec 2005	Net value at 31 Dec 2004
Domestic customers	3,273,435	60,795	3,212,640	3,790,216
Foreign customers	28,168,999	1,125,811	27,043,188	18,400,313
Total	**31,442,434**	**1,186,606**	**30,255,828**	**22,190,529**

The Group forms allowances for receivables according to criteria defined in relation to the risk of individual markets and customers as well as the actual repayability of receivables in the past.

Trade receivables are not secured.

In 2005, allowances for receivables were charged against the income statement in the amount of 448,298 thousand SIT (2004: 681,027 thousand SIT).

• Other receivables

Other receivables refer mostly to receivables arising from VAT refund.

4.5.1.7 Current investments

In thousand SIT	31 Dec 2005	31 Dec 2004
Equity shares held for trading	1,524,869	682,229
Other current investment	1,659,977	943,136
Current loans	206,159	250,318
Total	**3,391,005**	**1,875,683**

Acquisitions in 2005 resulted in the share's value that is composed of marketable shares (453,287 thousand SIT), non-marketable shares (29,180 thousand SIT) and shares issued by foreign companies (1,042,402 thousand SIT).

Other current investments increased mostly due to additional acquisitions made in government bonds and in mutual funds whose value at the year-end amounted to 555,173 thousand SIT and 752,755 thousand SIT respectfully.

4.5.1.8 Cash and cash equivalents

In thousand SIT	31 Dec 2005	31 Dec 2004
Cash in hand	19,219	14,824
Bank balances	2,964,091	2,774,782
Other	44,442	51,493
Total	**3,027,752**	**2,841,099**

4.5.1.9 Equity

Consolidated statement of changes in equity

In thousand SIT	Share capital	Reserves	Own shares	Retained earnings	Reserves for fair value	Translation reserves	Minority interest	Total
Balance at 1 Jan 2004	**14,170,448**	**33,585,325**	**–4,670,280**	**40,226,095**	**29,605**	**17,938**	**1,813,103**	**85,172,234**
Profit for the period	0	0	0	15,637,826	0	0	23,192	15,661,018
Formation of statutory reserves	0	500,000	0	–500,000	0	0	0	0
Dividends	0	0	0	–4,106,280	0	0	–22,176	–4,128,456
Income and expense recognised directly in equity	0	0	0	–116,931	490,381	42,021	5,357	420,828
Balance at 31 Dec 2004	**14,170,448**	**34,085,325**	**–4,670,280**	**51,140,710**	**519,987**	**59,959**	**1,819,476**	**97,125,625**
Profit for the period	0	0	0	23,288,582	0	0	30,546	23,319,128
Formation of statutory reserves	0	800,000	0	–800,000	0	0	0	0
Dividends	0	0	0	–4,786,297	0	0	–31,850	–4,818,147
Income and expense recognised directly in equity	0	0	0	–711,352	41,615	–55,311	–4,616	–729,663
Balance at 31 Dec 2005	**14,170,448**	**34,885,325**	**–4,670,280**	**68,131,642**	**561,602**	**4,648**	**1,813,556**	**114,896,941**

• Share capital

Share capital of the Company is divided into 3,542,612 ordinary shares 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 controlling company recorded 162,662 own shares amounting to 650,648 thousand SIT i.e. 4.6% of the share capitals' value. The number of shares in this reporting period remained unchanged if compared to 2004.

• Reserves

Reserves have increased by 800,000 thousand SIT in the reporting period which is mostly due to additionally formed statutory reserves. As at 31 December 2005 the item of reserves comprises revenue reserves (28,993,129 thousand SIT), legal reserves (3,592,196 thousand SIT) and statutory reserves (2,300,000 thousand SIT). In accordance with legal and statutory provisions none of the stated reserves may be used for dividend payout.

• Retained earnings

Retained earnings of the Krka Group have increased by the net profit in the amount of 23,288,582 thousand SIT. The decrease is due to the dividend payout (4,786,297 thousand SIT) and the net income and expense recognised directly in equity (711,352 thousand SIT) and the formation of additional statutory reserves (800,000 thousand SIT).

• Earnings per share

Earnings per share amount to 6,890.21 SIT and indicate an increase of 49% compared to the previous year's result (2004: 4,626.64 SIT). The calculation for both years bases upon 3,379,950 shares, as 162,662 own shares of the controlling 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.

4.5.1.10 Non-current liabilities

In thousand SIT	31 Dec 2005	31 Dec 2004
Borrowings	11,669,435	14,596,143
– long-term borrowings from banks	11,631,002	14,509,441
– long-term borrowings from other entities	38,433	86,702
Provisions	23,647,648	22,416,952
– provisions for pension and similar liabilities	32,358	18,995
– provisions for termination pay and anniversary bonuses	10,664,604	10,422,515
– provisions for tax liabilities	3,133	–5,607
– other provisions	12,947,553	11,981,049
Grants received	445,849	209,898
Deferred tax liabilities	285,236	248,948
Total	**36,048,168**	**37,471,941**

4.5.1.11 Borrowings

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term borrowings	11,669,435	14,596,143
– borrowings from domestic banks	11,631,002	11,847,392
– borrowings from foreign banks	0	2,662,049
– borrowings from other entities	38,433	86,702
Short-term borrowings	8,972,820	5,085,144
– borrowings from domestic banks	5,107,105	1,211,393
– borrowings from foreign banks	1,339,308	864,355
– borrowings from other entities	2,526,407	3,009,396
Interest payable	147,844	197,799
Total	**20,790,099**	**19,879,086**

The structure of Group's borrowings changed compared to 2004 as the controlling company raised short-term instead of long-term loans.

• Movements of long-term borrowings

In thousand SIT	Borrowings from banks	Borrowings from other entities	Total
Balance at 01 Jan 2004	**5,699,259**	**122,036**	**5,821,295**
– new borrowings	11,318,828	0	11,318,828
– repayments	–3,682,118	–12,199	–3,694,317
– balance of transfer at 1 Jan 2004	3,234,147	20,800	3,254,947
– transfer to current liabilities at 31 Dec 2004	–1,937,440	–49,421	–1,986,861
– revaluation	–123,235	5,486	–117,749
Balance at 31 Dec 2004	**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 1 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
– revaluation	395,963	2,994	398,957
Balance at 31 Dec 2005	**11,631,002**	**38,434**	**11,669,436**

• Movements of short-term borrowings

In thousand SIT	Borrowings from banks	Borrowings from other entities	Total
Balance at 1 Jan 2004	**13,339,787**	**3,988,021**	**17,327,808**
– new borrowings	19,311,000	2,580,594	21,891,594
– repayments	–32,487,521	–3,608,641	–36,096,162
– transfer from non-current liabilities	1,937,440	49,421	1,986,861
– revaluation	–24,958	0	–24,958
Balance at 31 Dec 2004	**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**

4.5.1.12 Provisions

Other non-current provisions in the amount of 12,947,553 thousand SIT represent the major item of the total provisions recorded by the Group as at 31 December 2005 in the amount of 23,647,648 thousand SIT, the latter representing a 5.5% increase against the previous year's figures. Other provisions mostly refer to provisions for lawsuits. Provisions for a new lawsuit relating to drugs for heart and cardiovascular diseases were formed by the Group in the amount of 12,502,563 thousand SIT, and provisions for the lawsuit of alleged infringement of the patent that protects the drug simvastatin in the amount of 11,444,803 thousand SIT were reversed, since the claim was rejected by the court's final decision. The newly formed and reversed provisions are included among other operating expenses or other operating revenues in the income statement.

Provisions for termination pay and anniversary bonuses in the amount of 10,664,604 thousand SIT represent another major item within the provisions formed by the Krka Group. Compared to 2004, they were increased by the actuarial losses in the amount of 242,089 thousand SIT.

In thousand SIT	Balance at 31 Dec 2004	Formation	Utilisation and reversal	Balance at 31 Dec 2005
Provisions for pensions and similar liabilities	18,995	13,363	0	32,358
Provisions for termination pay and anniversary bonuses	10,422,515	242,089	0	10,664,604
Provisions for tax liabilities	–5,607	8,740	0	3,133
Other provisions:	11,981,049	12,507,584	11,541,080	12,947,553
– for lawsuits	11,764,013	12,507,458	11,450,115	12,821,356
– for ecological restoration	161,025	0	41,088	119,937
– for other purposes	56,011	126	49,877	6,260
Total	**22,416,952**	**12,771,776**	**11,541,080**	**23,647,648**

4.5.1.13 Grants received

In the previous years, the Group received grants in the amount of 445,849 thousand SIT from the Ministry of the Economy for the investment in the Šentjernej plant, in the distribution centre in the Russian Federation, and for health resort facilities. The recorded amounts of grants received are decreased by the appropriate portions of depreciation of the assets to which the grants refer.

4.5.1.14 Trade payables

In thousand SIT	31 Dec 2005	31 Dec 2004
Payables to domestic suppliers	7,743,740	4,630,732
Payables to foreign suppliers	5,776,651	3,838,972
Payables from advances	523,180	603,733
Total	**14,043,571**	**9,073,437**

4.5.1.15 Financial instruments

Long-term stability of the Group's performance is managed by means of active risk management policies as presented in detail in "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 2005.

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. As at 31 December 2005, the contract value of the hedged item amounted to 12,113,395 thousand SIT, and the Group's interest rate swaps recorded at fair value amounted to 58,492 thousand SIT.

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

Long-term borrowings

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term borrowings	16,306,762	16,583,004
– short-term portion of long-term borrowings	4,637,327	1,986,861
Average balance of long-term borrowings	16,444,884	13,097,057
Interest paid (financial year)	546,648	447,840
Average cost of long-term borrowings (financial year)	3.3%	3.4%
Contracted to mature in three years or less	67%	56%
Contracted to mature in more than three years	33%	44%
Currency structure of long-term borrowings:		
US dollar	18%	23%
Euro	79%	72%
Slovenian tolar	3%	5%

Short-term borrowings

In thousand SIT	31 Dec 2005	31 Dec 2004
Short-term borrowings, including short-term portion of long-term loans, thereof:	8,972,820	5,085,144
– borrowings from banks	6,446,413	2,075,748
– other borrowings	2,526,407	3,009,396
Short-term borrowings	4,335,493	3,098,283
Average balance of short-term borrowings (financial year)	3,889,709	8,489,573
Interest paid (financial year)	183,529	470,827
Average cost of short-term borrowings (financial year)	4.7%	5.5%
Currency structure of short-term borrowings:		
Euro	41%	0%
Slovenian tolar	59%	100%

Foreign currency risk

The key currency pairs in 2005 were Euro/Tolar and Euro/US dollar, and further significant currency pairs were identified on the basis of the geographical position of the Group companies operating abroad: Euro/Polish zloty, Euro/Macedonian denar, Euro/Croatian kuna, and US dollar/Russian ruble. Due to the relatively low level of unsettled positions of the latter currencies in 2005, the primary focus was on the Group's management of long position regarding foreign operations denominated in Euro and US dollar. Currency options (i.e. range forwards) and futures are used to hedge against foreign currency risks. The contract value of the two derivative financial instruments as at 31 December 2005 amounted to 43,223,780 thousand SIT, and the fair value recorded in the Balance Sheet as at 31 December 2005 is –168,700 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 2005.

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 significantly impact 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	Carrying amount 2005	Fair value 2005	Carrying amount 2004	Fair value 2004
Long-term investments	2,169,989	2,169,989	2,163,395	2,163,395
Short-term investments	3,391,005	3,391,005	1,875,683	1,875,683
Trade and other receivables	33,008,703	33,008,703	23,910,769	23,910,769
Cash and cash equivalents	3,027,752	3,027,752	2,841,099	2,841,099
Interest bearing derivatives	58,491	58,491	–112,340	–112,340
Assets	65,619	65,619	15,212	15,212
Liabilities	–7,128	–7,128	–127,552	–127,552
Embedded foreign currency derivatives	–168,699	–168,699	287,264	287,264
Assets	59,013	59,013	287,264	287,264
Liabilities	–227,712	–227,712	0	0
Borrowings	–20,790,099	–20,790,099	–19,879,086	–19,879,086
Trade payables	–14,043,571	–14,043,571	–9,073,437	–9,073,437
Total	**6,653,571**	**6,653,571**	**2,013,347**	**2,013,347**

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, effective at 10:00, local time. 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, effective at 10:00, local time, 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, effective at 10:00, local time, by the use of specific derivatives valuation models available within Reuters information platform.

Shares available for sale

If the shares are listed on the stock exchange market, their fair value equals 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 shares 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 is recorded under consideration of the discounted cash flow of the principal and interest.

Receivables and liabilities

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

Events after the balance sheet date

There were no events after 31 December 2005 that would in any way impact the disclosures in the financial statements. Pfizer, the company that had filed a lawsuit in 2002 against Krka due to an alleged act of unfair competitive practices, allegedly committed by Krka upon obtaining the marketing authorisation for Yasnal®, withdrew the claim on 28 February 2006. No provisions had been formed for the said lawsuit.

4.5.2 Consolidated income statement

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 controlling company's headquarters. It must be taken into consideration that the major part of the assets held by the controlling company are also used for business activities referring to other geographical segments (production, storage, quality control etc.). 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".

• Geographical segment reporting

	European Union		South-East Europe		Eastern Europe		The remaining Western Europe and overseas markets		Elliminations		Total	
In thousand SIT	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Net sales to non-Group entities	74,744,854	67,973,211	22,629,039	20,397,488	32,762,642	22,161,692	2,621,092	2,784,750	0	0	132,757,627	113,317,141
Net sales to Group entities	17,465,891	20,093,270	9,453,177	7,907,766	2,558,096	1,998,687	0	0	–29,477,164	–29,999,723	0	0
Total net sales	**92,210,745**	**88,066,481**	**32,082,216**	**28,305,254**	**35,320,738**	**24,160,379**	**2,621,092**	**2,784,750**	**–29,477,164**	**–29,999,723**	**132,757,627**	**113,317,141**
Segment's results from operations	**16,771,965**	**9,105,113**	**6,237,398**	**3,374,844**	**5,232,387**	**2,973,962**	**562,900**	**443,436**	**0**	**0**	**28,804,650**	**15,897,355**
Other operating revenues											12,221,261	4,524,293
Unallocated costs											–12,502,653	–2,471,633
Operating profit											**28,523,258**	**17,950,015**
Net financial income/ expenses											1,006,720	350,054
Income tax expense											–6,210,850	–2,639,051
Profit for the period											**23,319,128**	**15,661,018**
Segment's assets	126,294,480	109,110,841	23,098,921	16,240,321	22,809,361	17,176,615	965,541	2,799,162	0	0	173,168,303	145,326,939
Unallocated assets											15,680,853	10,268,544
Total assets											**188,849,156**	**155,595,483**
Investments	19,842,467	20,638,078	1,446,984	1,152,666	210,754	135,152	0	0	0	0	21,500,205	21,925,896
Impairment of receivables and inventories											998,214	1,256,855
Total liabilities											**73,952,215**	**58,469,858**

4.5.2.1 Net sales by business segments

In thousand SIT	2005	2004
Human health products	121,884,064	103,039,280
– prescription pharmaceuticals	105,743,337	87,704,077
– self-medication products	14,107,551	12,450,964
– cosmetic products	2,033,176	2,884,239
Animal health products	4,795,829	4,133,374
Health resort and tourist service	5,848,349	5,965,995
Other	229,384	178,492
Total	**132,757,626**	**113,317,141**

4.5.2.2 Other operating revenues

In thousand SIT	2005	2004
Utilisation and reversal of non-current provisions	11,534,731	3,846,462
Reversal of allowances for receivables	162,436	60,671
Profit from the sale of fixed assets	306,133	176,669
Other operating revenues	217,961	440,492
Total	**12,221,261**	**4,524,294**

The highest amount of 11,498,778 thousand SIT among other operating revenues refers to the reversal of provisions for the lawsuit in connection with drugs for heart and cardiovascular diseases that ended in favour of Krka. In 2005, the controlling company received a grant from the Agency of the Republic of Slovenia for Agricultural Markets and Rural Development in the amount of 16,049 thousand SIT. Other Group companies did not receive any government grants.

4.5.2.3 Production cost of goods sold

In 2005, production cost of goods sold indicated an increase of 0.6% compared to the previous year's figures. As for their share among the net sales, the production costs decreased from 45.5% in 2004 to 39.1% in 2005. 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).

4.5.2.4 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 the reporting period, the sales and marketing expenses were higher by 54% than in 2004. The increase was influenced by the newly formed provisions (12,502,563 thousand SIT) for the lawsuit relating to drugs for heart and cardiovascular diseases. The amount of provisions formed in 2004 was 2,471,633 thousand SIT and increased the sales and marketing expenses.

4.5.2.5 R&D costs

All R&D costs recorded are charged against the income statement of 2005, since research and development costs are not capitalised. Compared to 2004, the relevant costs increased by 15.6%, whereas its share among the net sales was 7.2%.

4.5.2.6 Administrative expenses

Compared to the previous year's figures, administrative expenses increased by 2.7%, and its share in the structure of net sales imply a decrease from 11.5% to 10.1%. The item of administrative expenses encompasses also other operating expenses.

4.5.2.7 Costs in terms of types

In thousand SIT	2005	2004
Cost of goods and materials	35,766,811	29,499,774
Cost of services	24,044,136	20,719,430
Employee benefits expense (refer to Note 4.5.2.8)	34,593,855	31,455,468
Depreciation	10,970,573	10,348,495
Provisions formed	12,502,563	2,471,633
Other operating expenses (refer to Note 4.5.2.9)	3,656,048	3,815,934
Total costs	**121,533,986**	**98,310,734**
Changes in the value of inventories	5,078,357	–1,580,685
Total	**116,455,629**	**99,891,419**

4.5.2.8 Employee benefits cost

In thousand SIT	2005	2004
Gross wages and salaries and continued pay	25,971,593	22,855,851
Social security contributions and payroll tax	6,363,912	5,793,892
Other employee benefits cost	2,258,350	2,805,725
Total	**34,593,855**	**31,455,468**

Other employee benefits cost in 2005 include the vacation bonus, travel allowances, termination pays, tenure awards, and some other repayments to employees.

4.5.2.9 Other operating expenses

In thousand SIT	2005	2004
Grants, assistance	520,989	523,180
Environmental levies	342,076	302,150
Fiscal charges irrespective of operating results	496,470	534,584
Loss in the sale of fixed assets	252,734	495,829
Impairments and inventory write-offs	549,916	575,828
Impairments and receivable write-offs	448,298	681,027
Other costs	1,045,565	703,336
Total	**3,656,048**	**3,815,934**

4.5.2.10 Financial income and financial expenses

In thousand SIT	2005	2004
Exchange differences	3,599,769	3,032,903
Interest income	140,197	119,646
Gain on remeasurement of investments at fair value	10,966	0
Other income	238,395	392,990
Total financial revenue	**3,989,327**	**3,545,539**
Exchange differences	1,611,147	1,926,860
Interest paid	730,177	918,667
Impairments due to remeasurement of investments at fair value	39,748	13,429
Other expenses	601,535	336,529
Total financial expenses	**2,982,607**	**3,195,485**
Net financial income	**1,006,720**	**350,054**

In 2005, the Group generated 64,744 thousand SIT of gains and 231 thousand SIT of losses from the sale of securities. 27,726 thousand SIT of financial income and 589,690 thousand SIT financial expenses arise from derivative financial instruments.

4.5.2.11 Income tax expense

In thousand SIT	2005	2004
Actual income tax	9,758,335	3,328,397
Deferred tax	–3,547,485	–689,345
Total	**6,210,850**	**2,639,052**
Profit before tax	29,529,978	18,300,070
Income tax calculated using the 25-percent tax rate	7,382,495	4,575,018
Non-deductible expenses	1,272,294	794,308
Tax incentives	–1,161,781	–2,156,572
Tax exempt revenues	–750,533	–190,730
Effect of restatements due to the transition to IFRS	–233,479	–232,353
Effects of differences in tax rates and other items	–298,146	–150,619
Total	**6,210,850**	**2,639,052**

4.5.2.12 Deferred tax

In thousand SIT	2005	2004
Adjustments of current assets	–280,617	3,160
Adjustments of non-current assets	170,585	–73,165
Formation of non-current provisions	–3,137,170	–318,820
Loss brought forward	–388,695	–297,744
Effects of differences in tax rates upon the deferred tax	88,412	–2,777
Total	**–3,547,485**	**–689,345**

4.5.3 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 sold.

4.5.4 Data on groups of persons

As at the year-end, the members of the Management Board of the controlling company held 5,173 of shares in Krka, representing a 0.15% of the total equity, and the Managing Directors of subsidiaries held 1,207 of shares or 0.03% 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 2005.

Emoluments of groups of persons in 2005

In thousand SIT	Total receipts	Hereof participation in profit according to the annual meeting resolution
Members of the Management Board	636,237	0
Members of the Supervisory Board of the parent and the Supervisory Boards of the subsidiaries	60,166	51,291
Persons employed under individual employment contracts	4,471,295	0
Total	**5,167,698**	**51,291**

Emoluments of the Management Board members represent salaries and wages, fringe benefits, any other receipts, and refund of expenses. Emoluments of the parent company's Supervisory Board represent remuneration for the tasks performed within the Supervisory Board. Emoluments of persons employed under individual employment contracts include salaries and wages, fringe benefits, holiday allowance, any other receipts (tenure awards etc.), and refund of expenses.

Emoluments of members of the Supervisory Boards in subsidiaries which also perform the function of Management Board 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

In thousand SIT	Loan balance at 31 Dec 2005	Repayments in 2005
Members of the Management Board	5,990	1,142
Members of the Supervisory Board in the parent company (employee representatives)	517	173
Persons employed under individual employment contracts	116,438	24,700
Total	**122,945**	**26,015**

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

4.5.5 Accounting judgements and estimates

Significant accounting judgements and estimates applied when preparing the financial statements are presented below.

Provisions for payables to employees and termination payments

Provisions for payables to employees are based on a calculation performed by a certified actuary, whereby a discount rate of 2.75% p.a. was selected, 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. No material discrepancies from the assumptions applied may be expected in the near future.

Provisions for lawsuits

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.

Receivables

Receivables in the balance sheet are recorded at net amounts. The allowances for bad receivables are computed on the basis of the methodology taking into account the individual customers' credit ratings as well as the specific country risk levels. The methods used and the credit ratings applied are verified by the Group twice a year, whereas the calculations of any possible losses arising from payment defaults are performed on a quarterly basis.

4.5.6 Disclosures referring to the transition to IFRS

These are the Group's first consolidated financial statements prepared in compliance with the IFRS.

The accounting policies presented in a separate chapter were taken account of upon the preparation of the financial statements for the financial year ended 31 December 2005, upon the preparation of the comparative financial statements prepared for the financial year ended 31 December 2004, as well as upon the preparation of its opening balance sheet as at 1 January 2004 in compliance with the IFRS, the latter representing the date of transition to IFRS reporting.

The individual items of the opening balance sheet that were previously presented in accordance with the Slovenian Accounting Standards have been brought in compliance with the IFRS requirements. Explanations of how the transition to IFRS has affected the reported financial position, financial performance, and cash flows of the Group are provided in the schedules and notes presented below. Furthermore, those changes in the financial statements which result from a different allocation of the individual accounting items have also been presented.

4.5.6.1 Reconciliation of equity

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

(a) Property, plant and equipment

The useful lives of the items of property, plant and equipment with a higher recorded value were reviewed. Furthermore, the individual parts of an item of property, plant and equipment which differ in their expected useful lives were accounted for as individual assets, for which depreciation is accounted for individually. The adjustments were made for the entire period since their bringing into use.

The lower depreciation amounts result in higher carrying amounts of the items of property, land and equipment by 3,566,637 thousand SIT as at 1 January 2004 and by 4,389,908 thousand SIT as at 31 December 2004.

Depreciation in 2004 was lower by 714,462 thousand SIT, thereof its effect upon the decrease in the value of inventories amounted to 67,741 thousand SIT, whereas the remaining 646,721 thousand SIT were recorded in the income statement as follows: production cost of goods sold was decreased by 158,800 thousand SIT, sales and marketing by 154,834 thousand SIT, R&D costs by 81,672 thousand SIT, and administrative expenses by 251,415 thousand SIT.

The transfer of the amounts of 'intangible assets' in the value of 102,418 thousand SIT as at 1 January 2004 and 349,336 thousand SIT as at 31 December 2004 to the item of investments in assets not owned by the Group resulted in an additional increase in the value of buildings and equipment.

(b) Intangible assets

The Group recorded a decrease in intangible assets as at 1 January 2004 due to the transfer of the amounts of 'investments in assets not owned by the Group' to the item of 'property, plant and equipment', the transfer of the amounts recorded in 'long-term operating lease' to 'long-term receivables' and the transfer of the amounts recorded in 'long-term deferred construction costs' to 'other operating expenses', totalling 322,433 thousand SIT as at 1 January 2004 and 523,150 thousand SIT as at 31 December 2004.

Research and development costs are not capitalised. They are recorded as an expense in the total amount immediately when incurred. Both pursuant to the SAS and the IFRS, the only costs referring to the research and development that are debited against intangible assets are the costs of the purchased registration documents.

(c) Deferred tax assets

Certain Group companies kept records of deferred tax assets already before the transition to IFRS. Deferred tax assets amounted to 324,016 thousand SIT as at 1 January 2004, and 743,298 thousand SIT as at 31 December 2004.

Due to the transition to IFRS reporting, the balance of deferred tax assets as at 1 January 2004 increased by 1,078,826 thousand SIT, and by 1,170,244 thousand SIT as at 31 December 2004. For a detailed presentation of the calculation and of the impact upon the items of equity, please refer to Note (m) below.

(d) Other non-current assets

Other non-current assets as at 1 January 2004 were decreased by the amount of own shares (4,670,280 thousand SIT) which are recorded as a deduction item within equity in the balance sheet prepared in accordance with IFRS. They were also increased by the change in fair value of investments in shares and securities in the amount of 39,473 thousand SIT which were recorded at their market value and categorised as available for sale. The effect of the adjustment is recorded within equity, under reserves for fair value. The increase is also a result of the transfer of receivables from long-term operative lease in the amount of 46,426 thousand SIT from the item 'intangible fixed assets'.

The balance of assets recorded in compliance with the IFRS as at 31 December 2004 was changed by a decrease in the amount of own shares (4,670,280 thousand SIT), by an increase due to adjustment of investments in shares and securities to their market value in the amount of 693,316 thousand SIT, and by the transfer of items under long-term operative lease in the amount of 40,586 thousand SIT from 'intangible fixed assets'.

(e) Inventories

As to the valuation of inventories pursuant to IFRS, there were no changes in comparison to the SAS. However, the balance of finished products and work in progress was lower by 50,284 thousand SIT as at 1 January 2004 and by 127,694 thousand SIT as at 31 December 2004 due to the decreased depreciation amounts.

(f) Trade receivables

The Group recorded an increase in trade receivables by 195,027 thousand SIT as at 1 January 2004 and by 259,628 thousand SIT as at 31 December 2004, due to the transfer of short-term receivables and other assets which were recorded under other current assets in the balance sheet prepared in compliance with the SAS, referring to short-term deferred costs and short-term accrued revenues.

(g) Investments

Investments in shares are recorded in the income statement at their fair value, resulting in an increase in investments by 15,289 thousand SIT as at 1 January 2004 and by 61,883 thousand SIT as at 31 December 2004. The effects of the change in fair value are recorded under retained earnings.

Financial revenue was increased by the amount of changes in the value of derivative financial instruments due to the restatement at fair value in the amount of 138,108 thousand SIT, which was pursuant to the SAS accounted for under 'reserves for fair value', and by the changes in the value of securities due to the restatement at fair value in the amount of 46,593 thousand SIT. In accordance with the SAS, no value increase of assets was carried out.

(h) Reserves for fair value

The Group recorded 21,888,482 thousand SIT of reserves for fair value in the balance sheet as at 1 January 2004. During the transition to IFRS, the general capital revaluation adjustment was eliminated from the reserve for fair value as at 1 January 2004 in the amount of 21,724,114 thousand SIT, which was accounted for under reserves at the beginning and at the end of the period. Revaluation of derivative financial instruments in the amount of 164,368 thousand SIT is under IFRS included in the item of retained earnings. In addition, the reserve for fair value has increased by 29,605 thousand SIT based on the adjustment of the value of non-current investments to the fair value. The above-mentioned amount represents the balance of reserves for fair value as at 1 January 2004 in the balance sheet prepared in accordance with the IFRS.

As at 31 December 2004 reserves for fair value amount to 519,987 thousand SIT, resulting from the increase in non-current investments by the fair value adjustment, i.e. 653,843 thousand SIT, and the decrease of the deferred tax i.e. 163,461 thousand SIT.

(i) Translation reserves

The transition to IFRS resulted also in a decrease of exchange differences in connection with capital revaluation adjustment. They occur during the translation of items of financial statements of subsidiaries abroad and decreased by 19,507 thousand SIT as at 1 January 2004 and by 18,849 thousand SIT as at 31 December 2004.

(j) Minority interest

The reconciliation of items within equity required by the transition to IFRS resulted also in a decrease of minority interest by 167,037 thousand SIT as at 1 January 2004 and by 173,538 thousand SIT as at 31 December 2004.

(k) Non-current provisions

The payables to employees for anniversary bonuses and termination pays were not disclosed in the financial statements prepared in accordance with the SAS. In compliance with the IFRS, the calculation of payables to employees was performed by a certified actuary. The selected discount rate is 2.75% p.a..

The balance of payables to employees is disclosed under liabilities within provisions in the amount of 10,205,172 thousand SIT as at 1 January 2004 and 10,422,514 thousand SIT as at 31 December 2004. Actuarial losses (increase in payables to employees) in the amount of 217,342 thousand SIT are recognised in the income statement for 2004, thus increasing the following items within operating expenses for 2004: production cost of goods sold by 137,176 thousand SIT, sales and marketing by 18,210 thousand SIT, R&D costs by 22,340 thousand SIT, and administrative expenses by 39,616 thousand SIT.

(l) Trade payables

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

(m) Deferred tax

	1 Jan 2004		31 Dec 2004	
In thousand SIT	Tax base	Tax	Tax base	Tax
Restatement of intangible assets and property, plant and equipment	734,537	149,062	1,027,198	223,899
Provisions for employees	1,481,672	370,418	1,521,137	380,284
Other non-current provisions	2,661,791	665,448	3,134,178	783,545
Tax loss brought forward, other items	891,748	217,915	2,208,186	525,814
Gross deferred tax receivables	**5,769,748**	**1,402,843**	**7,890,699**	**1,913,542**
Long-term investments	–39,473	–9,868	–693,316	–173,329
Short-term investments	–164,368	–41,092	–302,476	–75,619
Gross deferred tax liabilities	**–203,841**	**–50,960**	**–995,792**	**–248,948**
Net deferred tax receivables	**5,565,907**	**1,351,883**	**6,894,907**	**1,664,594**
Deferred tax receivable prior to the transition to the IFRS		324,016		743,298
Deferred tax receivable due to the transition to the IFRS		1,027,866		921,297

Certain Group companies kept records of deferred tax assets already before the transition to IFRS. Deferred tax assets amounted to 324,016 thousand SIT as at 1 January 2004. The legal tax rate of the income tax effective in the respective country was applied when preparing the adjustments to IFRS.

(n) Retained earnings

In thousand SIT	Notes	1 Jan 2004	31 Dec 2004
Intangible assets - transfer to costs	b	–173,590	–133,228
Property, plant and equipment	a	3,566,645	4,389,909
Investments	g	179,657	364,358
Inventories	e	–50,284	–127,695
Payables to employees	k	–10,205,172	–10,422,514
Deferred tax	m	1,037,734	1,094,626
Total reconciliation of equity		**–5,645,010**	**–4,837,205**
Thereof:			
– translation reserves		–19,507	–21,509
– equity holders of the parent		–5,458,466	–4,642,158
– minority interest		–167,037	–173,538

4.5.6.2 Reconciliation of profit for 2004

In thousand SIT	Notes	Income statement under SAS	Effect of the transition to IFRS	Income statement under IFRS
Net sales		113,317,141	0	113,317,141
Production cost of goods sold	a, k	51,698,079	–21,624	51,676,455
Gross operating yield		**61,619,062**	**21,624**	**61,640,686**
Sales and marketing	a, k	27,006,114	–136,624	26,869,490
R&D costs	a, k	8,372,923	–59,332	8,313,591
Administrative expense	a, k	13,213,618	–181,735	13,031,883
Other operating revenues		4,364,063	160,230	4,524,293
Operating profit		**17,390,470**	**559,545**	**17,950,015**
Financial income	g	3,355,646	189,893	3,545,539
Financial expenses	g	3,323,750	–128,265	3,195,485
Net financial expenses		**31,896**	**318,158**	**350,054**
Extraordinary revenues/expenses		116,172	–116,172	0
Profit before tax		**17,538,538**	**761,531**	**18,300,069**
Income tax expense		2,878,183	–239,132	2,639,051
Profit for the period		**14,660,355**	**1,000,663**	**15,661,018**
Equity holders of the parent		14,630,663	1,007,163	15,637,826
Minority interest		29,692	–6,500	23,192
Profit for the period		**14,660,355**	**1,000,663**	**15,661,018**
Earnings per share		4,329	298	4,627

4.5.6.3 Disclosures as to the adjustments made in the cash flow statement

Due to the changes in the balance sheet and the income statement, certain changes of the individual items were recorded, whereas the balance of cash and cash equivalents at the end of period remained the same.

4.6 Auditor's Report

KPMG

Auditor's Report

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

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

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

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

KPMG SLOVENIJA,

podjetje za revidiranje, d.o.o.

Marjan Mahnič, B.Sc.Ec.

Managing Partner and Certified Audit

Andrej Korinšek, B.Sc.Ec.

Managing Partner and Certified Audit

KPMG Slovenija, d.o.o.

Ljubljana, March 23, 2006

5 Financial statements of Krka, d. d., Novo mesto prepared in accordance with the International Financial Reporting Standards

5.1 Balance sheet

In thousand SIT	Notes	31 Dec 2005	31 Dec 2004
Assets			
Property, plant and equipment	5.5.2.1	78,103,851	71,527,763
Intangible assets	5.5.2.2	4,897,744	3,947,586
Investments in subsidiaries	5.5.2.3	27,756,710	25,307,556
Deferred tax assets	5.5.3.12	3,732,861	1,103,451
Other non-current assets	5.5.2.4	2,097,824	2,120,726
Non-current assets		**116,588,990**	**104,007,082**
Inventories	5.5.2.5	26,883,175	18,483,216
Trade and other receivables	5.5.2.6	33,774,998	25,745,309
Current investments	5.5.2.7	3,933,668	1,981,639
Cash and cash equivalents	5.5.2.8	758,768	1,100,954
Current assets		**65,350,609**	**47,311,118**
Total assets		**181,939,599**	**151,318,200**
Off balance sheet items	5.5.2.17	19,352,546	18,599,067
Equity	5.5.2.9		
Share capital		14,170,448	14,170,448
Own shares		–4,670,280	–4,670,280
Reserves		34,885,325	34,085,325
Retained earnings		69,193,532	53,031,991
Reserves for fair value		561,602	519,986
Total equity		**114,140,627**	**97,137,470**
Liabilities			
Borrowings	5.5.2.11	10,011,560	13,786,543
Provisions	5.5.2.12	22,692,910	21,488,397
Grants received	5.5.2.13	87,605	100,492
Deferred tax liabilities	5.5.3.12	265,879	248,949
Total non-current liabilities	5.5.2.10	**33,057,954**	**35,624,381**
Trade payables	5.5.2.14	12,713,863	8,312,672
Borrowings	5.5.2.11	8,495,030	4,628,896
Income tax liabilities		6,598,933	1,347,211
Provisions and other liabilities	5.5.2.15	6,933,192	4,267,570
Total current liabilities		**34,741,018**	**18,556,349**
Total liabilities		**67,798,972**	**54,180,730**
Total equity and liabilities		**181,939,599**	**151,318,200**
Off balance sheet items	5.5.2.17	19,352,546	18,599,067

5.2 Income statement

In thousand SIT	Notes	2005	2004
Net sales	5.5.3.1	116,570,332	97,977,511
Production cost of goods sold	5.5.3.3	45,055,228	43,918,709
Gross operating yield		**71,515,104**	**54,058,802**
Sales and marketing	5.5.3.4	35,056,183	22,022,101
R&D costs	5.5.3.5	9,487,512	8,313,591
Administrative expenses	5.5.3.6	10,050,639	9,961,612
Other operating revenues	5.5.3.2	11,880,171	4,255,175
Operating profit		**28,800,941**	**18,016,673**
Financial income	5.5.3.10	3,283,180	3,043,936
Financial expenses	5.5,3,10	3,734,629	3,066,041
Net financial expenses		**–451,449**	**–22,105**
Profit before tax		**28,349,492**	**17,994,568**
Income tax expense	5.5.3.11	5,890,302	2,684,951
Profit for the period		**22,459,190**	**15,309,617**
Earnings per share		6,645	4,530

5.3 Cash flow statement

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

5.4 Statement of recognised income and expenses

In thousand SIT	2005	2004
Revaluation of long-term investments to market price	55,071	653,843
Deferred taxes	–812,470	–354,318
Subsequent decrease in income tax	0	73,925
Refund of default interest paid in respect of taxes	87,663	0
Net income and expense recognised directly in equity	**–669,736**	**373,450**
Profit for the period	**22,459,190**	**15,309,617**
Total recognised income and expense for the period	**21,789,454**	**15,683,067**

5.5 Notes to the financial statements

5.5.1 Summary of significant accounting policies

Krka, d. d., Novo mesto is the controlling company of the Krka Group with its registered seat at Šmarješka cesta 6, 8501 Novo mesto in Slovenia.
The issue of the Company's financial statements has been approved by the Management Board on 23 March 2006.

1. Statement of compliance

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

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

IFRS 6 *Exploration for and Evaluation of Mineral Resources* (effective from 1 January 2006)
The Standard includes a requirement to distinguish between tangible and intangible assets that are used in the exploration for and evaluation of mineral resources, and specifies when impairment testing should be carried out. The new standard shall have no impact on the Company's operations.

IFRS 7 *Financial Instruments: Disclosures* (effective from 1 January 2007)
The Standard will require increased disclosure in respect of the Company's financial instruments. It supersedes IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and is applicable to all entities that prepare financial statements in accordance with IFRS. Significant additional disclosures required will relate to the Company's financial risk management objectives, policies and processes.

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards and IFRS 6 Exploration for and Evaluation of Mineral Resources* (effective from 1 January 2006)
The amendment clarifies that a first-time adopter of IFRS for a period beginning before 1 January 2006 that applies IFRS 6 voluntarily need not apply the disclosure, recognition and measurement requirements of IFRS 6 to the comparative information included in its first IFRS financial statements. This amendment shall have no impact on the Company's operations.

Amendment to IAS 1 *Presentation of Financial Statements – Capital Disclosures* (effective from 1 January 2007)
As a complimentary amendment, the standard will require increased disclosure in respect of the Company's capital.

Amendment to IAS 19 *Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures* (effective from 1 January 2006)
The amendment includes an option for actuarial gains and losses to be recognised in full as they arise, outside of the income statement in a statement of recognised income and expense. The Company has not yet determined whether it will elect to apply the allowed option. Currently the Company recognizes actuarial gains and losses in full in the year that they arise.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions* (effective from 1 January 2006)
The amendment allows the foreign currency risk of a highly probable forecast intragroup transaction to qualify as a hedged item if certain criteria are met. This amendment is not relevant to the Company's operations, as the Group does not have any intragroup transactions that would qualify as a hedged item.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement – The Fair Value Option* (effective from 1 January 2006)
The amendment restricts the designation of financial instruments as "at fair value" through profit or loss. The Company believes that this amendment should not have a significant impact on the classification of financial instruments, as it should be able to comply with the amended criteria for the designation of financial instruments at fair value through profit or loss.

Amendment to IAS 39 *Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts – Financial Guarantee Contracts* (effective from 1 January 2006)
The amendment requires guarantees that are not insurance contracts to be measured at fair value upon initial recognition. Where the Company issues financial guarantees to guarantee the indebtedness of other Group entities, the Company considers these to be insurance arrangements and accounts for them as such. The Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee. As at 31 December 2005 the value of guarantees issued amounted to 1,917,521 thousand SIT.

Amendment to IAS 21 *The Effects of Changes in Foreign Exchange Rates – Net Investment in a Foreign Operation* (effective from 1 January 2006)
The amendment clarifies in which circumstances a loan may form part of a reporting entity's net investment in a foreign operation, and the currency in which such an item may be denominated. The Company currently has no items comprising net investments in foreign operations that will be affected by the amendment.

IFRIC 4 *Determining whether an Arrangement contains a Lease* (effective from 1 January 2006)
The Interpretation requires certain arrangements to be accounted for in compliance with IAS 17 Leases, even if they are not in the legal form of a lease. The Company has not yet completed its analysis of the impact of the new Interpretation.

IFRIC 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds* (effective from 1 January 2006)
The Interpretation deals with funds created for the purpose of settling decommissioning and similar expenses. The respective Interpretation is not relevant to the Company.

IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment* (effective from 1 December 2005)
The Interpretation deals with obligations arising from the European Union Directive regulating the collection, treatment, recovery and environmentally sound disposal of waste equipment. The respective Interpretation is not relevant to the Company.

IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies* (effective from 1 March 2006)
The Interpretation contains guidance on how an entity would restate its financial statements pursuant to IAS 29 in the first year it identifies the existence of hyperinflation in the economy of its functional currency. The Interpretation is not relevant to the Company as it does not operate in hyperinflation environment.

IFRIC 8 *Scope of IFRS 2* (effective from 1 May 2006)
The Interpretation clarifies that the accounting standard IFRS 2 Share-based Payment applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. The Interpretation is not relevant to the Company as it has not entered into any share-based payments arrangements for apparently nil or inadequate consideration.

IFRIC 9 *Reassessment of Embedded Derivatives* (effective from 1 June 2006)
The treatment of an embedded derivative is assessed by the entity when the entity first becomes a party to the contract, and that reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract. The Interpretation is not relevant to the Company as it has no embedded financial instruments.

2. Basis of preparation

The financial statements are presented in Slovene tolar (SIT), rounded to the nearest thousand. They are prepared on the historical cost basis, while derivative financial instruments, financial instruments held for trading, and financial instruments classified as available-for-sale are stated at their fair value.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and 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.

The 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 if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.
The Company applies the same accounting policies in its opening balance sheet as at 1 January 2004 pursuant to IFRS and all periods, presented in the accompanying financial statements.

3. Foreign currency

Foreign currency transactions

Transactions and balances in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Slovenian tolars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Slovenian tolars at foreign exchange rates ruling at the dates the fair value was determined.

4. Derivative financial instruments and hedging

The Company uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at cost. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The recognition of subsequent changes to the fair value depends upon whether a certain derivative financial instrument qualifies for hedge accounting:

- At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk;
- The hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship;
- For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss; and
- The effectiveness of the hedge can be reliably measured i.e. the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured.

The derivative financial instrument is recorded differently in respect to its purpose in case of a specific hedge accounting.

Changes to fair values of derivative financial instruments earmarked for hedging the fair value of assets or liabilities are disclosed in the income statement. The income statement includes also changed values of assets or liabilities to which the derivative financial instruments refer.

Hedging of net investments in foreign operations is disclosed in the same manner as cash flow hedging. Exchange differences arising on this transaction are included in equity under joint exchange difference.

Changes to fair values of derivative financial instruments earmarked for hedging in various economic sense but not meeting the stated criteria, are recorded and subsequently valued as each other asset or liability. Gains and losses that occurred due to the changed fair value are disclosed in the income statement.

5. Property, plant and equipment

Items of property, plant and equipment are stated at cost as deemed cost less accumulated depreciation and impairment losses (see accounting policy 'Impairment'). The cost of self-constructed assets includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads.
Certain items of property, plant and equipment that had been revalued to fair value on or prior to 1 January 2004, the date of transition to IFRSs, are measured on the basis of deemed cost, being the revalued amount at the date of that revaluation. Where 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 subsequent cost of an item of property, plant and equipment is recognised in the carrying amount when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Company. All other subsequent costs are recognised in the income statement as an expense as incurred.

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The depreciation rates are determined on the basis of the estimated useful lives. Land is not depreciated.

The estimated useful lives are as follows:

- buildings 8–40 years
- plant and equipment 5–20 years
- furniture 5 years
- computer equipment 4–6 years
- means of transportation 5–15 years

The residual value, if not insignificant, is reassessed annually.

6. Intangible assets

Research and development

As for the research and development activity, 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 in the Company are stated at cost less accumulated amortisation and 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 on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets and starts, when the asset is available for its intended use. The estimated useful lives are as follows:

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

7. Investments

Investments in subsidiaries

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.

Investments in debt and equity securities

Financial instruments held for trading are classified as current assets and are stated at fair value, with any resultant gain or loss recognised in the income statement.

Other financial instruments held by the Company are classified as being available-for-sale and are stated at fair value. Any resultant gain or loss is recognised directly in equity, except for impairment losses and, in the case of monetary items such as debt securities, foreign exchange gains and losses. When these investments are derecognised, the cumulative gain or loss previously recognised directly in equity is recognised in profit or loss. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in profit or loss.

The fair value of financial instruments classified as held for trading and available-for-sale is their quoted bid price at the balance sheet date.

Financial instruments classified as held for trading or available-for-sale investments are recognised/derecognised by the Company on the date it commits to purchase/sell the investments. Securities held-to-naturity are recognised/derecognised on the day they are transferred by the Company.

8. Trade and other receivables

Trade and other receivables are stated at their cost less impairment losses (see accounting policy 'Impairment').

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 average cost of purchase. 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 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.

10. Cash and cash equivalents

Cash and cash equivalents comprises 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.

11. Impairment

The carrying amounts of the Company's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement. The recoverable amount is calculated as the present value of estimated future cash flows. Short-term receivables are not discounted.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in profit or loss even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in profit or loss is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

Calculation of recoverable amount

The recoverable amount of the Company's investments in held-to-maturity securities and receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e., the effective interest rate computed at initial recognition of these financial assets). Short-term receivables are not discounted.

The recoverable amount of other assets is the greater of their net selling price and value in use. 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. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.
Reversal of impairment

An impairment loss in respect of a held-to-maturity security or receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of an investment in an equity instrument classified as available for sale is not reversed through profit or loss. If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in profit or loss, the impairment loss shall be reversed, with the amount of the reversal recognised in profit or loss.
An impairment loss in respect of goodwill is not reversed. In respect of other assets, 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.

12. Equity

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 change in equity. Repurchased shares are classified as treasury shares and presented as a deduction from total equity.

Dividends

Dividends are recognised in the consolidated financial statements in the period, in which the annual meeting adopted the resolution on dividend payout.

13. Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

14. Provisions

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

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 in countries where the controlling company and its subsidiaries are located, 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.

The Company has formed provisions as at 1 January 2004 i.e. date of the opening balance sheet prepared according to IFRS, except for those companies, where the obligation already existed pursuant to the local legislation. 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 discount rate is 2.75% p.a.. 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.

15. Trade and other payables

Trade and other payables are stated at historical cost, indicated in relevant documents.

16. Net sales

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. 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.

17. Net financing cost

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method, interest receivable on funds invested, dividend income, foreign exchange gains and losses, and gains and losses on hedging instruments that are recognised in the income statement and valued at market value.

Interest income is recognised in the income statement as it accrues, using the effective interest method. Dividend income is recognised in the income statement on the date the entity's right to receive payments is established.

18. 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.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.
Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences are not provided for investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

19. 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 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 controlling 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 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 net sales. 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.

20. Cash Flow Statement

The cash flow statement has been prepared under the direct method based upon items from the balance sheet as at 31 December 2005 and 31 December 2004, the income statement for the year that ended 31 December 2005, as well as additional data required for the adjustment of inflows and outflows.

Notes to the financial statements

5.5.2 Balance sheet

5.5.2.1 Property, plant and equipment

In thousand SIT	31 Dec 2005	31 Dec 2004
Property	2,908,502	2,775,096
Plant	33,550,558	35,168,988
Equipment	27,201,905	25,664,553
PPE under construction	14,442,886	7,919,126
– advances for PPE	594,677	1,356,002
Total	**78,103,851**	**71,527,763**

In 2005, Krka invested 15,032,686 thousand SIT in property, plant and equipment. The biggest investments in terms of value are: the construction of a new plant for the production of pharmaceutical active substances called Synthesis 4 that is expected to be concluded by this year's autumn. Further investments were made also in the construction of a new warehouse for liquid raw materials, investments made for increasing the production capacities of the Specifika plant and doubling the capacities of the warehouse of finished products, all referring to sites in Novo mesto.

Movements of property, plant and equipment in 2005

In thousand SIT	Property	Plant	Equipment	PPE under construction	Advances for PPE	Total
Cost at 31 Dec 2004	**2,775,096**	**58,068,332**	**72,072,619**	**6,563,124**	**1,356,002**	**140,835,173**
Additions	0	0	0	15,032,686	–761,325	14,271,361
Capitalisations	133,406	962,753	6,733,220	–7,743,736	0	85,643
Disposals, write-offs	0	–230,895	–3,100,746	-3,865	0	–3,335,506
Cost at 31 Dec 2005	**2,908,502**	**58,800,190**	**75,705,093**	**13,848,209**	**594,677**	**151,856,671**
Accumulated depreciation at 01 Jan 2005	**0**	**22,899,344**	**46,408,066**	**0**	**0**	**69,307,410**
Depreciation	0	2,430,101	5,055,406	0	0	7,485,507
Capitalisations	0	0	85,070	0	0	85,070
Disposals, write-offs	0	–79,813	–3,045,354	0	0	–3,125,167
Accumulated depreciation at 31 Dec 2005	**0**	**25,249,632**	**48,503,188**	**0**	**0**	**73,752,820**
Carrying amount at 31 Dec 2004	**2,775,096**	**35,168,988**	**25,664,553**	**6,563,124**	**1,356,002**	**71,527,763**
Carrying amount at 31 Dec 2005	**2,908,502**	**33,550,558**	**27,201,905**	**13,848,209**	**594,677**	**78,103,851**

Movements of property, plant and equipment in 2004

In thousand SIT	Property	Plant	Equipment	PPE under construction	Advances for PPE	Total
Cost at 31 Dec 2003	**2,745,570**	**55,231,869**	**62,416,567**	**6,678,653**	**371,968**	**127,444,627**
Additions	0	0	0	16,218,831	984,035	17,202,866
Capitalisations	20,126	3,913,193	11,523,739	–16,186,258	0	–729,200
Disposals, write-offs	9,400	–1,076,730	–1,867,687	–148,102	0	–3,083,119
Cost at 31 Dec 2004	**2,775,096**	**58,068,332**	**72,072,619**	**6,563,124**	**1,356,003**	**140,835,174**
Accumulated depreciation at 1 Jan 2003	**0**	**21,765,411**	**43,200,370**	**0**	**0**	**64,965,781**
Depreciation	0	2,314,050	4,966,592	0	0	7,280,642
Capitalisations	0	–701,208	–50,472	0	0	–751,680
Disposals, write-offs	0	–478,909	–1,708,424	0	0	–2,187,333
Accumulated depreciation at 31 Dec 2004	**0**	**22,899,344**	**46,408,066**	**0**	**0**	**69,307,410**
Carrying amount at 31 Dec 2003	**2,745,570**	**33,466,458**	**19,216,197**	**6,678,653**	**371,968**	**62,478,846**
Carrying amount at 31 Dec 2004	**2,775,096**	**35,168,988**	**25,664,553**	**6,563,124**	**1,356,002**	**71,527,763**

5.5.2.2 Intangible assets

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term deferred R&D cost	530,924	513,329
Long-term property rights	3,532,260	3,083,960
Intangible assets under construction	834,560	350,297
Total	**4,897,744**	**3,947,586**

In 2005, the Company acquired intangible assets in the amount of 1,853,563 thousand SIT. Investments in long-term property rights amounted to 1,157,077 thousand SIT, of which 740,592 thousand SIT refers to the upgrading of the software SAP and WERUM. Intangible assets under construction encompass predominantly registration documents for new drugs.

Movements of intangible assets in 2005

In thousand SIT	Long-term deferred R&D cost	Long-term property rights	IA under construction	Total
Cost at 31 Dec 2004	**1,021,035**	**3,756,181**	**350,297**	**5,127,513**
Additions, capitalisations	212,156	1,157,144	484,263	1,853,563
Disposals, write-offs	–25,365	–19,057	0	–44,422
Cost at 31 Dec 2005	**1,207,826**	**4,894,268**	**834,560**	**6,936,654**
Accumulated amortisation at 31 Dec 2004	**507,706**	**672,221**	**0**	**1,179,927**
Amortisation	194,561	698,618	0	893,179
Disposals, write-offs	–25,365	–8,831	0	–34,196
Accumulated amortisation at 31 Dec 2005	**676,902**	**1,362,008**	**0**	**2,038,910**
Carrying amount at 31 Dec 2004	**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**

Movements of intangible assets in 2004

In thousand SIT	Long-term deferred R&D cost	Long-term property rights	IA under construction	Total
Cost at 31 Dec 2003	**935,098**	**1,120,761**	**728,407**	**2,784,266**
Additions, capitalisations	85,937	2,643,363	–378,110	2,351,190
Disposals, write-offs	0	–7,942	0	–7,942
Cost at 31 Dec 2004	**1,021,035**	**3,756,182**	**350,297**	**5,127,514**
Accumulated amortisation at 31 Dec 2003	**334,948**	**400,033**	**0**	**734,981**
Amortisation	172,758	280,130	0	452,888
Disposals, write-offs	0	–7,941	0	–7,941
Accumulated amortisation at 31 Dec 2004	**507,706**	**672,222**	**0**	**1,179,928**
Carrying amount at 31 Dec 2003	**600,150**	**720,728**	**728,407**	**2,049,285**
Carrying amount at 31 Dec 2004	**513,329**	**3,083,960**	**350,297**	**3,947,586**

5.5.2.3 Investments in subsidiaries

Movements of investments in subsidiaries in 2005

In thousand SIT	Investments in subsidiaries	Long-term loans	Total
Gross value			
Balance at 31 Dec 2004	**25,178,132**	**129,424**	**25,307,556**
Increase	1,283,659	198,938	1,482,597
Decrease	0	–199,122	–199,122
Revaluation	1,099,811	65,868	1,165,679
Balance at 31 Dec 2005	**27,561,602**	**195,108**	**27,756,710**
Carrying amount at 31 Dec 2004	**25,178,132**	**129,424**	**25,307,556**
Carrying amount at 31 Dec 2005	**27,561,602**	**195,108**	**27,756,710**

Movements of investments in subsidiaries in 2004

In thousand SIT	Investments in subsidiaries	Long-term loans	Total
Gross value			
Balance at 31 Dec 2003	**22,556,240**	**742,942**	**23,299,182**
Increase	2,147,444	0	2,147,444
Decrease	122,895	–587,167	–464,272
Revaluation	351,553	–26,351	325,202
Balance at 31 Dec 2004	**25,178,132**	**129,424**	**25,307,556**
Carrying amount at 31 Dec 2003	**22,556,240**	**742,942**	**23,299,182**
Carrying amount at 31 Dec 2004	**25,178,132**	**129,424**	**25,307,556**

• **Interests in subsidiaries**

In thousand SIT	Share in equity	Share capital	Value of share	
	31 Dec 2005	31 Dec 2005	31 Dec 2005	31 Dec 2004
KRKA ZDRAVILIŠČA, d. o. o., Novo mesto	100 %	3,535,466	10,881,283	10,881,283
KRKA-FARMA d. o. o., Zagreb, Croatia	100 %	3,541,914	3,614,230	2,468,273
KRKA-FARMA DOOEL, Skopje, Macedonia	100 %	191,297	192,272	183,908
KRKA-POLSKA Sp. z o. o., Warsaw, Poland	100 %	1,085,819	4,480,527	4,247,040
KRKA Aussenhandels GmbH, Munich, Germany	100 %	61,247	96,719	96,786
OOO "KRKA-RUS", Istra, Russian Federation	100 %	7,848,306	7,912,087	7,148,772
OOO "KRKA FARMA", Sergiev Posad, Russian Federation	100 %	27,363	118,300	83,297
KRKA ČR, s. r. o., Prague, Czech Republic	100 %	826	826	788
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	100 %	240	240	240
KRKA Sverige AB, Stockholm, Sweden	100 %	3,826	198,283	3,996
KRKA Magyarorszàg Kft, Budapest, Hungary	100 %	11,952	10,641	10,850
HELVETIUS-S.R.L., Trieste, Italy	80 %	12,362	46,125	46,158
"KRKA-FARMA", d. o. o., Novi Sad, Serbia and Montenegro	100 %	307	10,069	6,741
Total			**27,561,602**	**25,178,132**

Hereinafter shortened corporate names are applied.

In 2005 the Company purchased a share of 1% in its subsidiary Krka Magyarorszàg, Budapest in the amount of 103 thousand SIT, as well as a 40% share in Krka-Farma, Novi Sad amounting to 4,311 thousand SIT. Consequently Krka is now the sole owner of both companies.

An increase of capital stock was carried out in following companies: Krka Farma, Sergiev Posad (by 25,764 thousand SIT), Krka-Farma, Zagreb (by 1,054,629 thousand SIT) and Krka Sverige AB, Stockholm (by 198,850 thousand SIT).

• **Long-term loans extended 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 was deferred for two years (repayment is to begin in 2008).

In 2005, Krka-Farma Zagreb fully repaid its long-term loan. The Company extended no new loans in the reporting period.

5.5.2.4 Other non-current assets

In thousand SIT	31 Dec 2005	31 Dec 2004
Equity shares available-for-sale	1,167,910	1,112,128
Other investments	62,391	62,391
Loans to other entities	858,695	898,792
Trade receivables	8,828	47,415
Total	**2,097,824**	**2,120,726**

Movements of other non-current investments in 2005

In thousand SIT	Equity shares	Other investments	Loans to other entities	Total
Gross value				
Balance at 31 Dec 2004	**1,119,723**	**62,391**	**915,676**	**2,097,790**
Increase	313	0	289,678	289,991
Decrease	0	0	–334,319	–334,319
Revaluation to fair value	55,576	0	1,674	57,250
Balance at 31 Dec 2005	**1,175,612**	**62,391**	**872,709**	**2,110,712**
Value adjustment				
Balance at 31 Dec 2004	**7,595**	**0**	**16,884**	**24,479**
Increase	107	0	91	198
Decrease	0	0	–2,961	–2,961
Balance at 31 Dec 2005	**7,702**	**0**	**14,014**	**21,716**
Carrying amount at 31 Dec 2004	**1,112,128**	**62,391**	**898,792**	**2,073,311**
Carrying amount at 31 Dec 2005	**1,167,910**	**62,391**	**858,695**	**2,088,996**

Movements of other non-current investments in 2004

In thousand SIT	Equity shares	Other shares	Other investments	Loans to other entities	Total
Gross value					
Balance at 31 Dec 2004	**120,256**	**461,223**	**213,859**	**865,026**	**1,660,364**
Increase	0	1,000	0	185,899	186,899
Decrease	–120,256	0	–151,468	–148,702	–420,426
Revaluation to fair value	0	657,500	0	13,453	670,953
Balance at 31 Dec 2004	**0**	**1,119,723**	**62,391**	**915,676**	**2,097,790**
Value adjustments					
Balance at 31 Dec 2003	**0**	**7,339**	**0**	**5,576**	**12,915**
Increase	0	256	0	14,569	14,825
Decrease	0	0	0	-3,261	-3,261
Balance at 31 Dec 2004	**0**	**7,595**	**0**	**16,884**	**24,479**
Carrying amount at 31 Dec 2003	**120,256**	**453,884**	**213,859**	**859,450**	**1,647,449**
Carrying amount at 31 Dec 2004	**0**	**1,112,128**	**62,391**	**898,792**	**2,073,311**

• 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 market interest-rate that is valid during the conclusion of the loan contract.

5.5.2.5 Inventories

In thousand SIT	31 Dec 2005	31 Dec 2004
Material	9,510,900	5,746,953
Work in progress	4,929,239	3,928,564
Products	11,812,302	8,379,440
Merchandise	630,146	428,259
Advances	588	0
Total	**26,883,175**	**18,483,216**

Higher balances of inventories are influenced by the wider scope of sale, greater range of products, increasing number of markets with more and more specific requirements by individual customers, as well as the Company's policy of having safety stocks in order to ensure flexible and reliable delivery of its core products or to its core markets.

In the reporting period the Company carried out an impairment of inventories (470,664 thousand SIT) and a write-off of inventories amounting to 67,028 thousand SIT. In 2004 the impairment amounted to 311,989 thousand SIT whereas the write-off to 221,805 thousand SIT.

5.5.2.6 Trade and other receivables

In thousand SIT	31 Dec 2005	31 Dec 2004
Receivables due from Group companies	15,314,474	13,705,111
Trade receivables	16,907,748	10,946,013
Receivables due from other entities	1,552,776	1,094,185
Total	**33,774,998**	**25,745,309**

The increase in receivables is a result of higher sales, as well as the dynamics used in sales to markets of the Western Europe and the Russian Federation in the last quarter of 2005. Longer repayment periods for government procurements in the Russian Federation contributed to this increase as well.

• Receivables due from Group companies

In thousand SIT	31 Dec 2005	31 Dec 2004
KRKA Polska Sp. z o. o., Warsaw, Poland	4,488,802	4,360,100
KRKA FARMA d. o. o., Zagreb, Croatia	6,891,748	6,308,187
KRKA-FARMA DOOEL, Skopje, Macedonia	1,281,080	1,299,836
OOO KRKA FARMA, Sergiev Posad, Russian Federation	1,348,038	589,732
OOO KRKA-RUS, Istra, Russian Federation	248,094	495,171
KRKA-FARMA, d. o. o., Novi Sad, Serbia and Montenegro	607,187	463,957
KRKA Sverige AB, Stockholm, Sweden	442,509	0
Operating receivables due from other Group companies	7,015	188,128
Total	**15,314,474**	**13,705,111**

• **Trade receivables**

In thousand SIT	Gross value	Adjustments	Net value at 31 Dec 2005	Net value at 31 Dec 2004
Domestic customers	2,835,208	32,427	2,802,781	3,389,890
Foreign customers	14,588,332	483,365	14,104,967	7,556,123
Total	**17,423,540**	**515,792**	**16,907,748**	**10,946,013**

The Company forms allowances for receivables according to criteria stated in accounting policies and based on the risk of individual markets and customers as well as the actual repayability of receivables in the past.

Trade receivables are not secured. As at 31 December 2005 the ageing structure of trade receivables is as follows: 98% of receivables are past due by six months (including undue receivables), 1% of receivables are past due from six months to one year, and 1% of receivables are past due for over a year.

In 2005 allowances for receivables were charged against the income statement in the amount of 388,005 thousand SIT (2004: 612,606 thousand SIT).

• **Receivables due from other entities**

Receivables due from other entities in the amount of 1,552,776 thousand SIT refer mostly to receivables arising from VAT refund.

5.5.2.7 Investments

In thousand SIT	31 Dec 2005	31 Dec 2004
Current investments	3,068,998	1,207,300
– equity shares held for trading	1,524,869	682,229
– other current investments	1,544,129	525,071
Short-term loans	864,670	774,339
– short-term loans to subsidiaries	672,111	535,486
– short-term loans to other entities	192,559	238,853
Total	**3,933,668**	**1,981,639**

Equity shares held for trading include marketable shares (453,287 thousand SIT), non-marketable shares (29,180 thousand SIT) and shares issued by foreign companies (1,042,402 thousand SIT).

The major part of other current investments refers to government bonds (555,173 thousand SIT), mutual funds (752,755 thousand SIT and derivative financial instruments (124,632 thousand SIT).

Loans to Group companies include the short-term loan extended to Krka Zdravilišča in the amount of 546,000 thousand SIT and related loan interest amounting to 126,111 thousand SIT.

5.5.2.8 Cash and cash equivalents

In thousand SIT	31 Dec 2005	31 Dec 2004
Cash in hand	11,352	7,970
Bank balances	747,416	1,092,984
Total	**758,768**	**1,100,954**

5.5.2.9 Equity

Sttement of changes in equity

In thousand SIT	Share capital	Reserves	Own shares	Retained earnings	Reverves for fair value	Total
Balance at 01 Jan 2004	**14,170,448**	**33,585,325**	**–4,670,280**	**42,445,585**	**29,605**	**85,560,683**
Profit for the period	0	0	0	15,309,617	0	15,309,617
Formation of statutory reserves	0	500,000	0	–500,000	0	0
Dividends	0	0	0	–4,106,280	0	–4,106,280
Income and expense recognised directly in equity	0	0	0	–116,931	490,381	373,450
Balance at 31 Dec 2004	**14,170,448**	**34,085,325**	**–4,670,280**	**53,031,991**	**519,986**	**97,137,470**
Profit for the period	0	0	0	22,459,190	0	22,459,190
Formation of statutory reserves	0	800,000	0	–800,000	0	0
Dividends	0	0	0	–4,786,297	0	–4,786,297
Income and expense recognised directly in equity	0	0	0	–711,352	41,616	–669,736
Balance at 31 Dec 2005	**14,170,448**	**34,885,325**	**–4,670,280**	**69,193,532**	**561,602**	**114,140,627**

• 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 controlling company recorded 162,662 own shares amounting to 650,648 thousand SIT i.e. 4.6% of the share capitals' value. The number of shares in this reporting period remained unchanged if compared to 2004.

• Reserves

Reserves have increased by 800,000 thousand SIT in the reporting period which is mostly due to additionally formed statutory reserves. As at 31 December 2005 the item of reserves comprises revenue reserves (28,993,129 thousand SIT), legal reserves (3,592,196 thousand SIT) and statutory reserves (2,300,000 thousand SIT). In accordance with legal and statutory provisions none of the stated reserves may be used for dividend payout.

• Retained earnings

Retained earnings of the Company are increased by the profit for the period amounting to 22,459,190 thousand SIT, whereas the decrease refers to the dividend payout pursuant to the resolution adopted at the 10th annual meeting on 17 June 2005 in the amount of (4,786,297 thousand SIT), net expenses (711,352 thousand SIT) recognised directly in retained earnings, as well as the formation of statutory reserves (800,000 thousand SIT).

• Earnings per share

Earnings per share amount to 6,644.83 SIT and indicate an increase of 47% (2004: 4,529.54 SIT). The calculation for both years bases upon 3,379,950 shares, as 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.

5.5.2.10 Non-current liabilities

In thousand SIT	31 Dec 2005	31 Dec 2004
Borrowings	10,011,560	13,786,543
– long-term borrowings from banks	9,973,126	13,699,841
– long-term borrowings from other entities	38,434	86,702
Provisions	22,692,910	21,488,397
– provisions for termination pay and anniversary bonuses	9,752,747	9,536,707
– other provisions	12,940,163	11,924,690
Grants received	87,605	100,492
Deferred tax liabilities	265,879	248,949
Total	**33,057,954**	**35,624,381**

The structure of financial liabilities and trade payables has changed compared to 2004 as the Company made long-term instead of short-term borrowings. Accordingly, the share of non-current liabilities within the total liabilities decreased (from 23.5 to 18.2%) while the portion of current- mostly financial - liabilities increased (from 12.2 to 19.1%).

5.5.2.11 Borrowings

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term borrowings	10,011,560	13,786,543
– borrowings from domestic banks	9,973,126	11,397,392
– borrowings from foreign banks	0	2,302,449
– borrowings from other entities	38,434	86,702
Short-term borrowings	8,352,968	4,435,463
– borrowings from domestic banks	4,846,617	897,340
– borrowings from foreign banks	979,945	528,728
– borrowings from other entities	2,526,406	3,009,395
Interest payable	142,062	193,433
Total	**18,506,590**	**18,415,439**

• Movements of long-term borrowings

In thousand SIT	Borrowings from banks	Borrowings from other entities	Total
Balance at 1 Jan 2004	**4,387,118**	**122,036**	**4,509,154**
– new borrowings	11,318,828	0	11,318,828
– repayments	–3,682,118	–12,199	–3,694,317
– balance of transfer at 1 Jan 2004	3,234,147	20,800	3,254,947
– transfer to current liabilities at 31 Dec 2004	–1,426,068	–49,421	–1,475,489
– revaluation	–132,066	5,486	–126,580
Balance at 31 Dec 2004	**13,699,841**	**86,702**	**13,786,543**
– new borrowings	0	0	0
– repayments	–1,447,507	–49,745	–1,497,252
– balance of transfer at 1 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
– revaluation	396,342	2,994	399,336
Balance at 31 Dec 2005	**9,973,126**	**38,434**	**10,011,560**

Long-term borrowings referring to 2005 and recorded in the amount of 9,973,126 thousand SIT were all made in domestic banks.

Long-term borrowings have decreased mostly due to a regular repayment of loans extended by domestic banks. The borrowings refer to three domestic banks and are denominated in EUR and USD; they were extended for a period of seven years and for financing investments and current assets. The Company made 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; they were treated as contingent liabilities and are recorded among off balance sheet items. The Company hedged three long-term borrowings that are considered to form the major part of the borrowed amount by using interest rate swaps.

• Movements of short-term borrowings

In thousand SIT	Borrowings from banks	Borrowings from other entities	Total
Balance at 01 Jan 2004	**12,477,147**	**3,988,021**	**16,465,168**
– new borrowings	19,311,000	2,580,594	21,891,594
– repayments	–31,763,191	–3,608,641	–35,371,832
– transfer from non-current liabilities	1,426,068	49,421	1,475,489
– revaluation	–24,956	0	–24,956
Balance at 31 Dec 2004	**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**

Short-term borrowings increased by 88% during the year which is mostly due to additional short-term borrowings made and repaying the long-term borrowing in the amount of 4,101,618 thousand SIT, which is due as early as in 2006.

• Short-term borrowings from other entities

The item of short-term borrowings from other entities includes borrowings from domestic companies in the amount of 2,475,469 thousand SIT and related interest in the amount of 8,730 thousand SIT. The borrowings were made in Tolars for the period of one to six months, some for an indefinite period, or as money at call. Borrowings are not secured.

5.5.2.12 Provisions

The major part of provisions refers to lawsuits, which have recorded an increase by 1,056,493 thousand SIT. The increase includes the formation of new provisions (12,502,563 thousand SIT) for an outstanding lawsuit relating to the alleged patent infringements in connection with atorvastatin. Furthermore, the Company reversed provisions in the amount of 11,444,803 thousand SIT referring to the lawsuit of alleged infringement of the patent that protects the drug simvastatin, since the claim was rejected. Newly formed and reversed provisions are included among other operating expenses or other operating revenues in the income statement.

Provisions for termination pay and anniversary bonuses were increased by the actuarial losses in the amount of 189,040 thousand SIT.

In thousand SIT	Balance at 31 Dec 2004	Formation	Utilisation and reversal	Balance at 31 Dec 2005
Provisions for pensions and similar liabilities	9,563,707	189,040	0	9,752,747
Other provisions:	11,924,690	12,502,723	11,487,250	12,940,163
– for lawsuits	11,763,665	12,502,655	11,446,162	12,820,158
– for ecological restoration	161,025	0	41,088	119,937
– for other purposes	0	68	0	68
Total	**21,488,397**	**12,691,763**	**11,487,250**	**22,692,910**

5.5.2.13 Grants received

In the previous years, the Company received grants from the Ministry of the Economy for the investment in the Šentjernej plant and in the distribution centre in the Russian Federation. The recorded amounts of grants received are decreased by the appropriate portions of depreciation of the assets to which the grants refer.

5.5.2.14 Trade payables

In thousand SIT	31 Dec 2005	31 Dec 2004
Short-term operating liabilities to subsidiaries	157,079	1,730,768
Payables to suppliers	12,102,580	6,075,658
Payables from advances	454,204	506,246
Total	**12,713,863**	**8,312,672**

• Short-term operating liabilities to subsidiaries

In thousand SIT	31 Dec 2005	31 Dec 2004
HELVETIUS-S. R. L.,Trieste, Italy	–1,275	1,605,798
KRKA-FARMA d. o. o., Zagreb, Croatia	0	58,434
KRKA ZDRAVILIŠČA, d. o. o., Novo mesto	25,899	15,507
KRKA PHARMA DUBLIN LIMITED, Dublin, Ireland	79,735	23,490
KRKA-POLSKA, Sp. z o. o., Warsaw, Poland	52,067	27,539
KRKA Sverige AB, Stockholm, Sweden	176	0
“KRKA-FARMA”, d. o. o., Novi Sad, Serbia and Montenegro	477	0
Total	**157,079**	**1,730,768**

• **Payables to suppliers**

In thousand SIT	31 Dec 2005	31 Dec 2004
Payables to domestic suppliers	6,593,827	4,265,694
Payables to foreign suppliers	5,508,753	1,809,964
Total	**12,102,580**	**6,075,658**

5.5.2.15 Provisions and other liabilities

The item includes 3,307,117 thousand SIT of short-term deferred expenses referring to the contractually based discounts that shall be granted on products sold to other entities in 2005 and 258,748 thousand SIT of short-term deferred revenues referring to the contractually based discounts that shall be granted on products sold to subsidiaries in 2005.

5.5.2.16 Financial instruments

Long-term stability of the Company's performance is managed by means of active risk management policies as presented in detail in '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 2005.

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. As at 31 December 2005, the contract value of the hedged item amounted to 12,113,395 thousand SIT, and the Company's interest rate swaps recorded at fair value amounted to 58,492 thousand SIT.

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

Long-term borrowings

In thousand SIT	31 Dec 2005	31 Dec 2004
Long-term borrowings	14,164,116	15,262,032
– short-term portion of long-term borrowings	4,152,556	1,475,489
Average balance of long-term borrowings	14,713,074	11,513,066
Interest paid (financial year)	464,981	369,990
Average cost of long-term borrowings (financial year)	3.2%	3.2%
Contracted to mature in three years or less	69%	54%
Contracted to mature in more than three years	31%	46%
Currency structure of long-term borrowings:		
US dollar	21%	25%
Euro	78%	74%
Slovenian tolar	1%	1%

Short-term borrowings

In thousand SIT	31 Dec 2005	31 Dec 2004
Short-term borrowings, including short-term portion of long-term loans, thereof:	8,352,968	4,435,463
– borrowings from banks	5,826,562	1,426,068
– other borrowings	2,526,406	3,009,395
Short-term borrowings	4,200,412	2,959,974
Average balance of short-term borrowings (financial year)	3,747,940	8,254,351
Interest paid (financial year)	169,069	431,187
Average cost of short-term borrowings (financial year)	4.5%	5.2%
Currency structure of short-term borrowings:		
euro	43%	0%
SIT	57%	100%

Foreign currency risk

The key currency pairs in 2005 were Euro/Tolar and Euro/US dollar, and further significant currency pairs were identified on the basis of the geographical position of the Group companies operating abroad: Euro/Polish zloty, Euro/Macedonian denar, Euro/Croatian kuna, and US dollar/Russian ruble. Due to the relatively low level of unsettled positions of the latter currencies in 2005, the primary focus was on the Company's management of long position regarding foreign operations denominated in euro and US dollar. Currency options (i.e. range forwards) and futures are used to hedge against foreign currency risks. The contract value of the two derivative financial instruments as at 31 December 2005 amounted to 43,223,780 thousand SIT, and the fair value recorded in the Balance Sheet as at 31 December 2005 is -168,700 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 2005.

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 future considerable changes in exchange rates will not significantly impact 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

	Carrying amount	Fair value	Carrying amount	Fair value
In thousand SIT	2005	2005	2004	2004
Long-term investments	2,088,996	2,088,996	2,073,311	2,073,311
Short-term investments	3,933,668	3,933,668	1,981,639	1,981,639
Trade and other receivables	33,774,998	33,774,998	25,745,309	25,745,309
Cash and cash equivalents	758,768	758,768	1,100,954	1,100,954
Interest bearing derivatives	58,491	58,491	–112,340	–112,340
Assets	65,619	65,619	15,212	15,212
Liabilities	–7,128	–7,128	–127,552	–127,552
Embedded foreign currency derivatives	–168,699	–168,699	287,264	287,264
Assets	59,013	59,013	287,264	287,264
Liabilities	–227,712	–227,712	0	0
Borrowings	–18,506,590	–18,506,590	–18,415,439	–18,415,439
Trade and other payables	–12,713,863	–12,713,863	–8,312,672	–8,312,672
Total	**9,225,769**	**9,225,769**	**4,348,026**	**4,348,026**

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, effective at 10:00, local time. 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, effective at 10:00, local time, 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, effective at 10:00, local time, by the use of specific derivatives valuation models available within Reuters information platform.

Shares available for sale

If the shares are listed on the stock exchange market, their fair value equals 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 shares 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 is recorded under consideration of the discounted cash flow of the principal and interest.

Receivables and liabilities

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

5.5.2.17 Off balance sheet items

In thousand SIT	31 Dec 2005	31 Dec 2004
Bills of exchange issued as collateral for borrowings	14,164,115	13,453,199
Guarantees given to Group companies for borrowings	1,917,521	2,727,688
Other guarantees given	252,280	377,479
Other	3,018,630	2,040,701
Total	**19,352,546**	**18,599,067**

Bills of exchange issued as collateral for borrowings raised by subsidiaries are categorised as insurance contracts pursuant to IFRS 4, thus recorded as contingent liabilities.

Events after the balance sheet date

There were no events after 31 December 2005 that would in any way impact the disclosures in the financial statements. Pfizer, the company that had filed a lawsuit in 2002 against the Company due to an alleged act of unfair competitive practices, allegedly committed by Krka upon obtaining the marketing authorisation for Yasnal®, withdrew the claim on 28 February 2006. No provisions had been formed for the said lawsuit.

5.5.3 Income statement

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 referring to other geographical segments (production, storage, quality control etc.). 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".

- **Geographical segment reporting**

	European Union		South-East Europe		Eastern Europe		The remaining Western Europe and overseas markets		Total	
In thousand SIT	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004
Net sales	62,420,646	56,260,918	20,027,693	16,797,813	31,500,901	22,134,771	2,621,092	2,784,009	116,570,332	97,977,511
Segment's results from operations	**16,682,177**	**10,017,205**	**6,441,520**	**3,288,670**	**5,718,501**	**2,476,006**	**581,135**	**451,250**	**29,423,333**	**16,233,131**
Other operating revenues									11,880,171	4,255,175
Unallocated costs									–12,502,563	–2,471,633
Operating profit									**28,800,941**	**18,016,673**
Net financial income/expenses									–451,449	–22,105
Income tax expense									–5,890,302	–2,684,951
Profit for the period									**22,459,190**	**15,309,617**
Segment's assets	101,883,833	87,651,555	20,102,116	14,291,265	16,547,055	12,115,261	987,789	2,799,162	139,520,793	116,857,243
Unallocated assets									42,418,806	34,460,957
Total assets									**181,939,599**	**151,318,200**
Investments	16,886,249	18,570,021	0	0	0	0	0	0	16,886,249	18,570,021
Impairment of receivables and inventories									925,677	1,146,400
Total liabilities									**67,798,972**	**54,180,730**

5.5.3.1 Net sales by business segments

In thousand SIT	2005	2004
Human health products	111,762,137	93,946,353
– prescription pharmaceuticals	95,973,901	79,847,605
– self-medication products	13,825,788	11,362,910
– cosmetic products	1,962,448	2,735,838
Animal health products	4,602,791	3,884,460
Health resorts and tourist service	205,404	146,698
Total	**116,570,332**	**97,977,511**

5.5.3.2 Other operating revenues

In thousand SIT	2005	2004
Reversal of non-current provisions	11,498,778	3,788,275
Reversal of allowances for receivables	106,926	0
Profit from the sale of fixed assets	106,998	124,075
Other operating revenues	167,469	342,825
Total	**11,880,171**	**4,255,175**

The highest amount of 11,498,778 thousand SIT among other operating revenues refers to the reversal of provisions for the lawsuit in connection with drugs for heart and cardiovascular diseases that ended in favour of Krka. In 2005, the Company received a grant from the Agency of the Republic of Slovenia for Agricultural Markets and Rural Development in the amount of 16,049 thousand SIT.

5.5.3.3 Production cost of goods sold

In 2005, production cost of goods sold indicated an increase of 2.6% compared to the previous year's figures. As for their share among the net sales, the production costs decreased from 44.8% in 2004 to 38.7% in 2005. The decrease is partially a result of a more favourable product mix, as well as stronger cost efficiency due to the better productivity (contemporary technological procedures, an improved utilisation level of production capacities).

5.5.3.4 Sales and marketing

Sales and marketing comprise the costs of the marketing sales network comprising the Company and its representative offices abroad, as well as provisions formed for lawsuits, which may cause an irregular increase of these costs in individual periods. In the reporting period, the sales and marketing expenses were higher by 59.2% than in 2004. The increase was influenced by the newly formed provisions (12,502,563 thousand SIT) for the lawsuit relating to drugs for heart and cardiovascular diseases. The amount of provisions formed in 2004 was 2,471,633 thousand SIT and increased the sales and marketing expenses.

5.5.3.5 R&D costs

All R&D costs recorded are charged against the income statement of 2005, since research and development costs are not capitalised. Compared to 2004, the relevant costs increased by 14.1%, whereas its share among the net sales was 8.1%.

5.5.3.6 Administrative expenses

Compared to the previous year's figures, administrative expenses increased by 0.9%, and its share in the structure of net sales imply a decrease from 10.2% to 8.6%. The item of administrative expenses encompasses also other operating expenses.

5.5.3.7 Costs in terms of types

In thousand SIT	2005	2004
Cost of goods and materials	33,574,525	27,372,515
Cost of services	18,599,374	16,146,326
Employee benefits expenses (refer to Note 5.5.3.8)	28,657,196	26,359,527
Depreciation	8,378,686	7,733,529
Provisions formed	12,502,563	2,471,633
Other operating expenses (refer to Note 5.5.3.9)	2,743,836	3,002,626
Total costs	**104,456,180**	**83,086,156**
Changes in the value of inventories	4,806,618	–1,129,857

5.5.3.8 Employee benefits cost

In thousand SIT	2005	2004
Gross wages and salaries and continued pay	21,541,753	19,031,365
Social security contributions and payroll tax	5,333,490	4,911,068
Other employee benefits cost	1,781,953	2,417,094
Total	**28,657,196**	**26,359,527**

The item of other employee benefits cost in 2005 includes the vacation bonus, travel allowances, termination pays, tenure awards, and some other repayments to employees.

5.5.3.9 Other operating expenses

In thousand SIT	2005	2004
Grants, assistance	491,257	464,132
Environmental levies	306,305	260,494
Fiscal charges irrespective of operating results	258,283	311,802
Loss in the sale of fixed assets	198,452	353,599
Impairments and inventory write-offs	537,672	533,794
Impairments and receivable write-offs	388,005	612,606
Other costs	563,862	466,199
Total	**2,743,836**	**3,002,626**

5.5.3.10 Financial income and financial expenses

In thousand SIT	2005	2004
Exchange differences	2,956,142	2,300,968
Interest income	133,707	172,440
Gain on remeasurement of investments at fair value	10,966	0
Other income	182,365	570,528
Total financial revenue	**3,283,180**	**3,043,936**
Exchange differences	1,240,989	1,816,528
Interest paid	634,050	801,177
Impairments due to remeasurement of investments at fair value	39,748	13,429
Loss of subsidiaries and the covering of losses from previous years	1,150,399	1,424
Other expenses	669,443	433,483
Total financial expenses	**3,734,629**	**3,066,041**
Net financial expenses	**–451,449**	**–22,105**

In 2005, the Company generated 64,744 thousand SIT of gains and 231 thousand SIT of losses from the sale of securities. 27,726 thousand SIT of financial income and 589,690 thousand SIT financial expenses arise from derivative financial instruments.

5.5.3.11 Income tax expense

In thousand SIT	2005	2004
Actual income tax	9,315,564	2,963,774
Deferred tax	–3,425,262	–278,823
Total	**5,890,302**	**2,684,951**
Profit before tax	28,349,492	17,994,568
Income tax calculated using the 25-percent tax rate	7,087,373	4,498,642
Non-deductible expenses	1,227,238	691,541
Tax incentives	–1,140,676	–2,112,281
Tax exempt revenues	–750,533	–190,730
Effect of restatements due to the transition to IFRS	–533,100	–202,221
Total	**5,890,302**	**2,684,951**

5.5.3.12 Deferred tax

In thousand SIT	2005	2004
Change in fair value of short-term investments	–69,235	34,527
Provisions for employees	–6,561	–4,396
Allowances for bad receivables	–96,275	0
Allowances for inventories	–117,661	0
Impairment of securities	–9,890	0
Formation of provisions for lawsuits	–3,125,641	–308,954
Total	**–3,425,262**	**–278,823**

5.5.4 Transactions with related parties

Intragroup transactions

Transactions with Group companies in 2005 are presented below.

In thousand SIT	Sales	Expenses	Borrow-ings	Loans
KRKA ZDRAVILIŠČA, d. o. o., Novo mesto*	52,409	92,832	10,000	2,521,000
KRKA-FARMA d. o. o., Zagreb, Croatia	7,018,053	284,752	0	0
KRKA-FARMA DOOEL, Skopje, Macedonia	1,425,505	0	0	0
KRKA-POLSKA Sp. z o. o., Warsaw, Poland	11,519,474	178,712	0	0
OOO “KRKA-RUS”, Istra, Russian Federation	668,291	0	0	0
OOO “KRKA FARMA”, Sergiev Posad, Russian Federation	1,888,349	0	0	0
KRKA Pharma Dublin Limited, Dublin, Ireland	0	240,042	0	0
HELVETIUS-S.R.L., Trieste, Italy	93,584	4,327,949	0	0
“KRKA-FARMA”, d. o. o., Novi Sad, Serbia and Montenegro	1,008,014	3,536	0	0
KRKA Sverige AB, Stockholm, Sweden	601,604	990	0	198,939
Total	**24,275,283**	**5,128,813**	**10,000**	**2,719,939**

* Including Zdravilišče Strunjan and the associate Golf Grad Otočec.

The transactions carried out between the above-listed Group companies and the controlling company were based upon sales contracts, under the application of the market prices of the services performed and products sold.

Intragroup receivables and liabilities are disclosed under Notes 5.5.2.6 and 5.5.2.14.

5.5.5 Data on groups of persons

As at the year-end, the members of the Management Board of Krka held 5,173 of shares in Krka, d. d., Novo mesto, representing a 0.15% of the total equity, and the Managing Directors of subsidiaries held 1,207 of shares or 0.03% 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 2005.

Emoluments of groups of persons in 2005

In thousand SIT	Total receipts	Hereof participation in profit according to the annual meeting resolution
Members of the Management Board	365,145	0
Members of the Supervisory Board	63,066	51,291
Persons employed under individual employment contracts	3,812,416	0
Total	**4,240,627**	**51,291**

Emoluments of the Management Board members represent salaries and wages, fringe benefits, any other receipts, and refund of expenses. Emoluments of the Supervisory Board of the parent company represent remuneration for the tasks performed within the Supervisory Board. Emoluments of persons employed under individual employment contracts include salaries and wages, fringe benefits, holiday allowance, any other receipts (tenure awards etc.), and refund of expenses.

Emoluments of members of the Supervisory Boards in subsidiaries which also perform the function of Management Board 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

In thousand SIT	Loan balance at 31 Dec 2005	Repayments in 2005
Members of the Management Board	3,539	770
Members of the Supervisory Board in the Company (employee representatives)	517	173
Persons employed under individual employment contracts	98,152	22,124
Total	**102,208**	**23,067**

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

5.5.6 Accounting judgements and estimates

Significant accounting judgements and estimates applied when preparing the financial statements are presented below.

Provisions for payables to employees and termination payments

Provisions for payables to employees are based on a calculation performed by a certified actuary, whereby a discount rate of 2.75% p.a. was selected, 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. No material discrepancies from the assumptions applied may be expected in the near future.

Provisions for lawsuits

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.

Receivables

Receivables in the balance sheet are recorded at net amounts. The allowances for bad receivables are computed on the basis of the methodology taking into account the individual customers' credit ratings as well as the specific country risk levels. The methods used and the credit ratings applied are verified by the Company twice a year, whereas the calculations of any possible losses arising from payment defaults are performed on a quarterly basis.

5.5.7 Disclosures referring to the transition to IFRS

These are the Company's first consolidated financial statements prepared in compliance with the IFRS.

The accounting policies presented in chapter 5.5.1 were taken account of upon the preparation of the financial statements for the financial year ended 31 December 2005, upon the preparation of the comparative financial statements prepared for the financial year ended 31 December 2004, as well as upon the preparation of its opening balance sheet as at 1 January 2004 in compliance with the IFRS, the latter representing the date of transition to IFRS reporting.

The individual items of the opening balance sheet that were previously presented in accordance with the Slovenian Accounting Standards have been brought in compliance with the IFRS requirements. Explanations of how the transition to IFRS has affected the reported financial position, financial performance, and cash flows of the Company are provided in the schedules and notes presented below. Furthermore, those changes in the financial statements which result from a different allocation of the individual accounting items have also been presented.

5.5.7.1 Reconciliation of equity

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

(a) Property, plant and equipment

The useful lives of the items of property, plant and equipment with a higher recorded value were reviewed. Furthermore, the individual parts of an item of property, plant and equipment which differ in their expected useful lives were accounted for as individual assets, for which depreciation is accounted for individually. The adjustments were made for the entire period since their bringing into use.

The lower depreciation amounts result in higher carrying amounts of the items of property, land and equipment by 3,053,773 thousand SIT as at 1 January 2004 and by 3,570,907 thousand SIT as at 31 December 2004.

Depreciation in 2004 was lower by 517,134 thousand SIT, thereof its effect upon the decrease in the value of inventories amounted to 54,858 thousand SIT, whereas the remaining 462,276 thousand SIT were recorded in the income statement as follows: production cost of goods sold was decreased by 196,841 thousand SIT, sales and marketing by 61,254 thousand SIT, R&D costs by 81,672 thousand SIT and administrative expenses by 122,509 thousand SIT.

The transfer of the amounts of 'intangible assets' in the value of 102,418 thousand SIT as at 1 January 2004 and 349,336 thousand SIT as at 31 December 2004 to the item of investments in assets not owned by the Company resulted in an additional increase in the value of property, land and equipment.

(b) Intangible assets

The Company recorded a decrease in intangible assets as at 1 January 2004 due to the transfer of the amounts of 'investments in assets not owned by the Company' to the item of 'property, plant and equipment', and the transfer of the amounts recorded in 'long-term operating lease' to 'long-term receivables', totalling 148,844 thousand SIT as at 1 January 2004 and 389,922 thousand SIT as at 31 December 2004.

Research and development costs are not capitalised. They are recorded as an expense in the total amount immediately when incurred. Both pursuant to the SAS and the IFRS, the only costs referring to the research and development that are debited against intangible assets are the costs of the purchased registration documents.

(c) Investments in subsidiaries

In compliance with the SAS, investments in subsidiaries were accounted for using the equity method. Under the equity method, the investments are increased by the corresponding profit and/or decreased by the corresponding losses to recognise the Company's share of net profit or loss of the subsidiary and are accounted for as an increase in financial revenues or expenses of the Company.

In the opening balance sheet as at 1 January 2004 prepared in compliance with the IFRS, the investments were decreased by the corresponding profits recorded in the previous years in the amount of 879,310 thousand SIT, as the Company's participation in profit will be recognised in the income statement of the controlling company only after the latter has obtained the right to dividend payout. The balance of investments in subsidiaries was further decreased by the eliminated profits of subsidiaries for 2004 totalling 890,014 thousand SIT and increased by the eliminated losses for 2004, by the covering of losses from previous periods totalling 1,103,859 thousand SIT and the participation in profit at one of the subsidiaries in the amount of 200,000 thousand SIT.

(d) Deferred tax assets

The Company recorded deferred tax for the first time in the opening balance sheet prepared in compliance with the IFRS, amounting to 929,998 thousand SIT. The balance of deferred tax assets as at the year-end is 854,503 thousand SIT. For a detailed presentation of the calculation and of the impact upon the items of equity, please refer to Note (l) below.

(e) Other non-current assets

Other non-current assets as at 1 January 2004 were decreased by the amount of own shares (4,670,280 thousand SIT) which are recorded as a deduction item within equity in the balance sheet prepared in accordance with IFRS. They were also increased by the change in fair value of investments in shares and securities in the amount of 39,473 thousand SIT which were recorded at their market value and categorised as available for sale. The effect of the adjustment is recorded within equity, under reserves for fair value. The increase is also a result of the transfer of long-term operative lease in the amount of 46,426 thousand SIT from the item 'intangible fixed assets'.

The balance of assets recorded in compliance with the IFRS as at 31 December 2004 was changed by a decrease in the amount of own shares (4,670,280 thousand SIT), by an increase due to adjustment of investments in shares and securities to their market value in the amount of 693,316 thousand SIT, and by the transfer of items under long-term operative lease in the amount of 40,586 thousand SIT from 'intangible fixed assets'.

(f) Inventories

As to the valuation of inventories pursuant to IFRS, there were no changes in comparison to the SAS. However, the balance of finished products and work in progress was lower by 54,858 thousand SIT as at 31 December 2004 due to the decreased depreciation amounts.

(g) Trade receivables

The Company recorded an increase in trade receivables by 51,868 thousand SIT as at 1 January 2004 and by 134,827 thousand SIT as at 31 December 2004, due to the transfer of short-term receivables and other assets which were recorded under other current assets in the balance sheet prepared in compliance with the SAS, referring to short-term deferred costs and short-term accrued revenues.

(h) Investments

Investments in shares are recorded in the income statement at their fair value, resulting in an increase in investments by 15,289 thousand SIT as at 1 January 2004 and by 61,882 thousand SIT as at 31 December 2004. The effects are recorded under retained earnings.

Financial revenue was increased by the amount of changes in the value of derivative financial instruments due to the restatement at fair value in the amount of 138,108 thousand SIT, which was pursuant to the SAS accounted for under 'reserves for fair value', and by the changes in the value of securities due to the restatement at fair value in the amount of 46,593 thousand SIT. In accordance with the SAS, no value increase of assets was carried out.

(i) Reserves for fair value

The Company recorded 21,724,114 thousand SIT of the general capital revaluation adjustment within the item 'reserves for fair value' in the balance sheet as at 1 January 2004 prepared in accordance with the SAS. The general capital revaluation adjustment was accounted for under reserves at the beginning and at the end of 2004. Under 'reserves for fair value', the Company also recorded revaluation of derivative financial instruments in the amount of 164,368 thousand SIT, which is under IFRS included in the item of retained earnings. In addition, the reserve for fair value has increased by 29,605 thousand SIT based on the adjustment of the value of non-current investments to the fair value. The above-mentioned amount represents the balance of reserves for fair value as at 1 January 2004 in the balance sheet prepared in accordance with the IFRS.

As at 31 December 2004 reserves for fair value amount to 519,987 thousand SIT, resulting from the increase in non-current investments by the fair value adjustment, i.e. 653,843 thousand SIT, and the decrease of the deferred tax i.e. 163,461 thousand SIT.

(j) Non-current provisions

The payables to employees for anniversary bonuses and termination pays were not disclosed in the financial statements prepared in accordance with the SAS. In compliance with the IFRS, the calculation of payables to employees was performed by a certified actuary. The selected discount rate is 2.75% p.a.

The balance of payables to employees is disclosed under liabilities within provisions in the amount of 9,432,295 thousand SIT as at 1 January 2004 and 9,563,707 thousand SIT as at 31 December 2004. Actuarial losses (increase in payables to employees) in the amount of 131,412 thousand SIT are recognised in the income statement for 2004, thus increasing the following items within operating expenses for 2004: production cost of goods sold by 68,334 thousand SIT, sales and marketing by 15,769 thousand SIT, R&D costs by 22,340 thousand SIT, and administrative expenses by 24,968 thousand SIT.

(k) Trade payables

As at 1 January 2004, trade payables showed an increase of 442,712 thousand SIT due to the transfer of accrued costs from the item of provisions and other liabilities.

(l) Deferred tax

The aforementioned adjustments affected the deferred tax recorded by the Company. In compliance with the SAS, the Company did not account for deferred tax for 2004. The legal tax rate of the income tax (25%) was applied when preparing the adjustments to IFRS.

In thousand SIT	Notes	1 Jan 2004		31 Dec 2004	
		Tax base	Tax	Tax base	Tax
Provisions for employees	j	1,262,041	315,510	1,279,624	319,906
Other non-current provisions	j	2,661,791	665,448	3,134,178	783,545
Gross deferred tax receivables		**3,923,832**	**980,958**	**4,413,802**	**1,103,451**
Other non-current assets	e	–39,473	–9,868	–693,316	–173,329
Investments	h	–164,368	–41,092	–302,476	–75,619
Gross deferred tax liabilities		**–203,841**	**–50,960**	**–995,792**	**–248,948**
Net deferred tax receivables		**3,719,991**	**929,998**	**3,418,010**	**854,503**

Net deferred tax receivables decreased by 75,495 thousand SIT from 1 January 2004 until year-end. The change includes a decrease in reserves for fair value of investments available for sale (163,461 thousand SIT) and a decrease in profit brought forward from previous periods (190,857 thousand SIT). The changes had a positive effect upon the net profit of the period (278,823 thousand SIT).

(m) Retained earnings

The effect of the adjustments upon retained earnings is as follows:

In thousand SIT	Notes	1 Jan 2004	31 Dec 2004
Property, plant and equipment	a	3,053,773	3,570,908
Investments in subsidiaries	c	–879,310	–465,465
Investments	l, h	179,657	364,358
Inventories	f	0	–54,858
Provisions for employees	j	–9,432,295	–9,563,707
Deferred tax	l	939,866	1,027,832
Total reconciliation of equity		**–6,138,309**	**–5,120,932**

5.5.7.2 Reconciliation of profit for 2004

In thousand SIT	Notes	Income statement under SAS	Effect of the transition to IFRS	Income statement under IFRS
Net sales		97,977,511	0	97,977,511
Production cost of goods sold	a, j	44,047,215	–128,506	43,918,709
Gross operating yield		**53,930,296**	**128,506**	**54,058,802**
Sales and marketing	a, j	22,067,586	–45,485	22,022,101
R&D costs	a, j	8,372,923	–59,332	8,313,591
Administrative expense	a, j	10,048,354	–86,742	9,961,612
Other operating revenues		4,143,124	112,051	4,255,175
Operating profit		**17,584,557**	**432,116**	**18,016,673**
Financial income	c, h	3,549,249	–505,313	3,043,936
Financial expenses	c, h	4,169,900	–1,103,859	3,066,041
Net financial expenses		**–620,651**	**598,546**	**–22,105**
Extraordinary revenues/expenses		101,252	–101,252	0
Profit before tax		**17,065,158**	**929,410**	**17,994,568**
Income tax expense	l	2,963,774	–278,823	2,684,951
Profit for the period		**14,101,384**	**1,208,233**	**15,309,617**
Earnings per share		3,981	341	4,322

5.5.7.3 Disclosures as to the adjustments made in the cash flow statement

Due to the changes in the balance sheet and the income statement, certain changes of the individual items were recorded, whereas the balance of cash and cash equivalents at the end of period remained the same.

5.6 Auditor's Report

KPMG

Auditor's Report

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

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

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

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

KPMG SLOVENIJA,

podjetje za revidiranje, d.o.o.

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

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

Ljubljana, March 23, 2006

KPMG Slovenija, d.o.o.

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