

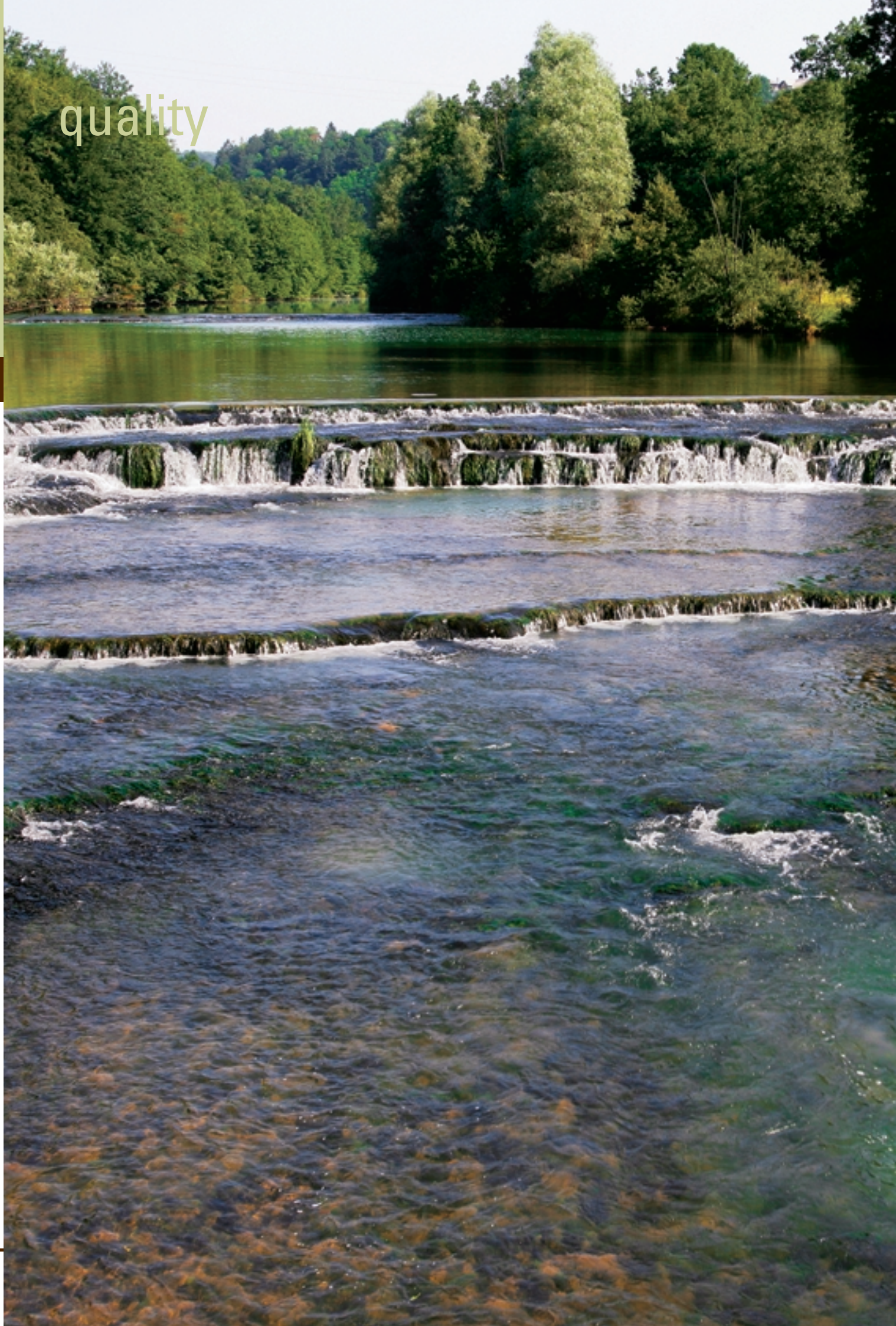


*Living a healthy life.*

quality

2

annual report 2005







# Introduction



*Krka means quality – from our technology  
to our business processes, from our  
products to our people.*

# Introduction

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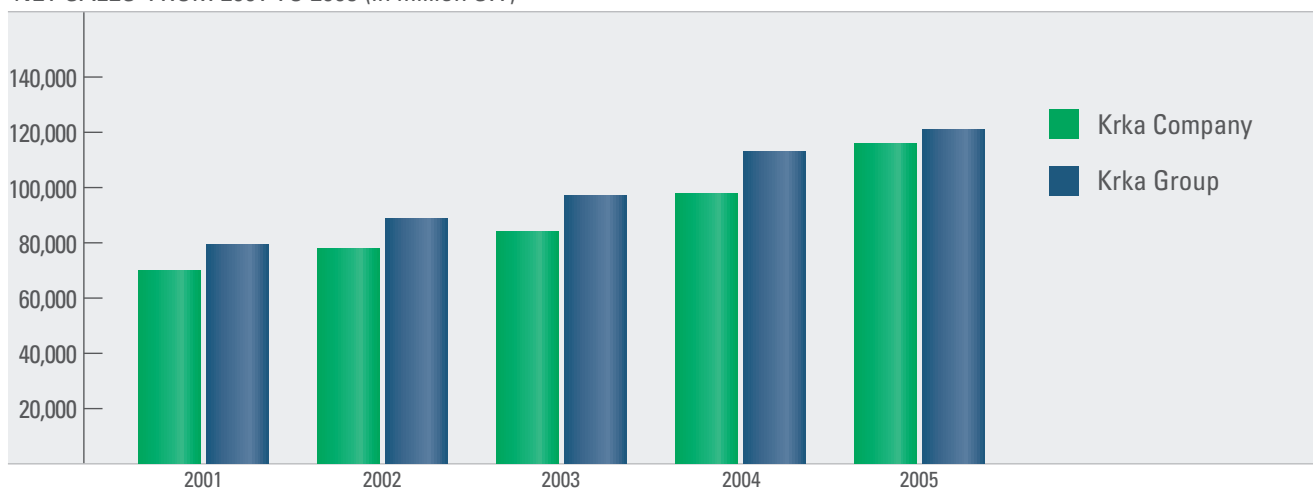


# Significant achievements

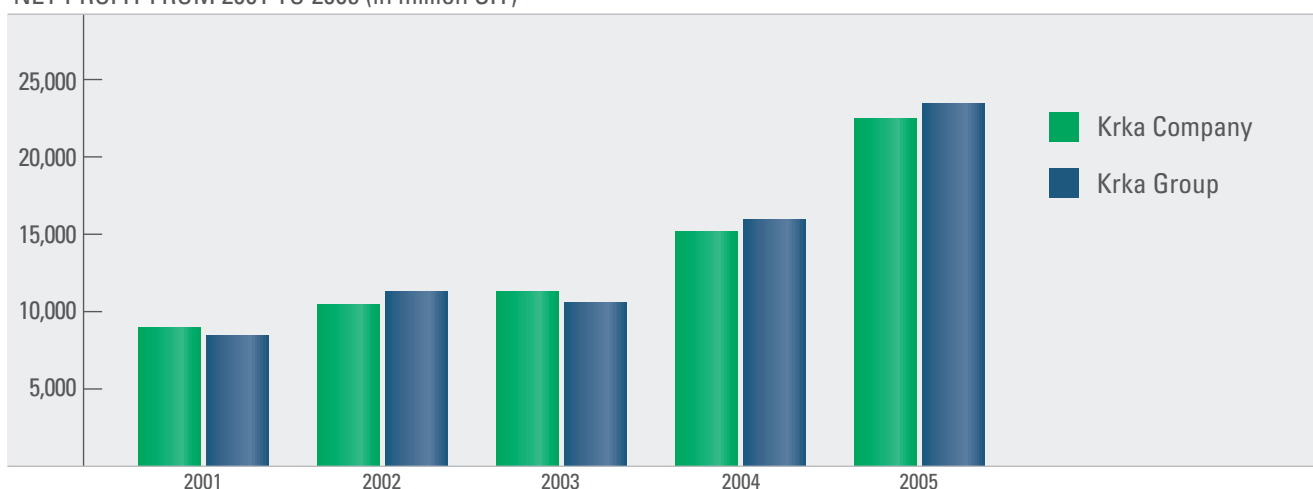
- In 2005 the Krka Company generated an operating profit of 28.8 billion SIT, which is 60% greater than the previous year, while the Krka Group generated 28.5 billion SIT (59% growth).
- The net profit was 22.5 billion SIT (47% growth) for the Krka Company, and 23.3 billion SIT (49% growth) for the Krka Group.
- The Krka Company recorded sales of products and services worth 116.6 billion SIT, while the Krka Group sold products and services worth 132.8 billion SIT.
- Double-digit growth over 2004 sales was recorded by both the company and the group: the Krka Company recorded 19% growth and the Krka Group 17%.
- The highest growth in sales and highest proportion of overall sales for both the Krka Group and Krka Company was recorded in the Regions East Europe and Central Europe.
- The proportion of sales on foreign markets was 82% for the Krka Group, and 84% for the Krka Company. The production of solid pharmaceutical forms increased by 28%.
- The company has successfully implemented the new SAP information system.
- Production started in the new production and distribution centre in Jastrebarsko in Croatia.
- Last year Krka was granted market authorisations for 272 products in 552 forms, 8 of which were first authorisations for new products. In western European countries, 113 marketing authorisations were granted for 12 products in 41 forms.
- The Krka Group allocated 21.5 billion SIT to investments, 18 billion SIT of which by the Krka Company and 3.5 billion SIT by subsidiaries.
- The number of employees in the Krka Group passed the 5,000 mark. The new jobs created were primarily abroad. Now over 30% of all Krka employees are employed abroad.
- Based on the resolution adopted by the 10th General Meeting, held on 17 July 2005, Krka paid a dividend of 1,400 SIT (gross) per share.
- The Krka share price quoted on the Ljubljana Stock Exchange grew by 22% in 2005, and was 102,342 SIT per share on 31 December 2005.

# Performance indicators for the Krka Company and Krka Group

NET SALES FROM 2001 TO 2005 (in million SIT)

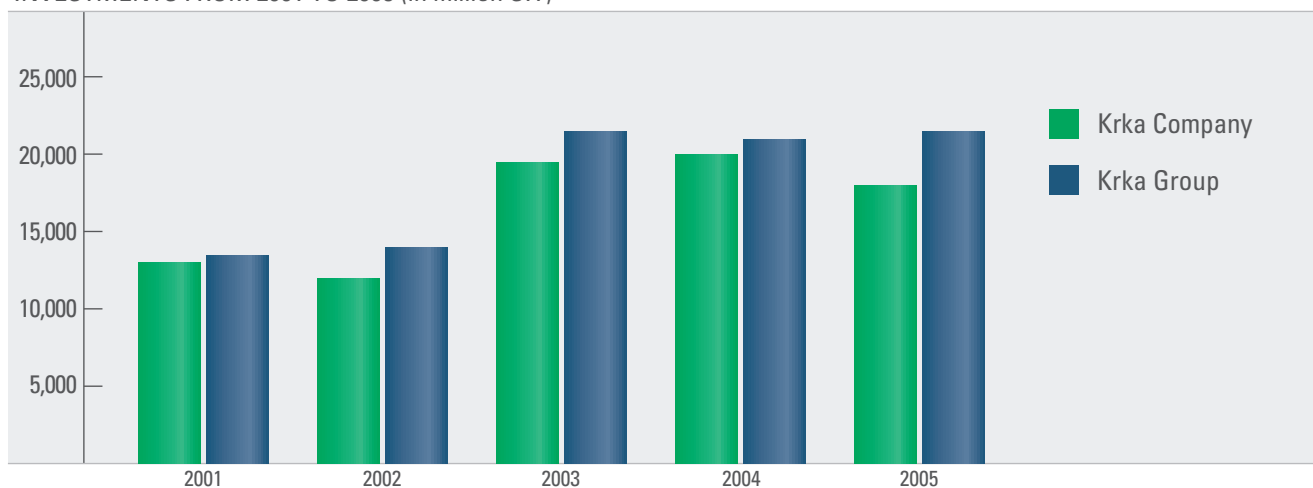


NET PROFIT FROM 2001 TO 2005 (in million SIT)



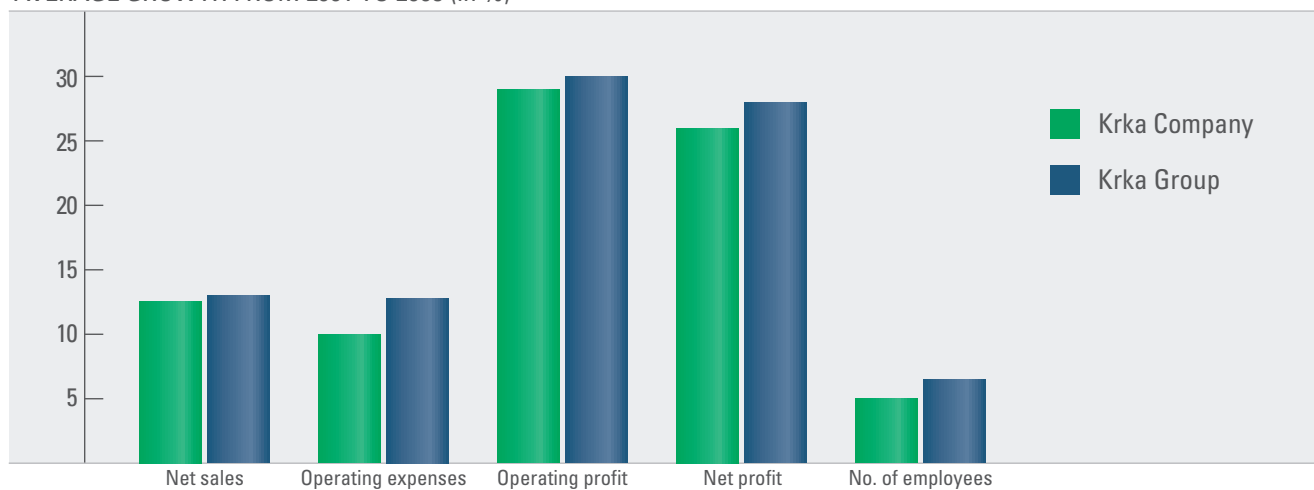
Note: Data for 2001 – 2003 calculated according to SAS, 2004 – 2005 according to IFRS.

INVESTMENTS FROM 2001 TO 2005 (in million SIT)



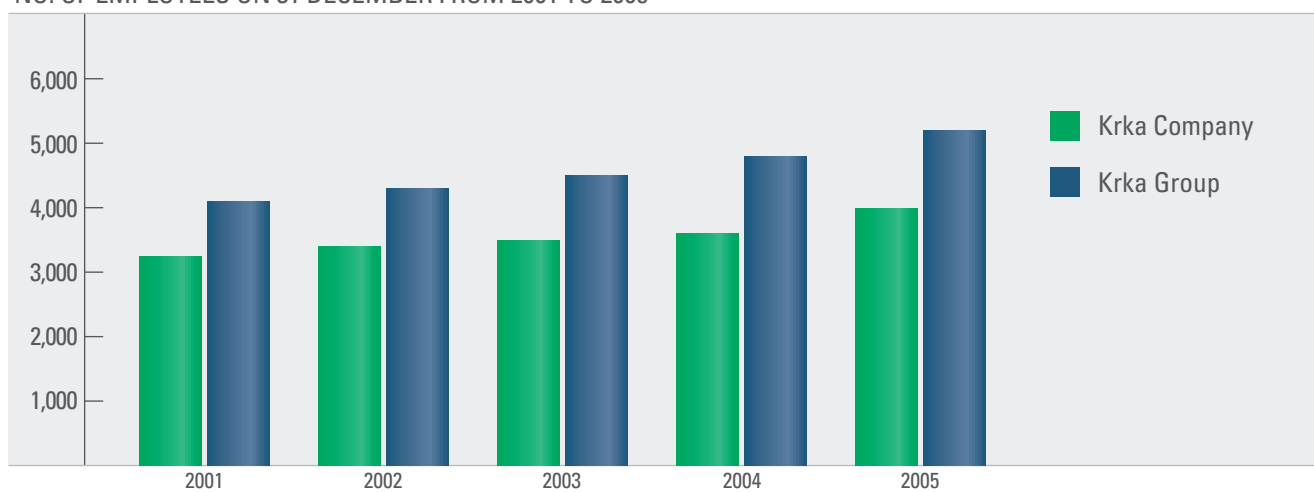


## AVERAGE GROWTH FROM 2001 TO 2005 (in %)

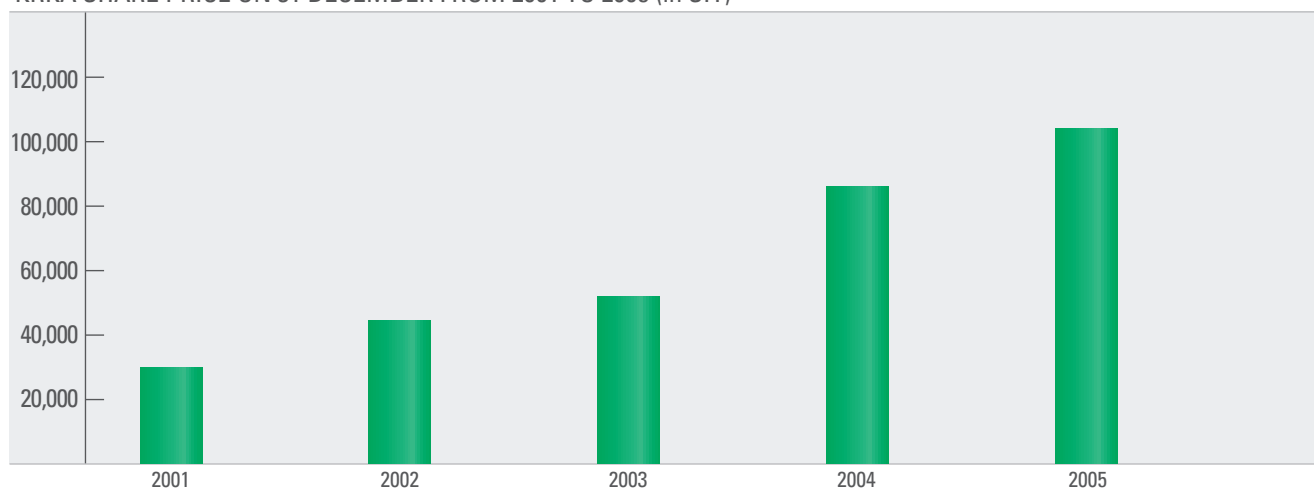


Note: Data for 2001 – 2003 calculated according to SAS, 2004 – 2005 according to IFRS.

## NO. OF EMPLOYEES ON 31 DECEMBER FROM 2001 TO 2005



## KRKA SHARE PRICE ON 31 DECEMBER FROM 2001 TO 2005 (in SIT)



# Significant data on operations

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

EXCHANGE RATES	2005	2004
USD (average)	192,819 SIT	192,318 SIT
USD (31 December)	202,430 SIT	176,243 SIT
EUR (average)	239,636 SIT	238,885 SIT
EUR (31 December)	239,576 SIT	239,743 SIT

SHARE INFORMATION (Krka Group)	2005	2004	2003	2002	2001
Total number of shares issued	3,542,612	3,542,612	3,542,612	3,542,612	3,542,612
Earnings per share in SIT*	6,890	4,627	3,113	3,266	2,521
Dividend per share in SIT	1,400	1,200	1,050	950	700
Share price at the end of year in SIT	102,342	84,482	52,188	42,458	28,711
Price/Earnings ratio per share (P/E)	14.9	18.3	16.8	13.0	11.4
<b>Market capitalisation at year end in million SIT</b>	<b>362,558</b>	<b>299,289</b>	<b>184,882</b>	<b>150,414</b>	<b>101,712</b>

Note: Performance indicators for 2004 and 2005 were calculated from data in financial statements prepared in accordance with IFRS, while for all other periods, indicators were calculated from data in financial statements prepared in accordance with SAS.

\* Net profit of Krka Group majority shareholders/average number of shares issued in the period (no own shares)



# Significant events

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

## Significant events after the accounting period

- Krka successfully implemented its sales plans during the first quarter of 2006.
- On 28 February 2006, the Pfizer company withdrew the action it filed against Krka in 2002, alleging Krka was guilty of unfair competition in relation to a marketing authorisation for the Yasnal® product.

## Significant awards

- The world's leading credit ratings house Dun & Bradstreet awarded Krka its Rating of the Year 2004 award for the highest possible rating of A1.
- The President of the Management Board and CEO Jože Colarič, was awarded the Finance newspaper award for outstanding business achievement at the 7th Finance Business Conference, held in Portorož on the Slovenian coast.
- At the Kapital 2005 finance conference, Krka was awarded the prize for the best reputed Slovenian company. Kapital magazine awards the prize every year on the basis of an opinion poll of Slovenian managing directors and Slovenian finance journalists.
- Krka was awarded the third prize for Best 2004 Annual Report, which in 2005 was again organised by the Finance newspaper.
- In Poland, Krka won the Pharmacy World – Product of the Year 2005 for the Bilobil® capsules.
- At the prestigious Polish Pharmaceutical Day event in Warsaw, Krka Polska received an award entitled Master of Pharmacy 2005 for Introducing Modern Generic Medicines to the Pharmaceutical Market.
- At the end of October Krka's representative office in Ukraine received the prestigious Panacea award for its healthy living and ecological action to protect Mt Goverla. The award is presented annually to the best project in the field of medicine and pharmacy by the Ukrainian Ministry of Health in accordance with the Ukrainian Association of Pharmaceutical Producers and the Ukraine Pharmaceutical Association.



# Statement by the President of the Management Board

## Dear Shareholders and Business Partners,

*It gives me great satisfaction to present the business results achieved by the Krka Group in 2005, and to draw your attention to some of the factors that have ensured we have once more concluded a successful business year.*

*We exceeded our 2004 sales figures by 17%, continuing the ongoing growth we have now enjoyed for many years. The excellent sales results have been achieved by placing a wide range of high quality products on the market, with almost half of these being products launched on the individual markets within the past five years. This was despite government health policies, pressure to reduce prices, unfavourable legislative changes and ever greater competition in both developing and selling pharmaceuticals that all had a significant impact on Krka's sales.*

*Our high sales growth coupled with low growth in expenses has led to the company operating profit – calculated according to Slovenian Accounting Standards – increasing by 60%, and the net profit of 21.6 billion SIT increasing by 53%. As a further innovation in 2005 the Krka Company and Krka Group financial statements have been drawn up in accordance with the International Financial Reporting Standards, which confirmed the excellent business results. The Krka Company's net profit calculated in line with these standards was 22.5 billion SIT, and was 23.3 billion SIT for the Group. Most of the indicators we use to monitor our operating results are above the longer term average.*

*Every customer and every market is important to Krka, but I would like to draw particular attention to operations in two regions, which have been outstanding in terms of sales growth. These are our*

*Regions East Europe and Central Europe. On two of our key markets we have become the second and third placed supplier of generic medicines - the Russian Federation and Poland respectively. Our sales growth on both markets has exceeded the average sales growth for other pharmaceutical producers, due in part to the successful operations of our two companies on those markets. In the Russian Federation where sales were up 47% on the previous year, we reorganised our marketing and sales network and increased the number of employees. We were able to make good use of favourable economic conditions relating above all to the high price of oil derivatives and changes in the health system that increased per capita pharmaceutical consumption. We forecast that in 2006 the Russian market will again play a significant role in the overall growth of Krka sales. We also forecast growth for sales in the Regions of Central Europe, South-East Europe and West Europe and Overseas Markets, while on the Slovenian market we will retain our position as the leading pharmaceutical company, despite fierce competition and reductions in medicine prices.*

*We recorded a 21% growth in sales of prescription pharmaceuticals, and their proportion in overall sales will continue to increase in the coming years. Solid dosage forms, and tablets in particular, continue to be our predominant pharmaceutical form – we now sell six billion per year. Sales of self-medication products have increased by 13%, while we have concentrated our range of cosmetics, selecting those that will produce a healthy sales growth in 2006. We also expect improved sales of health resort and tourism services, which did not record any growth last year.*

*Our modern production capacity allows us to apply a vertically integrated production model. In autumn*



2006 we will be opening a new active pharmaceutical ingredient (API) plant, because we want to monitor the entire production process, from raw materials to finished products. This ensures we can offer high quality, effective, and safe pharmaceuticals and successfully manage intellectual property issues, which can be seen from the number of court cases we have won. In 2005 we won a case at the Ljubljana District Court that related to alleged patent violations for simvastatin. To date the courts have found in Krka's favour in every significant patent dispute we have been involved in. Every court action represents a continual checking and perfection of our knowledge of chemistry, pharmacy, law and economics.

Our success has also been reflected in the Krka share price, which passed the 100,000 SIT mark for the first time in November 2005. We will continue to invite interest from foreign investors – who at year-end held over 6% of Krka shares – in the future, by organising presentations and ensuring a dispersed ownership base. Since we wish to achieve a high liquidity level, and further increase the share price we are considering the possibility of some Krka shares being listed on the London stock market.

Krka's international orientation means that more and more of its business takes place outside Slovenia. This has been matched by the increase in employment abroad, with over one third of the Krka workforce now employed outside Slovenia. I am very conscious of the fact that employees are fundamental to our further development, as only with well trained and motivated employees who can respond to market demands, will we be able to realise our plans and strategy.

As part of our economic, social and natural responsibility to people and the environment, in 2005

we also allocated significant funds to sponsorship and donations, as well as investment in reducing the burden on the environment.

Krka's development strategy, which sets out our plans until 2010, states that Krka will achieve an average sales growth of over 10% per year, and that we wish to remain an independent concern. This does not mean that we will not strengthen different forms of cooperation in a number of fields. Through organic growth and potentially also acquisitions we plan to remain a leading generics producer on markets stretching from Dublin to Vladivostok. The European and Central Asia markets will remain our priority, while we will also be present in the United States. In line with our strategy we want to improve our cost efficiency, innovation, and offer customers the most competitive selection of products possible, and to market pharmaceuticals in a new therapeutic group.

I would like to thank the members of the Supervisory Board and our partners for their positive cooperation to date and their support for our development vision. Their desire and commitment means they overcome everyday difficulties and help us tackle all the challenges in our path. I am convinced that together with all those who contribute in any way to enhancing the reputation and profile of this modern, international pharmaceutical company we will realise all our most important objectives. And for that reason I believe that Krka will remain a very sound investment.



Jože Colarič  
President of the Management Board and CEO



# Report of the Supervisory Board

## *A report on the process and the result of the review of the 2005 Annual Report of Krka, d. d., Novo mesto and the Krka Group, and the proposal regarding the appropriation of accumulated profit*

### *I.*

According to Article 274a of the Companies Act, the Supervisory Board of a company shall each year review the prepared Annual Report of the company and the proposal regarding the appropriation of accumulated profit, both of which are submitted to the Supervisory Board by the Management Board. The result of the review is to be presented as a written report at the General Meeting of the company. The Supervisory Board shall indicate in its report in what way and to what extent it reviewed the management of the Company during the year, and shall also take up its position on the Auditor's Report. At the end of its report, the Supervisory Board shall state any comments it has on the Annual Report and whether it approves the Annual Report. If the Supervisory Board approves the company's Annual Report, then the report is deemed adopted.

### *II.*

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

The Supervisory Board of the Krka Company has performed all statutory reviews and prepared a report for the General Meeting on:

- the review and approval of the 2005 Annual Report of the Krka Company and the Krka Group and the result of this review,
- the review of the proposal regarding appropriation of accumulated profit,
- the Supervisory Board's position on the Auditor's Report,
- the process and scope of the review of the management of the Company during the year,
- an evaluation of the company's operations and development.

## *III. Review and approval of the 2005 Annual Report of the Krka Company and the Krka Group*

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

In January 2006 the Supervisory Board already discussed the unaudited financial statements. At the end of March 2006 the Supervisory Board, in the presence of a certified auditor at both the meeting of the Audit Committee and the meeting of the Supervisory Board, also discussed the audited financial statements of the Krka Company and the Krka Group as well as the draft of the 2005 Annual Report of the Krka Company and the Krka Group.

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

During the process of discussing and reviewing the 2005 Annual Report of the Krka Company and the Krka Group, the Supervisory Board found that the Annual Report met all statutory requirements in respect of form and content of a company's annual report. The Annual Report was prepared well, with a full and clearly presented content and provides both owners and the public an appropriate overview of the conditions and results of operations in 2005, as well as of Krka's development and business plans for the following years.

The 2005 Annual Report of the Krka Company and the Krka Group was approved by the Supervisory Board at its meeting on 24 April 2006. Thus, the Annual Report was adopted.



#### ***IV. Review and submission of the proposal regarding appropriation of accumulated profit***

The Management Board submitted to the Supervisory Board a calculation of accumulated profit and a proposal regarding its appropriation, together with the Annual Report. Out of net profit for the period, the amount of 800,000,000 SIT was appropriated to statutory reserves. Upon mandatory appropriation, the amount of 6,500,000,000 SIT was appropriated to other revenue reserves. The accumulated profit established at 20,255,287,402 SIT comprises the remaining net profit of 14,280,823,149 SIT and the profit from previous periods in the amount of 5,974,464,253 SIT.

The Supervisory Board agreed with the Management Board that the proposed dividend of 1,650 SIT gross per share is in line with the established policy of dividend growth and the strategic policy regarding the share of net profit for the period to be appropriated annually for dividend payout. The Supervisory Board also estimated as adequate the proposed appropriation of accumulated profit, of which in the amount of 7,312,000,711 SIT to other revenue reserves, in the amount of 7,312,000,711 SIT to earnings carried forward to the following year, and in the amount of 54,368,480 SIT for other purposes (Supervisory Board's participation in profit).

After the review, the Supervisory board concluded, in accordance with the law and on the basis of prior coordination with the Management Board of the Krka Company, that all conditions had been met to submit, under Paragraph 4, Article 282 of the Companies Act, the proposal regarding appropriation of accumulated profit, together with the Annual Report, to the General Meeting of the Krka Company.

#### ***V. The Supervisory Board's position on the Auditor's Report***

In accordance with Paragraph 2, Article 274a of the Companies Act, the Supervisory Board discussed the Auditor's Report, which includes the auditor's opinion on the financial statements of the Krka Company and the Krka Group and the statement of compliance of the Management Report with the audited financial statements. In 2005, the Company prepared the financial statements of the controlling company in accordance with Slovenian Accounting Standards (SAS) and International Financial Reporting Standards (IFRS), while the financial statements of the Krka Group were prepared in accordance with IFRS.

The auditing company KPMG Slovenija d.o.o. was appointed by the General Meeting as the auditor of the 2005 financial statements. The majority of the subsidiaries in the Krka Group also had their financial statements audited by the local branches of the KPMG.

Before the end of the business year, the auditor informed the members of the Audit Committee of the Supervisory Board of its findings from the preliminary audit procedures, the object of which is to check the functioning of internal controls. Then, the members of the Audit Committee proposed which areas of operation the auditor should, in particular, verify before completing the audit. The auditor

submitted its report on the result of its review to the Audit Committee in the first half of April before approval of the Annual Report.

Krka's shares are listed in the Prime Market of the Ljubljana Stock Exchange, so the financial statements of the Krka Company and Krka Group prepared under IFRS have been included in the Annual Report for the first time. The auditor reported on this to the members of the Audit Committee and the members of the Supervisory Board, informing the members of the method and effects of the transition to IFRS.

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

#### ***VI. Scope and method of reviewing the management of the company during the year***

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

In relation to the 2004 report, the Supervisory Board agreed with the Management Board's resolution on long-term provisions and studied the preliminary unaudited financial statements and the audited financial statements of the Krka Company and the Krka Group. It first discussed the draft annual report and then the proposed version before issuing its approval. It also adopted its position on the auditor's report. Together with the Management Board it proposed that the General Meeting adopt a resolution on the appropriation of accumulated profit and the discharge of the Management Board. It agreed with the Management Board's proposal regarding the agenda of the General Meeting, it prepared a proposed list of candidates for shareholder representatives, and a proposal to appoint a certified auditor for 2005. It also accepted the Supervisory Board's report on the process and results of the review of the Annual Report.

On the proposal of the human resource committee, the Supervisory Board adopted the Rules of Remuneration of the Management Board and determined the remuneration

of the Management Board for 2004. It also discussed information providing comparative data on Krka's operations and those of select pharmaceutical companies in 2004. It studied the operating plan for 2005 and the report on operations of the Krka Company and the Krka Group for the first quarter of 2005. Every quarter, the Supervisory Board discussed the information on treasury shares in accordance with the Rules governing treasury shares fund.

During the year, the Supervisory Board monitored the implementation of set objectives on the basis of comprehensive regular reports presented by the Management Board on the results and conditions of operations of the Krka Company and the Krka Group, and thus reviewed, on a day-to-day basis, the Company's performance and the Management Board's work in managing the company, comparing them with the adopted development strategy and annual plan.

In the same period, the Audit Committee met twice, chaired by Janko Kastelic. The Committee agreed with the documents of the Internal Audit Department such as the 2004 report, with the medium-term work programme for 2005 to 2008, and the work programme for 2005. On the Audit Committee's recommendation, the authorised audit firm KPMG prepared a special report for the Audit Committee on a detailed review of individual areas of operation. The Audit Committee agreed with the findings in the report and the additional explanations given by the certified auditor at a meeting of the Committee. The Audit Committee also informed itself of the content of the management letter and approved the bases for preparation of the Supervisory Board's report.

The Human Resource Committee also met twice and was chaired by Borut Jamnik. It studied the report on the emoluments of the Management Board. In accordance with the Rules of remuneration of the Management Board, it proposed the amount of remuneration of the Management Board for 2004.

In the period from 21 June 2005 to the year-end 2005, the Supervisory Board was comprised of the following members: shareholders' representatives: Mateja Božič, MSc, Gregor Gomišček, PhD (President), Marko Kranjec, PhD (Deputy President), Anton Rous, Draško Veselinovič, PhD, and Alojz Zupančič; workers' representatives: Sonja Kermc, Tomaž Sever, MSc, and Mateja Vrečer, PhD.

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

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

At its following meeting the Supervisory Board discussed in detail the operations of the Krka Company and the Krka Group in the first half of 2005, and following the proposal of the Human Resource Committee determined the amount

of remuneration of the Management Board members in advance for the first half of 2005. It also studied offers submitted for the performance of the 2006 audit, and information on treasury shares fund.

The third meeting of the Supervisory Board was the most extensive and most complex. After discussing the report on operations of the Krka Company and the Krka in the period from January to September 2005, it assessed operations as very successful. It studied the 2006 general operational plan, gave its consent to the development strategy of the Krka Group for the period from 2006 to 2010, and informed itself of comparative data on the results of Krka's operations and those of selected pharmaceutical companies for the first half-year of 2005. Based on the Audit Committee's opinion, the Supervisory Board decided to propose to the General Meeting to appoint the auditing company KPMG as auditor for the 2006 business year. It also adopted a timetable of its meetings throughout 2006 and studied information on treasury shares fund. It also agreed with the Management Board's proposal to take out liability insurance for the Company bodies in favour of the Company.

Draško Veselinovič chairs the five-member Audit Committee in the new term in office. At its November meeting, the Committee discussed the report submitted by the certified auditor on the 2005 preliminary audit 2005, and set out guidelines for the certified auditor to follow in performing a detailed review of specific areas of operations in 2005. It prepared a proposal for the Supervisory Board to consider regarding the appointment of the certified auditor for 2006, which will be decided on by the General Meeting. It also adopted a report on the work of the Internal Audit Department for the first year of 2005.

In the new term in office, the three-member Human Resource Committee is chaired by Alojz Zupančič. At its first regular meeting, the Committee drew up a proposal for the Supervisory Board to determine the remuneration of the Management Board members in advance for the first half-year of 2005.

On the grounds of detailed and timely reports prepared by the Management Board, its answers and explanations, materials and analyses prepared also on special request of the Supervisory Board, and other data on the Company, the Supervisory Board was provided with a thorough insight in the guidelines and performance indicators, movement in sales by activity, region and product group, as well as the Company's financial statements. The Supervisory Board is informed of the Company's stable position as a generic company in the global pharmaceutical industry, the development of new generic products, investments, and successful adjustment of its product portfolio to the demands of the global market. On the basis of reports requested from and prepared by the Management Board, the Supervisory Board is periodically informed of data on operations of other similar producers of generic pharmaceuticals in the global market and their comparison with Krka operations.

The Management Board and the Supervisory Board cooperate successfully, and the presidents of the two boards communicate frequently, also in the period between the meetings of the Supervisory Board.

## VII. Evaluation of operations and development

The Supervisory Board monitors the operations of the Krka Company and the Krka Group regularly throughout the year. Together with the Management Board it additionally discussed deviations from the plans and at the same time found that realising Krka's long-term objectives requires rapid and flexible adaptation to development changes in the generic pharmaceutical industry. Keen competition will require additional efforts – cost management, risk management, investments in production, development, staff, knowledge, sales and marketing activities.

In 2005 Krka operated in accordance with its annual plans and strategic objectives. Its sales results were well above average, with the Krka Company recording a 19% increase and the Krka Group a 17% increase in net sales. This increase was mainly due to an increase in sales in the East Europe and Central Europe regions, which was significantly up on the 2004 figures. Krka's long-term policy of strengthening its pharmaceutical and chemical production was consolidated by a 21% increase in prescription pharmaceuticals sales. The Company's total profit recorded under SAS increased by 61%, profit before tax recorded by the Company under IFRS increased by 58%, and profit before tax recorded by the Group under IFRS increased by 61% over the previous year's figures. The increased profit before tax, the reduced investment relief, and the utilization and formation of provisions led to the Group's corporate income tax almost doubling. Nevertheless, there was a significant increase in net profit: 53% in the Company (under SAS), 47% in the Company (under IFRS), and 49% in the Group (under IFRS). All Krka's performance indicators, which are regularly monitored during the year by the Supervisory Board, exceeded both last year's and budgeted figures.

In 2005 intense investing activities continued, of which the Supervisory Board was informed on an ongoing basis. The new Sinteza 4 plant for manufacture of active substances, which will start operation in autumn 2006, will further strengthen Krka's vertical integration, a vital company strategy. Other investments in manufacture of pharmaceuticals that are planned or underway can also be expected to yield significant positive results in the future. In 2005 Krka's investment in its own plant in the Russian Federation proved to be a sound business move, which contributed to an increase in the Krka Group's sales in 2005.

Krka has realised also other planned objectives. It has a modern portfolio of quality products that it uses to generate almost half its sales, it manages well its regulatory procedures, which is evident from a number of new products granted marketing authorisations, as well as patent and legal requirements relating to lawsuits. It plans investments in employees, strengthens its marketing and sales networks, and internationalises individual business functions. The uniform share price of Krka's shares on the Ljubljana Stock Exchange grew by 22% in a year and was higher than its carrying amount by 190% at the year-end 2005.

The results of the Krka Company and the Krka Group have been achieved despite growing price pressures, unfavourable legislative changes, ever increasing competition in development of pharmaceuticals, and a global economic slowdown. The Supervisory Board therefore evaluates Krka's operations and achievements as

very successful and recognises the work of all those who have contributed.

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

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

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

## VIII. Changes in the Management Board and the Supervisory Board

In 2005, the management of the Krka Company underwent the following significant changes:

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

## IX. Notice of resignation by the Supervisory Board members

The members of the Supervisory Board Tomaž Sever and



Gregor Gomišček purchased Krka's shares in the period in which the public (other shareholders) had not yet been informed of the operating results. The former purchased 50 shares on 23 August, and the latter purchased 12 shares on 24 and 25 August. They were reproached in the media for misuse of insider information to their own benefit. On 14 September 2005, Gregor Gomišček submitted a notice of resignation to the President of the Management Board, stating he would resign as a Supervisory Board member as from the date of the regular General Meeting. He submitted a notice resignation for reasons of principle, although he did not personally feel responsible for the misuse of insider information.

Tomaž Sever submitted his notice of resignation to Sonja Kermc, the President of the Works Council. On 21 September 2005, the Works Council decided not to accept the notice of resignation, as it found that there were no grounds for his dismissal. Tomaž Sever agreed with the decision of the Works Council.

The Supervisory Board was informed of the notice of resignation of the Supervisory Board member Gregor Gomišček and the resolution adopted by the Works Council in respect of the notice of resignation of the Supervisory Board member Tomaž Sever at its 3rd regular meeting on 23 November 2005. None of the Supervisory Board members raised an objection to Gregor Gomišček continuing to fulfil his function as President of the Supervisory Board.

On 5 April 2006, the Securities Market Agency presented to Gregor Gomišček, on the basis of his request, the findings in the supervision procedure no. N-PP-nelic-79/05, in which his purchase of twelve KRKG shares in August 2005, when he was member of the Supervisory Board of the issuer of these shares, i.e. Krka, d. d., Novo mesto, was discussed.

"After having inspected and investigated the entire documentation, the Agency established that the suspicion of trading on the basis of insider information was unfounded. On the basis of documents and explanations collected it was established that the act was not considered a lesser offence, therefore a decision on violation would not be issued."

On the basis of this finding, Gregor Gomišček withdrew his notice of resignation on 14 April 2006 by sending a letter to the President of Krka's Management Board.

## **X. Conflicts of interest of the Supervisory Board members**

There was no conflict of interests recorded in 2005, either when discussing the items of the agenda at the meeting of the Supervisory Board or when decisions were made by the Supervisory Board. In view of the provisions of the Code of Corporate Governance of Public Limited Companies that entered into effect on 14 December 2005, the conflicts of interest shall be determined and their management procedures defined by the Supervisory Board in amendments and supplements to the Rules of Procedure of the Supervisory Board, most probably already in 2006, but latest in 2007 when the Rules of Procedure of the Supervisory Board will also have to be supplemented or modified due to the adoption of the new Companies Act.

## **XI. Conclusion and summary of the Supervisory Board's report, positions and proposals to the General Meeting**

- The Supervisory Board reviewed the 2004 Annual Report of the Krka Company and the Krka Group within the statutory time limit, i.e. within a month from the date when it was submitted by the Management Board.

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

By approving the Annual Report at the Supervisory Board's meeting on 24 April 2006, the 2005 Annual Report of the Krka Company and the Krka Group was formally adopted.

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

The certified auditor's report on the audit of the financial statements and the management report of the Krka Company and the Krka Group was unqualified. The Supervisory Board had no comments on the auditor's work and the auditor's report.

- The Supervisory Board examined the Management Board's proposal on appropriation of accumulated profit in the amount of 20,255,287,402 SIT, and approved it after mutual coordination.
- Based on the examination and coordination referred to in the preceding point and pursuant to Paragraph 4, Article 282 of the Companies Act, which states that the General Meeting decides on the appropriation of accumulated profit on the proposal of the Management Board and the Supervisory Board, the Supervisory Board and the Management Board propose to the General Meeting to adopt the resolution on the appropriation of accumulated profit, the wording of which is submitted in writing to the General Meeting together with this Report.
- Based on the data from the 2005 Annual Report of the Krka Company and the Krka Group, the Auditor's Report, and this report, the Supervisory Board proposes to the General Meeting to approve a release of the members of the Management Board and the Supervisory Board of the Krka Company in accordance with the provisions of Article 282a of the Companies Act.
- The Supervisory Board accepted this report unanimously at its meeting of 24 April 2006.



Gregor Gomišček, PhD  
President of the Supervisory Board

Novo mesto, 24 April 2006

# ID card

**Company name:** Krka, tovarna zdravil, d. d., Novo mesto  
**Registered office:** Šmarješka cesta 6,  
 8501 Novo mesto, Slovenija  
**Telephone:** +386 7 331 21 11  
**Fax:** +386 7 332 15 37  
**E-mail:** info@krka.biz  
**Basic activity:** Production of chemical, pharmaceutical  
 raw materials and finished products  
**Year established:** 1954  
**Registration entry:** 1/00097/00, District Court Novo  
 mesto

**VAT number:** 82646716

**Company identification number:** 5043611

**Called-up capital:** 14,170,448,000 SIT

**Shares:** 3,542,612 ordinary registered shares at par  
 value of 4,000 SIT. Krka's shares were listed on the  
 Ljubljana Stock Exchange in 1997 with the trading symbol  
 KRKG.

The Krka Group comprises the controlling company, Krka, d. d., Novo mesto, and the following subsidiaries and associated companies:

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

\* company not operating

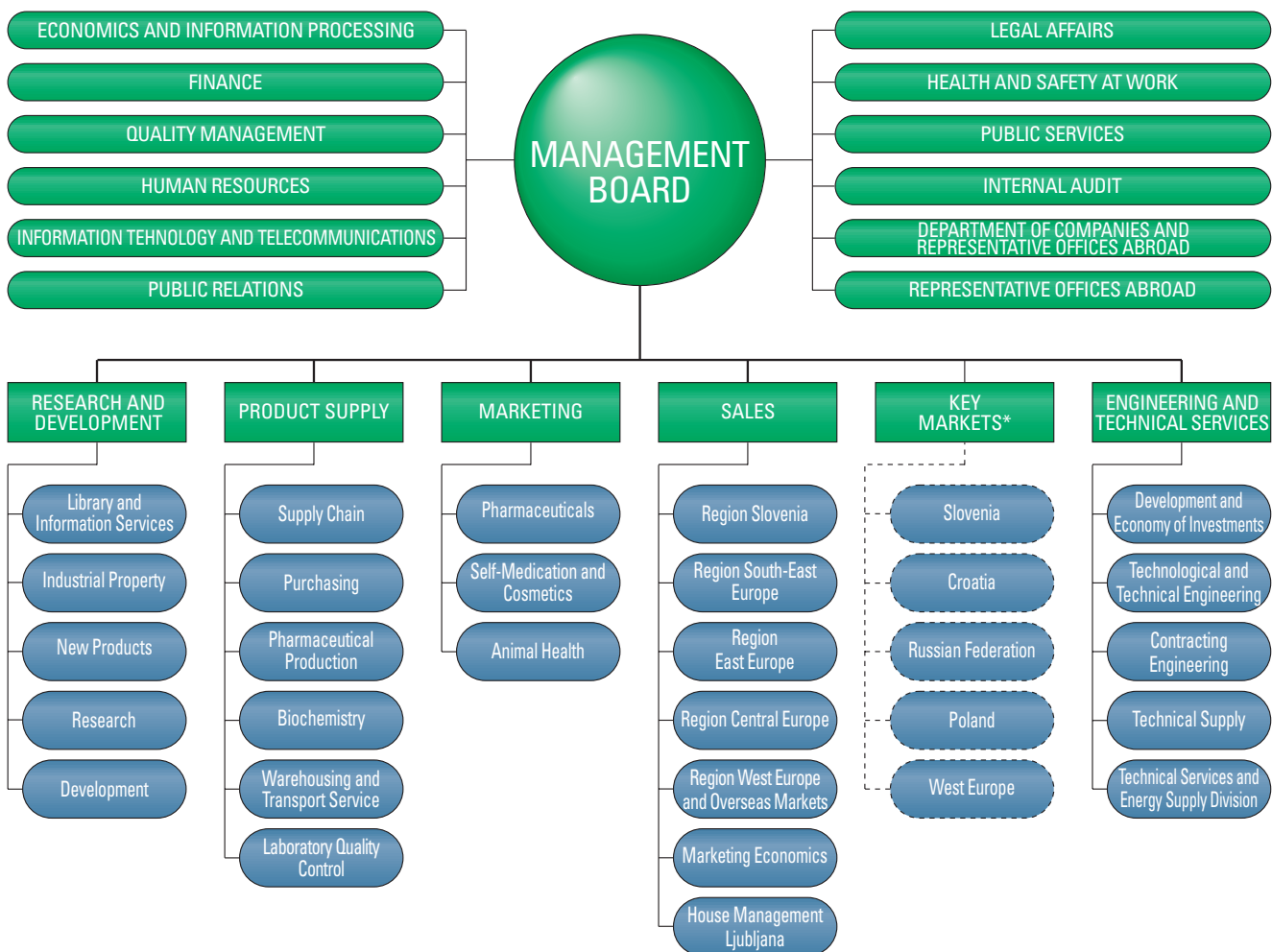
\*\* company being wound up

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

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

Abbreviated company names are used in the text below.

# Organisational chart of the Krka Company



\* Key markets are countries that represent especially important markets for Krka as well as those countries in which Krka has organised development, marketing and production and distribution activities that Krka representative offices and/or subsidiaries perform on the key markets.

# Krka corporate governance



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

The company's management bodies comprise:

- the Management Board
- the Supervisory Board
- the General Meeting, at which shareholders exercise their rights relating to company affairs.

## General Meeting

In accordance with the provisions of the Companies Act, the General Meeting is the highest body of the company in which the company's shareholders can participate directly and make decisions affecting company operations and its articles of association.

The Management Board convenes a regular General Meeting once a year; the convening of the General Meeting is made public at least 30 days before the session of the General Meeting.

Shareholders recorded in the shareholders' registrar on the cut-off date given in the General Meeting notice have the right to attend a General Meeting and exercise voting rights. The same rights may be exercised by shareholders' representatives and agents who file the appropriate power of attorney when registering for a General Meeting.

The Tenth General Meeting of the Krka public limited company was held on 17 June 2005 and deliberated the following points:

- information on the annual report and the Supervisory Board's report
- decisions on the use of the accumulated profit
- the election of the supervisory board, and
- the appointment of the auditor for 2005.

The following day the resolutions adopted at the General Meeting were published in the Delo newspaper, and before that the news was available on the SEOnet information system.

The full material was available from the day the General Meeting was convened until the day of the meeting at the company's registered office, and was accessible to all participants in the General Meeting.

In 2006 the Annual General Meeting (AGM) is planned for 6 June. The announcement convening the General Meeting with the proposed resolutions and location of the meeting will be published on the Ljubljana Stock Exchange's SEOnet information system and in Delo newspaper, and the entire text of the proposed resolutions, conditions for participation and material will be available on the company's website.

## Supervisory Board

The work of the Supervisory Board is set out in detail in the report on the process and results of its review of the 2005 Annual Report for Krka, d. d., Novo mesto and the Krka Group on page 10. The Report also includes the proposal for use of the accumulated profit. The Supervisory Board also issued an opinion on the auditor's report, setting out in detail the extent and manner of verifying the company's management during the year. New members were appointed to the Supervisory Board in the middle of 2005. Their number was reduced from 12 to 9, with the number of shareholder (owner) representatives remaining the same at six, while the number of worker representatives was halved to three. The Supervisory Board also produced an evaluation of the company's operations and the Krka Group's 2006-2010 development strategy.

The Supervisory Board concluded that in general the company had complied with all the provisions of the Corporate Governance Code, which was amended in 2005. In 2006 it will update the rules of procedure for the Supervisory Board, and its Audit Committee and Human Resource Committee with missing provisions that will define the responsibilities and procedures for the individual bodies in greater detail.



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

## Shareholder representatives

### Gregor Gomišček, PhD, 49 years President of the Supervisory Board

Gregor Gomišček finished his natural science studies in physics at the University of Ljubljana and received his Doctor's Degree in technical sciences from the Vienna University of Technology. He enrolled in management studies (General Management Programme) at IEDC – Bled School of Management. He worked almost ten years at the University of Vienna, Institute of Medicinal Physics, Centre for Biomedical Engineering and Physics. Now he is employed at the Institute of Biophysics of the Faculty of Medicine in Ljubljana as researcher and Assistant Professor. At the Faculty of Social Sciences, he lectures on Technological politics in the USA.

### Marko Kranjec PhD, 66 years Deputy to the President of Supervisory Board

Marko Kranjec took his diploma and his Doctor's Degree at the Faculty of Economics, University of Ljubljana. He was a macro-economist with the OECD in Paris and with the World Bank in Washington. Between the years 1990 and 1991 he acted as Minister of Finance in the government of the Republic of Slovenia, and between 1991 and 1997 as Vice Governor and Member of the Governing Board of the Bank of Slovenia. Until the year 2002 he was Ambassador of the Republic of Slovenia with the European Union in Brussels. He has been a Professor in public finance at the Faculty of Administration, University in Ljubljana since 2002.

### Mateja Božič, MSc, 39 years

Mateja Božič took her Master's Degree in management and organisation. She was employed in Petrol, d. d., where she actively participated in the restructuring process and in the company's strategic development. Ever since 2003 she has worked as a Consultant to the member of the Management Board in the field of finance and energy management. She got involved in controlling

and in the implementation of activity based costing (ABC). At present she is the member of the management board of Kapitalska družba.

### Anton Rous, 66 years

Anton Rous graduated from the Faculty of Law in Ljubljana. In 1970 he started his 11-year long service as Managing Director of Avtoradgona. He was CEO of SOZD Integral for two terms and director of group business for Hidromontaža Maribor. Later he was elected chair of the Executive Council of Maribor. He retired prematurely after his four and a half year long mandate. He is now state secretary in the Office of the Prime Minister of the Republic of Slovenia.

### Draško Veselinovič, PhD, 47 years

Draško Veselinovič received a Doctorate of Science at the Faculty of Economics, University Ljubljana, was trained at different institutions abroad, and finished the specialist study on global finance and international marketing. He was President and Chief Executive Officer of the Ljubljana Stock Exchange from 1991 to 2004 and is now President of the Management Board of Deželna banka of Slovenia, d. d., Ljubljana. He is an Associate Professor at the Faculty of Economics in Ljubljana and a Visiting Lecturer at post-graduate programs within the scope of IEDC. In this Supervisory Board he is the President of the Audit Committee.

### Alojz Zupančič, 67 years

Alojz Zupančič is a university graduate engineer of chemical technology and Master's Degree Candidate in organisation and management at the Faculty of Economics, University in Ljubljana. He was first employed in the glass factory INIS Novo mesto and later in IMV – a precursor of the present Revoz. From 1969 to 1998 he worked in Krka, in the end as Consultant to the Director of the Veterinary Programme. In Krka's Supervisory Board he is the President of the Human Resource Committee.



## Employee representatives

### Sonja Kermc, 54 years

Sonja Kermc, university graduate engineer of chemical technology started her employment in Krka in 1976. She is presently head of Applied Water Services and in charge of applied media systems and of cooperation with the technological and technical engineering while developing new systems. She is a member of the Workers' Council for the third term and its President in the period from 2004 to 2008.

### Tomaž Sever, MSc, 38 years

Tomaž Sever took his Master's Degree in management and organisation, being a university graduate in mechanical engineering by profession. Prior to his employment in Krka, he worked, from 1992 to 1995, in IBM Slovenija, d. o. o., in the field of information systems. He has been employed in Krka Company, since 1995 and is now Deputy Director of Sales and also Director of the Region Central Europe, entrusted primarily with Krka's presentation on individual markets and building up of the sales network abroad.

### Mateja Vrečer, PhD, 39 years

Mateja Vrečer started working in Krka in 1990 as a university graduate in pharmacy, and later received her Master's and also Doctor's Degree. She also passed a specialist exam in pharmacy engineering. She first worked in the Research and Development Division. She has been working in the field of quality management since 1997 as Deputy Director in Quality Management. She is an internal auditor for the quality systems within Krka and is an auditor for contractual partners.

## Management Board

Krka plc, i.e. the Krka Company is managed by the Management Board which is appointed by the Supervisory Board. The Management Board has five members: the President of the Management Board and Chief Executive, three members, and the Worker Director. The Worker Director representative represents the interests of the employees in relation to human resource and social issues, but is not authorised to represent the company.

On the first day of 2005, Jože Colarič assumed the office of President of the Management Board and Chief Executive. In March Zvezdana Bajc was appointed to the Management Board. She continues to hold the post of Director of Economics and Information Processing. Her term will expire at the end of 2009.

The Management Board manages the company and makes business decisions directly and independently. The Management Board meets at least once a month. It operates by coordinating opinions, and making decisions by consensus rather than on the basis of votes. The Rules of Procedure of the Management Board regulate the management board's work and the duties of individual members. The term-in-office for members of the Management Board is five years, with the possibility of re-election.

In line with the Rules of Organisation and the Rules of Procedure of the Management Board, members of the Management Board also have executive tasks, as may be seen from the presentation above, and they also represent a set number of organisational units on the Management Board, which facilitates direct cooperation between the Management Board and the executive directors.

The Management Board also has the following working bodies: board of directors, development committee, quality committee, investment committee, human resource committee, information technology committee, sales committee, economics and finance committee, and the corporate image committee. The committee comprises specialists on individual areas from different organisational units. They prepare detailed policies and strategies for individual areas and also have some decision-making responsibilities relating to implementing annual plans.

To improve connections between and supervision of the operations of subsidiaries, the Krka Company's Management Board functions as the general meeting for the subsidiaries. The members of the Management Board, depending on the provisions of the legislation of the country in which the company operates, also function as members of supervisory boards, supervisory committees or management committees of subsidiaries for which they do not receive any separate payment.

## *Members of the Management Board*

**Jože Colarič, 50 years**  
**President of the Management Board**  
**and Chief Executive**

**Janez Poljanec, 59 years**  
**Member of the Management Board**  
**and Director of Product Supply**

**Aleš Rotar, PhD, 45 years**  
**Member of the Management Board**  
**and Director of Research and Development**

**Zvezdana Bajc, 53 years**  
**Member of the Management Board**  
**and Director of the Economics**  
**and Information Processing**

**Danica Novak Malnar, 49 years**  
**Member of the Management Board -**  
**Worker Director**



Jože Colarič graduated from the Faculty of Economics in Ljubljana. He has been a member of Krka's staff since 1982, when he began work in the Financial Sector. In 1989 he took over leadership of the export service in the Export-Import Division. In 1993, he was appointed as deputy to the Chief Executive for the area of marketing and finance, and in September of the same year he became director of the Marketing and Sales Division. In 1997 he was appointed as member of the Management Board. In the following year, he was nominated by Krka's Supervisory Board as Deputy to the President of the Management Board, and in the year 2002 was verified as a future President of the Management Board and as an authorised person for preparation of the proposal for the new management. At its meeting held on 12 July 2004, the Supervisory Board appointed him for the future President of the Management Board and Chief Executive with a five year mandate, starting on 1 January, 2005.



Janez Poljanec graduated in 1972 from the Faculty of Natural Sciences and Technology. In 1974 he joined the staff of Krka, and in 1979 he became Director of the Division for Overseas in the Export-Import Sector, and later Director of the Sector. During the period 1985-1989, he worked for Krka through Generalexport in Combick, Frankfurt; in 1990 he again took over direction of the Export-Import Sector. In 1993, he became Director of the Procurement and Logistics Division, and four years later was appointed by the Supervisory Board to be a member of the Management Board, and for present membership again on 31 July 2002. Since 2002 he has been Director of Product Supply.



Aleš Rotar graduated in 1984 from the Ljubljana Faculty of Natural Sciences and Technology and completed the international MBA studies at the IEDC Centre at Brdo. In 2000, he acquired his doctorate from the Faculty of Pharmacy in Ljubljana. His employment at Krka began in 1984, when he was engaged in the Stability Testing Department. In 1991, he became Head of the Division for Pharmaceutical Technology, and two years later was appointed as Head of Pharmaceutical Development in the Research and Development Division. In 1998 he was appointed as Deputy Director of the Division, and in 1999 as Director. In 2001 he was elected as a member of the Management Board. His present membership has been voted on 31 July 2002, while he has remained as Director of Research and Development.



Zvezdana Bajc graduated from the Faculty of Economics in Ljubljana. She started working with Krka in 1977, first in the Economics Division and in 1979 she moved to the Investment Services. In 1986 she took over the direction of the Economic Planning Division, and in 1999 was appointed Director of the Economics and Information Processing Division. On 1 April 2005 she was appointed to be the member of the Management Board by at least 2009, while she has remained as Director of the Economics and Information Processing.



Danica Novak Malnar graduated from the Faculty of Natural Sciences and Technology in Ljubljana. She joined Krka's staff in 1982 and was appointed Head of the Pharmaceutical Division in Ljutomer in 1986, and for two years Head of the Division for Operative Production Planning. In 1994 she took over direction of the Production Planning Department. In 1998 she was elected to the Management Board – as Worker Director, while her present membership has started on 1 January 2003. Since 1999, she has been in charge of pharmaceutical production.



## Governance of the Krka Group

The Krka Group consists of the controlling company Krka, d. d., Novo mesto, thirteen subsidiaries abroad, and one in Slovenia. It is the majority owner of its subsidiaries and has a participating interest in an associated company. In 2006 two companies outside Slovenia will cease operations. All functioning subsidiaries are 100% owned by the Krka Company.

The operations of these companies take place in accordance with local legislation and mandatory internal rules and instructions for the operation of companies in the Krka Group, which are adopted by the Management Board of the controlling company.

## Internal auditing

On the basis of the Founding Charter of the Internal Auditing Service and the Rules of Procedure for the Internal Audit Service of the Krka Company, which were approved by the Management Board and Supervisory Board at the end of 2004, the Internal Audit Service (IAS) is responsible for preparing risk assessments for the Krka Group, based on a selected model. This involves assessing the existence and impact of risks in over 60 audit areas within the Krka Group. The IAS risk assessment formed the basis for the Medium-Term Work Plan 2005-2008 and the Annual Work Programme 2005. These two documents were adopted by the Management Board, and consent was also given by the Supervisory Board's Auditing Committee as its regular meeting of 14 February 2005.

Based on these programmes and work schedules, the IAS began actively performing its internal auditing role. The objectives are to improve internal controls, to identify opportunities to reduce costs, and to improve operation efficiency and effectiveness, and the management of the Krka Group.

The main focus of internal auditing in 2005 was on process auditing (purchasing, fermentation and chemical production, marketing, sales and investment). The IAS managers found that all these processes had internal controls in place, and assessed that they were functioning efficiently.

In 2005 the Service performed nine regular internal audits. Its exhaustive reports set out 144 recommendations for improvement of the internal control structure and operational efficiency and effectiveness. The Management Board adopted all the audit reports. Every level of company management responded to the recommendations, with managers implementing them as much as they were able. The IAS also produced a report on the realisation of its recommendations.

In addition to the constructive cooperation with the

Management Board, the IAS also worked with external auditors, primarily with a certified information systems auditor (CISA) and the Supervisory Board's Auditing Committee. The IAS reports to the Auditing Committee on its work twice a year, and with the Auditing Committee's consent, also produces the medium-term and annual work programmes.

The IAS devoted some of its time to permanent risk assessment. At the end of the year it produced a risk re-assessment in accordance with the Internal Auditing Standards, which was the basis for updating the medium-term work programme (up until 2009), and preparing the annual work programme for 2006. Both documents were adopted by the Management Board, and consent was also given by the Supervisory Board's Auditing Committee.

In addition to the regular internal auditing work, the IAS also performed informal consultancy work. In 2006 it will be further strengthened to match as closely as possible the requirements of its users, the Management Board and Auditing Committee. The IAS continually improves the quality of work by sharing its knowledge of internal control procedures, including testing and assessing such procedures, improving the internal auditing methodology and operating in accordance with the applicable standards. This provides a sound basis for acquiring the approval of the independent external specialists on the compliance of the IAS's work with those standards.

## External auditing

The certified auditing company KPMG carries out the audit of the financial statements of the controlling company and most of the subsidiaries. Their many years of auditing experience means they are very familiar with operations and identifying possible risks. In line with the Corporate Governance Code recommendation, the company changes its auditing partner every five years.

As part of the financial statement audit, external auditors review the functioning of internal controls in key business processes. The purpose of internal controls is to avoid or at least to reduce business risks through the early recognition of risk factors and risk management. After the external auditor has completed the first phase of auditing, it reports its findings to the Management Board and the Auditing Committee of the Supervisory Board. Each year in the second and final phase of auditing, the external auditor specifically examines individual operational sectors on the basis of the Auditing Committee's recommendations relating to the level of risk.

In 2005 the Krka Company also worked with the consultancy branch of the KPMG company. The independence of the auditing and consulting operations was assured by means of an appropriately separated

internal organisation and the internal standards of KPMG Slovenija, d. o. o.

## Communicating with the public

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

The main aims are:

- achieving a fair market value for Krka
- facilitating easier access to financing under more favourable conditions
- creating influential groups of people to support and trust Krka, and
- suitable liquidity for trading in Krka shares.

We achieve these objectives as follows:

- regular meetings with institutional investors at the company headquarters
- participating in investor conferences at home and abroad
- organising regular representative meetings (investor roadshow) in financial centres around the world
- issuing publications for investors (Utrip prihodnosti and other representative and promotional material for investors)
- Annual General Meetings
- press conferences to publish business results
- communications with financial media, and
- communication via the company website ([www.krka.si/si/finance/](http://www.krka.si/si/finance/)).

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

In 2005 work to promote the company on Slovenian and international financial markets was stepped up. We also organised two roadshows which involved visiting institutional investors in European financial centres (London, Frankfurt, Copenhagen, Stockholm, Vienna, Edinburgh, The Hague, Amsterdam, and Zürich). The success of these activities is clear from the positive response of participants, the higher proportion of international investors in Krka's ownership structure and growth in the Krka share price.

Krka has appointed a staff member responsible for communications and investor relations.

The company's Management Board adopted a set of Company Reporting Rules setting out the duties of

individual specialist services to ensure efficient and effective communications.

The company's website presents all the key data on its business and operations in Slovenian and English. This includes:

- a presentation of the company and its activities
- an overview of its companies and representative offices abroad
- the history and development of the company
- a presentation of strategy
- the financial calendar
- share prospectus for organised capital market
- data on trading in the company's shares
- share ownership details
- financial data for current year and past years
- annual and half-year business reports
- information on general meetings (announcements to convene, resolutions passed, general meeting quorum, etc.)
- news
- public announcements
- Corporate Governance Code Compliance Statement.

## Corporate Governance Code Compliance Statement

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

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



efficiency







# Business report

*Krka is committed to efficiency – and we  
improve our efficiency on a daily basis by  
developing new processes and new knowledge.*



# Business report

## Krka Group development

### Mission

#### Living a healthy life.

Our basic task is to enable people to enjoy a healthy, high quality of life. We achieve this through a wide range of products and services - with prescription pharmaceuticals, self-medication products, cosmetics and animal health products, and with our health-resort services, as well as through investing in people and the environment, and our involvement in sponsorship and donations.

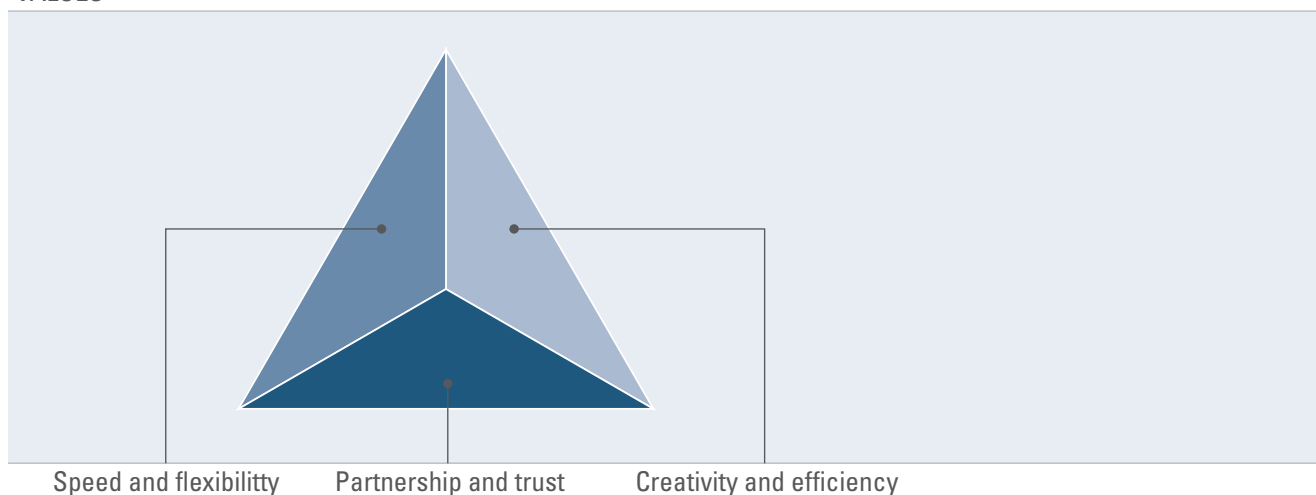
### Vision

**We are continually consolidating our position as one of the leading generic pharmaceutical companies on the European market.**

We are achieving this independently by strengthening our long-term business networks and establishing partnerships in the fields of development, product supply and marketing.

### Values

#### VALUES



Speed and flexibility

Partnership and trust

Creativity and efficiency

## Key strategies - to 2010

- Prioritising European markets and the markets of Central Asia and strengthening pharmaceutical and chemical activities.
- Expanding the range of prescription pharmaceuticals and self-medication products.
- Targeting key markets, key purchasers, and key products, and launching a new therapeutic range by 2008.
- Increasing vertical integration.
- Developing generic medicines and preparing marketing authorisation documentation at least three years before the expiry of the product patent for the original medicine.
- Strengthening synergy within the Krka Group (in expertise and costs), and maximising utilisation of competitive advantages in the business environments of Krka companies abroad.
- Internationalising all business functions.
- Strengthening creativity, innovation and motivation and an entrepreneurial and target-oriented approach.
- Continuing the systematic approach to caring for the quality of our employees' life and work.
- Upholding our economic, social and natural responsibilities to the environment in which we operate.
- Strengthening recognition and public approval of the Krka brand.

## Strategic objectives - to 2010

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

## The Krka Group's business objectives for 2006

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

## Macroeconomic environment in 2006

In addition to more common macroeconomic external factors, which we consider below, our business performance is more heavily influenced by industry-specific trends. These include government health policies, increasing competition from generic peers, and pressure from producers of original pharmaceutical products, which have been employing many different means to restrict the prescription and use of generic pharmaceuticals.

On our key markets there is a direct link between macroeconomic variables and changes in the prices of energy and strategic raw materials. Furthermore, changes in legislation concerning pharmaceuticals marketing authorisations, their prescription and rules governing patient payment participations are very common. To a limited extent extraordinary events, such as an outbreak of avian flu pandemic also influence broader environments.

Local economic and political factors in individual regions and countries will also have an impact on our operations. Below is a brief overview of expected macroeconomic developments in 2006 for our key markets. In our opinion they will not cause the actual results to be materially different from our sales and business plans.

### Slovenia

Forecasts indicate that the macroeconomic environment in Slovenia will remain stable, while the anticipated economic reforms will improve the international competitiveness of the Slovenian economy. During 2006 Slovenia will meet all five convergence criteria for joining the European economic and monetary union (EMU) and will join the eurozone on 1 January 2007.

### Russian Federation

We anticipate that economic stability and public financing of social programmes will continue (according to some statements in the international press, the value of the first phase of these programmes will amount to 1 billion USD), backed by continued economic growth, which could exceed 6%. The real appreciation of the rouble is expected to continue, as is the increase in the value of country's stabilisation fund, which has, by some estimates, already exceeded 50 billion USD in 2005. International credit ratings agencies expect the country's financial strength will continue to grow. They consider the major risks to be potential political and institutional changes in the period running up to elections in 2007 and 2008.

### Poland

Analysts have welcomed the nominal restriction on the budget deficit, which should not exceed 30 billion PLN (7.89 billion EUR). Poland is also expecting significant inflows from the EU budget and new foreign direct investment. We assess that these factors, backed by sound economic growth of over 4%, will lead to a relatively strong domestic currency (against the EUR). Although further appreciation of the PLN seems possible, analysts expect the EUR/PLN exchange rate to hover around 4 PLN to the EUR. Additional uncertainty could arise should there be further deferrals of the planned EMU entry, which is scheduled after 2010.

### Germany

Analysts anticipate Germany will enjoy one of its best years for economic growth in a decade in 2006. This is supported by increasing consumer confidence, which according to the most recent measurement (December 2005), is at its highest level since January 1999. Net exports, traditionally the most important indicator of German economic growth, should be matched - after stagnating in 2005 - by household consumption, although mainly due to a one-off increase caused by the higher VAT rate in 2007, and the football World Cup. Nevertheless, Germany will probably continue to face a budget deficit in 2006, and the success of the economic reforms planned for 2007 and later remains uncertain.

### Croatia

Without doubt a key positive for country's further development is the start of negotiations for full EU membership. The state of the economy will be most heavily influenced by the level of unemployment, the national budget and current account balance. In line with its macroeconomic stabilisation programme, which is linked to an agreement with the International Monetary Fund (IMF), Croatia forecasts the continuation of social security reforms in 2006. At the same time it will start paying off debts that arose due to lack of indexation of pensions in the mid-1990s. This will lead to an increase in government spending over the next two years by over 1% of GDP.





## **Czech Republic**

According to our assessments the 2006 economic growth in the Czech Republic will be similar to that in Slovenia, at around 4%. The budget deficit remains a major economic challenge, while increased foreign demand and a slowdown in the appreciation of the koruna (CZK) in real terms will reduce the trade deficit. Capital inflows from the privatisation of state assets and a significant increase in eurozone interest rates could have a major impact on the value of the domestic currency. The general election expected for 2006 will not significantly affect the Czech Republic's stability and its macroeconomic position.

## **Romania**

2006 is extremely important for Romania as it is set to join the European Union on 1 January 2007. The process should be helped by an agreement with the World Bank making 110 million EUR available for Romania to address some structural deficiencies as requested by the EU. In 2006 Romania will probably record a trade deficit due to high domestic demand, but we anticipate the value of the new leu (RON) to remain stable due to major capital inflows (including privatisation projects). Romania's progress has been recognised by international credit rating agencies. In 2005 they increased Romania's rating to investment grade level, mainly due to the relatively healthy state of its public finances.

## **Ukraine**

Despite stabilisation, Ukraine remains a country in transition. This makes adopting the 2006 budget and restricting the budget deficit to 2.5% of GDP in line with IMF recommendations extremely important. Resolving the issue of the price of gas supplied by the Russian Federation will probably affect the trade and current account balances, but forecasters expect the domestic currency to remain stable against major currencies.

# Business operations analysis of the Krka Company and the Krka Group

Financial statements for 2005 compared with results of 2004 of the Krka Group have been prepared in accordance with the International Financial Reporting Standards (IFRS), whereas for the Krka Company the financial statements have been prepared in compliance with IFRS as well as the

Slovenian Accounting Standards (SAS). The business operations analysis presents the results achieved in 2005 prepared according to IFRS and compared with figures of 2004. As for the period from 2001 to 2003 we have taken into account data prepared in compliance with SAS.

## COMPARISON OF THE BASIC ACCOUNTING ITEMS OF THE KRKA GROUP AND KRKA COMPANY FOR THE PERIODS 2005 AND 2004

in million SIT	Krka Company						Krka Group		
	IFRS	2005 SAS	Diff. in %	IFRS	2004 SAS	Diff. in %	2005 IFRS	2004 IFRS	Diff. in %
Operating revenues	128,451	128,386	0.1	102,233	102,121	0.1	144,979	117,841	23.0
Net sales	116,570	116,570	0.0	97,978	97,978	0.0	132,758	113,317	17.2
Operating profit	28,801	28,189	2.2	18,017	17,585	2.5	28,523	17,950	58.9
Net profit	22,459	21,581	4.1	15,310	14,101	8.6	23,319	15,661	48.9
Assets	181,940	182,826	-0.5	151,318	151,081	0.2	188,849	155,596	21.4
– non-current assets	116,589	114,013	2.3	104,007	103,768	0.2	120,455	106,933	12.6
– current assets	65,351	68,813	-5.0	47,311	47,313	0.0	68,394	48,663	40.5
Equity and liabilities	181,940	182,826	-0.5	151,318	151,081	0.2	188,849	155,596	21.4
– share capital	114,141	125,046	-8.7	97,137	106,711	-9.0	114,897	97,126	18.3
– liabilities	67,799	57,780	17.3	54,181	44,370	22.1	73,952	58,470	26.5

As regards the fact that the financial statements have been prepared according to the IFRS for the first time, there is a special chapter in the financial statements of

the annual report treating in detail the influence of the transition to the IFRS.

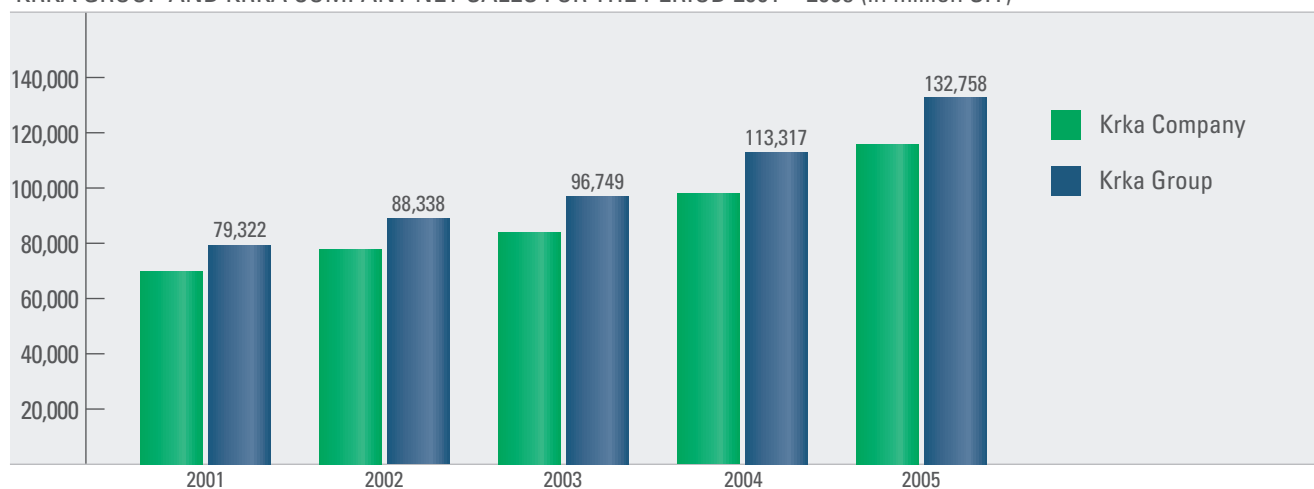
## Revenues

Net sales of the Krka Group increased by 17% while Krka Company generated an increase of 19%. The sales growth rate considerably exceeded the five-year average (13.7% in the Group and 13.2% in the Company) that was a result of the economic situation in some key markets, in particular the Russian Federation, as well as organisational and personnel changes within the marketing-sales network. The major part of net sales of the Krka Group i.e. 80% was generated through the sale of prescription pharmaceuticals. Compared to previous year's results the Company achieved a growth of 21% or 18 billion SIT. As for the growth rate, Regions East and Central Europe achieved the most outstanding results, namely East Europe leading with 48%, followed by Central Europe with a 34% growth. In the past financial

year the share of sales on the foreign markets increased from 78% to 82%. Krka plans to achieve a 13% increase in sales in 2006 and thus continue with the growth of the past years. A detailed analysis of the sales results in terms of individual markets and product groups is described in the Chapter Marketing and Sales.

Krka Company generated 131.7 billion SIT of revenues and the Krka Group 149 billion SIT indicating a 23% increase if compared to 2004. The increase in revenues is higher than the increase in sales which is mostly due to the reversal of provisions by Krka Company formed for the lawsuit in connection with medicines for the heart and cardiovascular diseases in the amount of 11.4 billion SIT that ended in favour of Krka. The aforesaid had an impact on the increase of other operating revenues as well.

KRKA GROUP AND KRKA COMPANY NET SALES FOR THE PERIOD 2001 – 2005 (in million SIT)



## Expenses

Expenses incurred by the Krka Group record an increase of 16% or 119.4 billion SIT in comparison to 2004. Without taking into account the newly formed provisions, the Group's expenses increased by 11%, which is 6% less than the sale's increase.

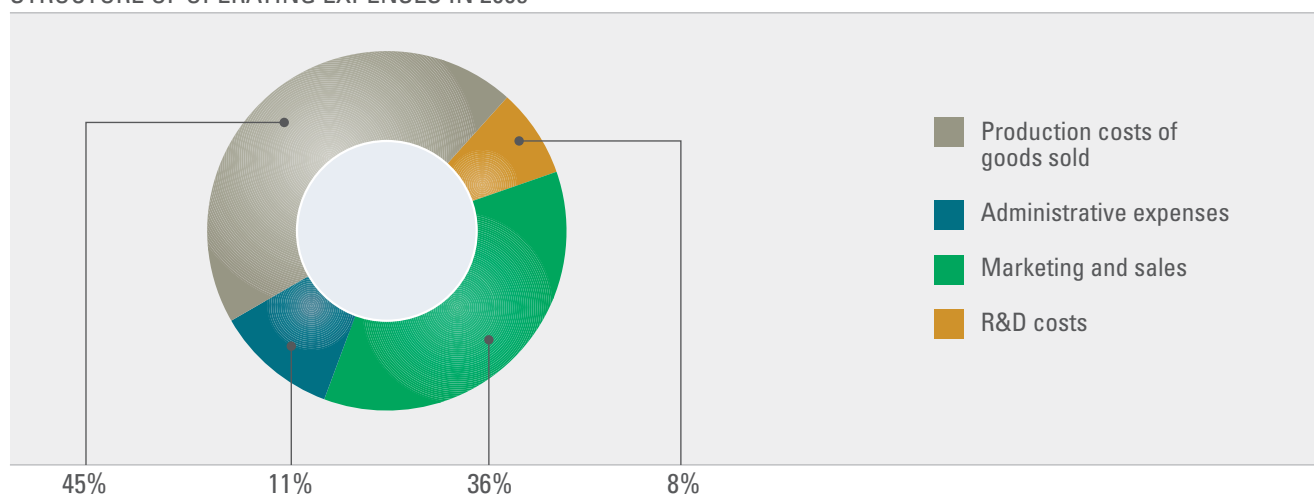
The Krka Group records operating expenses in the amount of 116.4 billion SIT of which 51.8 billion SIT refers to production cost of goods sold, 41.6 billion SIT to marketing and sales, 9.6 billion SIT to R&D costs and 13.4 billion SIT to administrative expenses.

Compared to 2004 the increase in production cost of goods sold by the Krka Group is not as great as the increase in sales. In the structure of the net sales, its share decreased in the past five years from 48% to 39%. This is mostly attributable to the rationalisation of operations as well as the introduction of contemporary technology that ensures a

greater productivity at major production quantities and accordingly the lowering of related costs.

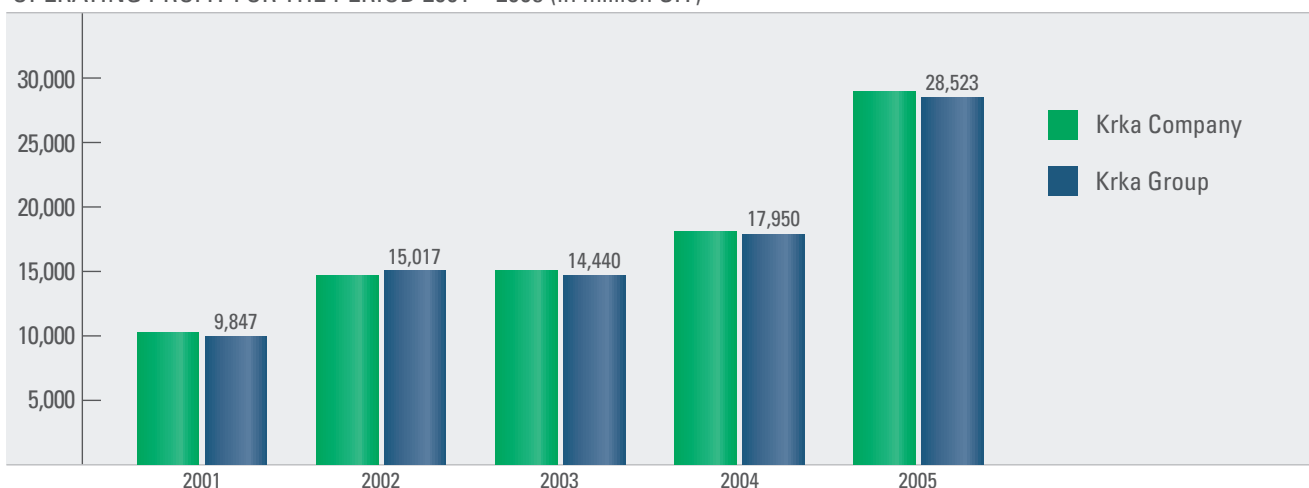
As for the marketing and sales and R&D costs the movement is quite different since the increasing demand of the market and the pressing competition require constant and larger investments. The expansion of the own marketing network on Krka's all significant markets resulted in an increase of the marketing and sales which amounted to 41.6 billion SIT in the reporting period and thus having a share of 36% in the structure of operating expenses. Marketing and sales comprise also 12.5 billion SIT of provisions formed by Krka in connection with the medicines for the heart and cardiovascular diseases. R&D costs recorded by the Krka Group show an increase of 16% compared to the previous year's figures and refer mostly to the controlling company. The R&D costs represent in its total amount the expense of the financial year since these costs are not capitalised. Administrative expenses record an increase of 3%.

STRUCTURE OF OPERATING EXPENSES IN 2005



# Operating result

OPERATING PROFIT FOR THE PERIOD 2001 – 2005 (in million SIT)



Note: SAS applied for data for the period 2001 – 2005 and IFRS for 2004 and 2005.

Operating profit of the Krka Group is recorded at 28.5 billion SIT and indicates an increase of 59% compared to 2004.

Profit before tax has increased by 61% and amounted to 29.5 billion SIT. Income tax amounted to 6.2 billion SIT, of which 9.8 billion SIT refer to the levied tax and 3.6 billion SIT to the deferred tax (mostly due to newly and reversed provisions for lawsuits of the controlling company). The taxation of the Group has increased from 14.4% to 21% which is mostly attributable to the smaller scope of tax benefits.

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

## Assets

By the end of the reporting period the assets of the Krka Group amounted to 188.8 billion SIT and increased by 21%. The share of current assets within the assets' structure increased from 31% to 36%. By the end of the year non-current assets represented 64% of the total assets and recorded an increase of 13%.

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

During the financial year current assets recorded an increase of 41% and as of the balance sheet date

amounted to 68.4 billion SIT. The respective rise is a result of the increased balance of inventories and receivables. Compared to the previous year, inventories increased by 45% or 8.9 billion SIT and by the year-end amounted to 29 billion SIT which is mostly due to the larger scope of production and sale, preparation of inventories for sale and production earmarked for the first quarter of 2006 as well as due to formation of safety stock especially for the most significant products. Operating receivables amounted to 33 billion SIT indicating an increase of 38%, which was a result of a higher sale in the last months of the year. Most of the receivables are not due yet.

## Equity and liabilities

The capital of the Group increased by 18% and has a 61% share in the structure of total liabilities. The respective increase is attributable mostly to the Group's net profit of 2005, which was 23.3 billion SIT. The decrease is due to the dividend payout of 4.8 billion SIT.

Non-current provisions increased by 5.5% and include provisions of 10.7 billion SIT for payables to employees and provisions of 12.8 billion SIT for lawsuits. Krka formed provisions in the amount of 12.5 billion SIT for the lawsuit relating to the medicine for the heart and cardiovascular diseases that is still in process and also reversed provisions that were formed for the lawsuit relating to simvastatin in the amount of 11.4 billion SIT as it ended in favour of the Krka Company. As for the balance sheets prepared in compliance with the IFRS, the Krka Company and the Krka Group formed provisions referring to termination pay and anniversary bonuses.

As of the balance sheet date borrowings amounted to 11.7 billion SIT and show a decrease of 20%. The Krka



Company raised no new loans and the decrease is almost entirely due to the repayment of the existing borrowings. Notwithstanding the subsidiaries Krka Zdravilišča and Krka Farma Zagreb took on new loans but in smaller scope.

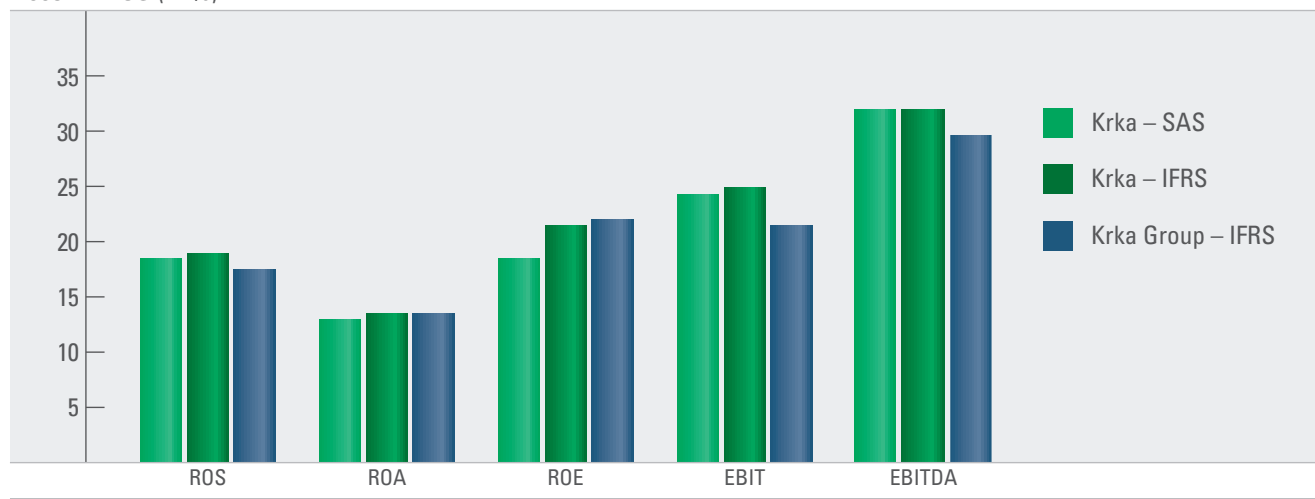
Current liabilities in the amount of 37.9 billion SIT are participating in the structure of total liabilities with a 20% share. This amount includes trade payables in the amount of 14.0 billion SIT that increased by 5.0 billion SIT or 55%. This increase was due to higher trade payables, a larger scope of acquisitions in the last quarter of the year, as well as agreed-upon longer payment terms. Due to the considerable increase of the corporate income tax levied, income tax liabilities rose to 6.7 billion SIT. Borrowings recorded at 9.1 billion SIT show an increase

of 73%, whereas long-term and short-term loans together increased by 5%. Half of the provisions and other current liabilities recorded at 8.1 billion SIT (a 56% increase) refers to current provisions for contractually based discounts on products sold in 2005.

## Ratios

Operational indicators of the Krka Company and the Krka Group are in compliance with strategic guidelines and objectives and indicate an increase compared to 2004. Net profit margin (ROS) of Krka Group achieved 17.6% (the Krka Company 19.3%), return on assets 13.5% (13.5%), return on equity 22.0% (21.3%), operating profit 21.5% (24.7%) and EBITDA share in net sales 29.7% (31.9%).

2005 RATIOS (in %)



# Risk management

## Foreign exchange risk

The international focus exposes the company to risks relating to foreign exchange movements. The key exchange rates in 2005 were EUR/SIT and EUR/USD. Other major currencies, PLN, MKD and RUB, were used by our main subsidiaries abroad. Net positions related to these currencies were insignificant in 2005, which means that the main focus was on managing the net long positions in EUR and USD.

As the EUR/SIT exchange rate was extremely stable, the net long EUR position did not materially affect our business. The USD/SIT and EUR/USD exchange rates, however, were much more volatile. The rapid growth of short-term interest rates in the United States led to the USD's gradual appreciation against both currencies. Despite the high level of volatility it had a positive impact on our performance in 2005. The exchange rate fell from 1.36 at the start of 2005 to close to 1.18 by the end of the year or by 13%. The fall resulted in foreign exchange gains arising from current transactions and translation of assets and liabilities.

We have hedged part of the planned net long USD position for 2006 with currency options and to a smaller extent with forward contracts. A small proportion of net long USD position remained unhedged. In addition, we continue matching foreign currency inflows and outflows in terms of their maturity and value.

## Interest rate risk

At the end of 2005, we had six long-term loans linked either to the 6-month LIBOR for the USD or to the 6-month EURIBOR.

We define interest rate risk as the uncertainty associated with future values of the above-mentioned short-term interest rates that directly determine its liabilities from long-term loans.

The US central bank raised its federal funds rate to 4.25% at year-end, which led to a rise in the 6-month LIBOR for USD. At the beginning of December, the European Central Bank followed suit, raising its main refinancing rate to 2.25%. Consequently, the 6-month EURIBOR rose as well.

Exposure to interest rate changes related to existing long-term loans was hedged prior to 2005. No new hedging instruments were bought during 2005.

The historically low interest rates on the international financial markets in recent years have prompted the company towards active interest risk management. We use effective duration of loans to evaluate its interest rate exposure. It enables us to identify the level of interest rate risk arising from long-term loans more accurately.

## Credit risk

We started carrying out credit control and other credit risk management related activities in the beginning of 2005. The process involves credit assessments of customers to which the parent company makes annual product sales worth over 100,000 EUR. We manage our credit exposure through regular monitoring of its operations and financial position, by restricting exposure to individual customers, and by utilizing a systematic and active receivables recovery process. The first results of the credit control process have been positive. We have reduced the total value of outstanding receivables, improved their maturity and reduced the average days sales outstanding. Over 250 of controlling company's customers were included in the daily credit control in 2005, which is fully supported by the SAP information system.

Last year we laid the foundations for implementing a similar credit risk management system in all key subsidiaries abroad. The system was launched at the start of 2006.

Receivables write-offs had no material impact on our financial position in 2005.

## Liquidity risk

Risks related to providing sufficient liquidity are managed through short-term and long-term cash flow planning. We use the SAP information system to prepare weekly, monthly and longer-term cash flow plans on a rolling basis. Plans are used in conjunction with short-term credit lines and a portfolio of money market instruments to fulfil short-term liquidity needs. We covered all cash flow requirements with short-term loans, thus no new long-term loan agreements were entered into in 2005.

Liquidity risk was very low in 2005, due to appropriate cash flow planning, agreed-upon credit lines and the ability to draw on additional funds quickly thanks to our high credit rating.

All liabilities were settled on time.

## Property, business interruption and liability insurance

We manage economic risks by using high quality insurance, optimizing loss retention, and preventive measures. Group insurance is managed at the corporate level. It includes the controlling company, all representative offices and all subsidiaries abroad via international insurance programmes.

Our fixed assets are exposed to the risk of natural disasters and perils. That means that economic risks from probable, sudden and unexpected events can reduce the value of our assets or reduce the possibility of increasing the assets' value, and thus reduce company earnings. The difference between the value of assets before and after an event is known as the economic loss.

Our insurance contracts set out in detail what events can lead to insurance payouts, what is actually insured, and the level of compensation in the case of damage liability. Based on past claim events, we have specified retention levels for losses and factors that reduce risks. These include preventive, technical and organisational measures, fire safety and anti-explosive measures, and other safety and protection measures to reduce risks. Consequently the insurance premiums have been reduced.

Insuring economic risks due to destruction, damage or disappearance of assets ensures compensation up to the actual value of equipment, inventories and other assets required for company's on-going operation, and compensation for the entire value of buildings and plant without depreciation. When assessing damage volume, we take into account the fact that our increasing size reduces the need to insure financial losses from minor risks. We have therefore introduced deductibles and transferred some of the risks to non-insurance subjects, in order to gradually increase retention levels and self-insurance.

When insuring liability to third parties that indemnify personal injury and/or material loss, maximum sums insured are set and the insurance company covers legally required compensation up to those limits, while also providing the company with the appropriate legal protection. Insurances that are specific to the pharmaceutical industry cover product liability, product recalls, clinical trials and environmental impairment liability.

Business interruption insurance ensures compensation for costs and loss of earnings should the production processes be interrupted. The sum insured covers labour costs, depreciation and other business expenses, and operating profit for a period of one year.

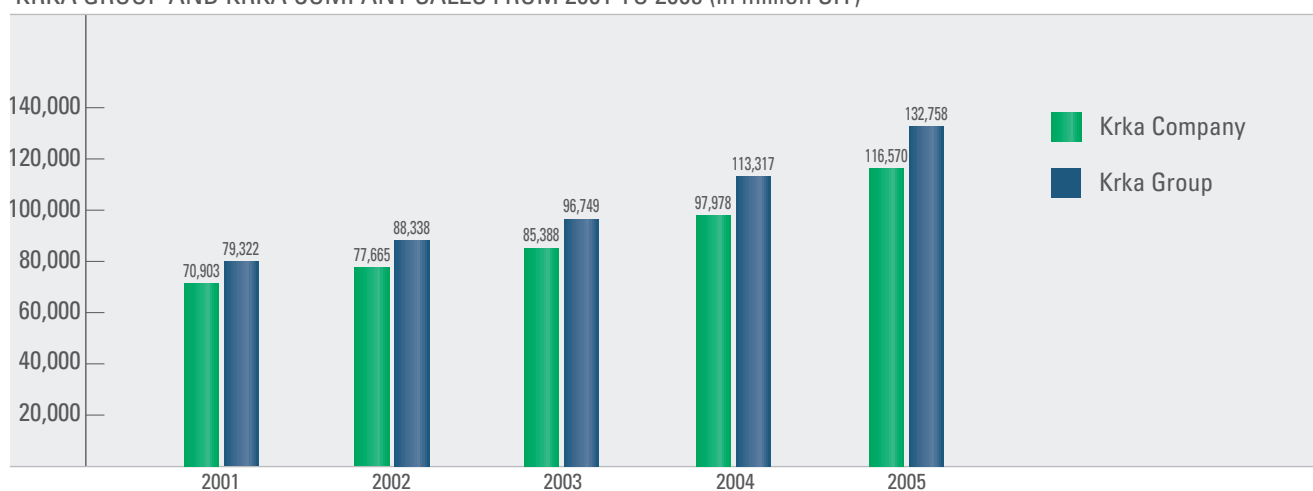
# Marketing and sales

## Krka achieves 17% growth

The sales results of the Krka Company and the Krka Group are presented below.

In 2005 the Krka Group sold 132.8 billion SIT worth of products and services, which is a 17% increase on 2004. The Krka Company sold 116.6 billion SIT worth of products, achieving a 19% increase in sales compared to 2004.

KRKA GROUP AND KRKA COMPANY SALES FROM 2001 TO 2005 (in million SIT)



KRKA GROUP AND KRKA COMPANY SALES BY REGIONS IN 2005

in million SIT	Krka Group	Proportion %	Krka Company	Proportion %
Slovenia	24,185	18	18,337	16
South-East Europe	22,629	17	20,027	17
East Europe	32,763	25	31,501	27
Central Europe	33,425	25	26,708	23
West Europe and Overseas Markets	19,756	15	19,997	17
<b>Total</b>	<b>132,758</b>	<b>100</b>	<b>116,570</b>	<b>100</b>

In 2005 the Krka Group achieved its highest sales growth in its Region East Europe and Region Central Europe, somewhat ahead of Region South-East Europe, where it nevertheless managed to achieve double-digit growth.

Sales in the Region Slovenia remained at the same level as in 2004, while sales in the Region West Europe fell somewhat after high growth in 2004.



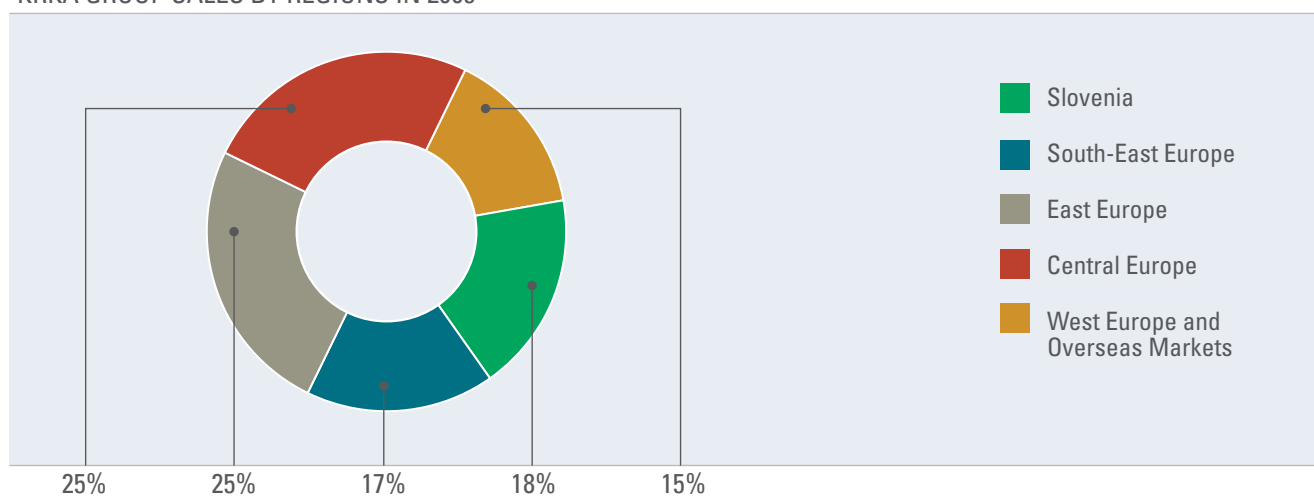
## KRKA GROUP SALES BY REGIONS IN 2004 AND 2005

in million SIT	2005	2004	Index 2005/2004
Slovenia	24,185	24,454	99
South-East Europe	22,629	20,397	111
East Europe	32,763	22,162	148
Central Europe	33,425	24,861	134
West Europe and Overseas Markets	19,756	21,443	92
<b>Total</b>	<b>132,758</b>	<b>113,317</b>	<b>117</b>

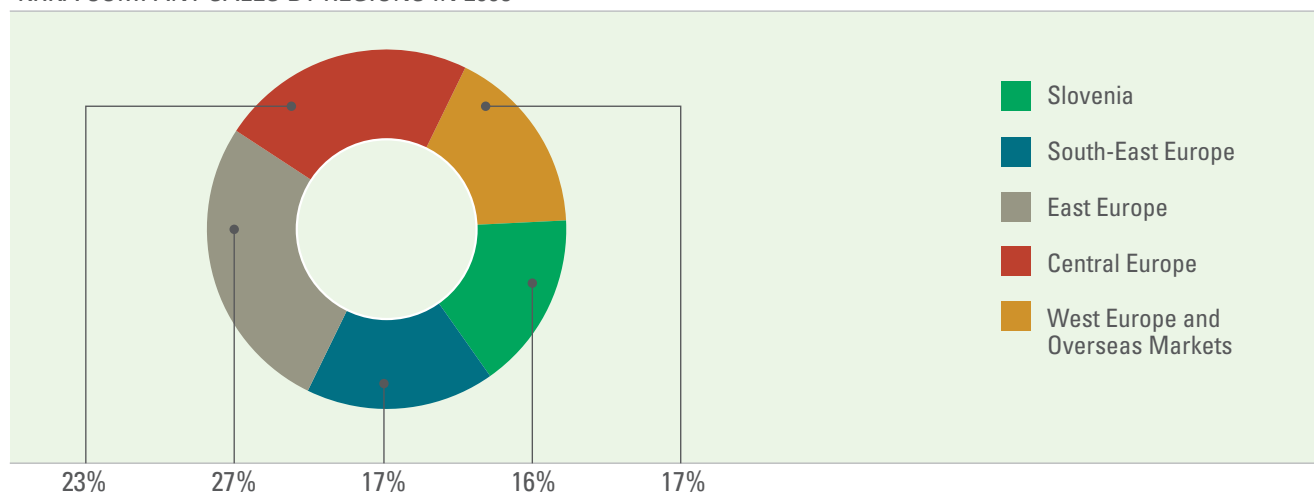
## KRKA COMPANY SALES BY REGIONS IN 2004 AND 2005

in million SIT	2005	2004	Index 2005/2004
Slovenia	18,337	18,475	99
South-East Europe	20,027	16,798	119
East Europe	31,501	22,135	142
Central Europe	26,708	19,380	138
West Europe and Overseas Markets	19,997	21,190	94
<b>Total</b>	<b>116,570</b>	<b>97,978</b>	<b>119</b>

## KRKA GROUP SALES BY REGIONS IN 2005



## KRKA COMPANY SALES BY REGIONS IN 2005



## Slovenia

Sales by the Krka Company in Slovenia were 1% down on sales in 2004 but still reached 18.3 billion SIT. The highest sales were for prescription pharmaceuticals for human consumption (referred to below as prescription pharmaceuticals) and self-medication products, together representing 93% of all sales. Sales of animal health products and cosmetics in particular were much lower due to the rationalisation of the product range and Krka's strategic decision to focus on its most promising key cosmetics brands.

The Krka Group, including the Krka Zdravilišča health resorts, generated 24.2 billion SIT from sales of products and services, which is 1% down on 2004.

In 2005 Krka placed new prescription pharmaceuticals on the market such as Rawel<sup>®</sup> SR, and Triginet<sup>®</sup>, and new forms of established medicines such as Kamiren<sup>®</sup> XL prolonged-release tablets, a new strength of Atoris<sup>®</sup> and others. We also launched Bilobil<sup>®</sup> forte, a new self-medication product.

We are the leading prescription pharmaceutical producer in three key areas of cardiovascular treatment – statins, ACE inhibitors and sartans. Despite the fierce competition we have acquired a market share for proton pump inhibitors, and our sales market share is also growing among pharmaceuticals for treatment of the central nervous system. We retained our leading position on the pharmaceutical market with a market share of over 17%.

## South-East Europe

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

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

In Croatia, the largest individual market in Region South-East Europe representing almost 40% of the entire region and one of the Krka's five key markets, the Krka Group achieved sales of 9 billion SIT, which is 9% more than in 2004. The Krka Company recorded sales of 7 billion SIT in

Croatia, an increase of 25% on the previous year. Krka is therefore the third ranking pharmaceutical producer in Croatia, just behind the two largest domestic producers. Three newly launched prescription pharmaceuticals – Atoris<sup>®</sup>, Tenox<sup>®</sup> and Zyllt<sup>®</sup> – contributed most to the increased growth. Krka will further consolidate its position in Croatia with its new production and distribution centre in Jastrebarsko, near Zagreb, where production of Tenox<sup>®</sup> and Zyllt<sup>®</sup> for the Croatian market took place in 2005. The plan in 2006 is to produce additional products in this plant for the Croatian and other markets.

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

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

## East Europe

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

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

The most important market in this region is the Russian Federation, which is also one of Krka's key markets. Sales increased by 47% compared to 2004. The highest growth was in prescription pharmaceuticals which represent 80% of overall sales. Their sales increased by 60%, compared to 2004. Krka's successful performance – with sales growth higher than the overall growth of the market

– saw it become the second most successful company in its sector in the Russian Federation. Krka also advanced one place in the rankings for a key pharmaceutical market segment – prescription pharmaceuticals – moving up to third place in the sales ranking. The growth of sales can be attributed to marketing of new products, and previous organisational changes that improved efficiency and making best use of new market conditions. These new circumstances included the introduction of new lists of pharmaceuticals covered by health insurance for specific patient groups. At the same time we almost doubled our marketing. The Krka-Rus company, where production started in 2004, supplies the market with two key products: Vasilip® and Nolicin®. Preparations are also underway for the manufacture of new products.

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

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

## Central Europe

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

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

medication products, Krka's most successful products were Bilobil® and products under the umbrella brand Pikovit®. Sales of animal health products were somewhat higher than in 2004.

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

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

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

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

## West Europe and Overseas Markets

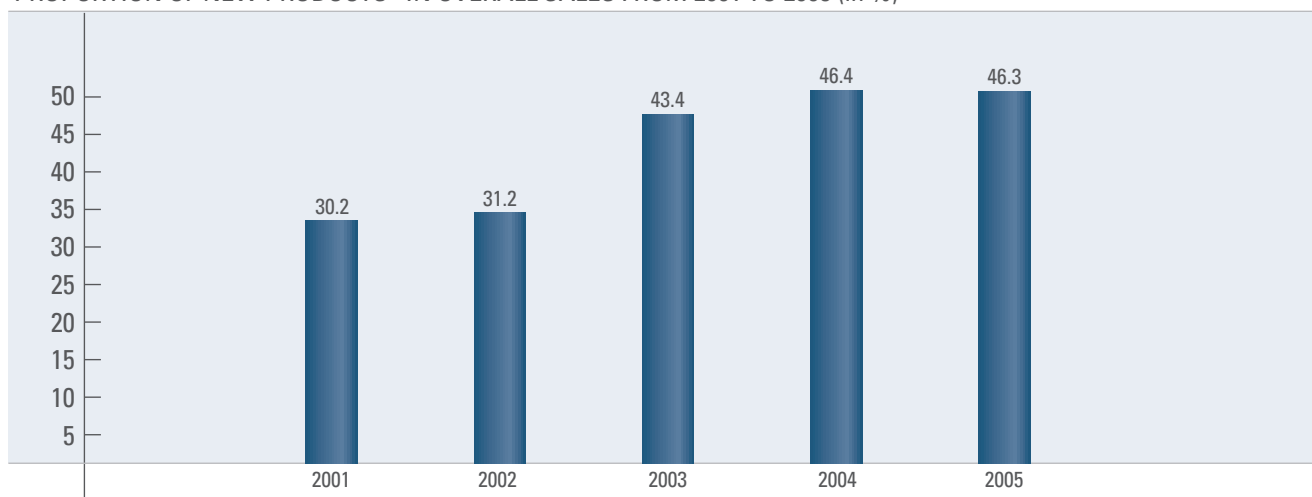
Krka's Region West Europe and Overseas Markets sold products worth 19.8 billion SIT, eight percentage points behind the 2004 sales figures. Sales on the markets of western Europe, another key market, represented 90% of sales in this region. The most important markets are Germany, Great Britain, the Nordic countries, and the Netherlands. Most of the sales were of prescription pharmaceuticals, which in cooperation with our partners, are now sold in almost all western European countries. In 2005 we started direct sales of Krka prescription pharmaceuticals in the Nordic countries, via Krka Sverige, Krka's Swedish subsidiary, which strengthened Krka's presence on those markets. We also successfully introduced sertraline tablets and lansoprazole capsules. With large market shares on the western European markets, Krka is the leading supplier of generic amlodipine, lansoprazole, carvedilol and norfloxacin and one of the leading suppliers of generic enalapril, simvastatin and mirtazapine. The Region recorded its highest growth in sales compared to 2004 in Africa, southern EU member states, and parts of Asia.

## New products making key contributions to sales growth

Krka continually offers new products to its markets in accordance with our business strategy and the opportunities offered through its consistent respect for the intellectual property of others. In 2005 Krka's new prescription pharmaceuticals included the following: the diuretic Rawel® SR (indapamide), the antiepileptic

Triginet® (lamotrigine), the platelet aggregation inhibitor Zylt® (clopidogrel) and at the end of the year, the antihypertensive Prenessa® (perindopril). At the same time we expanded our range of products under existing trademarks with the products Kamiren® XL (a doxazosin in a new and innovative prolonged-release formulation) and the Atifan® cream (terbinafine), while other existing products were supplemented by versions with new active ingredient strengths.

PROPORTION OF NEW PRODUCTS\* IN OVERALL SALES FROM 2001 TO 2005 (in %)



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

## Product groups

Prescription pharmaceuticals are Krka's most important product group, constituting 80% of overall sales. They are followed by self-medication products, health resort services, animal health products and cosmetics.

Krka recorded a growth in sales compared to 2004 in every product group except cosmetics, due to the decision to reduce the range of cosmetic products and focus on a select number of key brands.

### KRKA GROUP AND KRKA COMPANY SALES BY PRODUCT GROUPS IN 2005

in million SIT	Krka Group	Proportion %	Krka Company	Proportion %
Human health products*	121,884	92	111,762	96
– Prescription pharmaceuticals	105,743	79	95,974	82
– Self-medication products	14,108	11	13,826	12
– Cosmetic products	2,033	2	1,962	2
Animal health products	4,796	4	4,603	4
Health resorts and tourist services	5,848	4		
Other	230		205	
<b>Total</b>	<b>132,758</b>	<b>100</b>	<b>116,570</b>	<b>100</b>

\* Sales of cosmetic products were recorded as consumer health products in 2005 due to organisational changes. The 2004 data has been adapted accordingly.



## KRKA GROUP SALES BY PRODUCT GROUPS IN 2004 AND 2005

in million SIT	2005	2004	Index 2005/2004
Human health products*	121,884	103,039	118
– Prescription pharmaceuticals	105,743	87,704	121
– Self-medication products	14,108	12,451	113
– Cosmetic products	2,033	2,884	70
Animal health products	4,796	4,133	116
Health resorts and tourist services	5,848	5,966	98
Other	230	179	128
<b>Total</b>	<b>132,758</b>	<b>113,317</b>	<b>117</b>

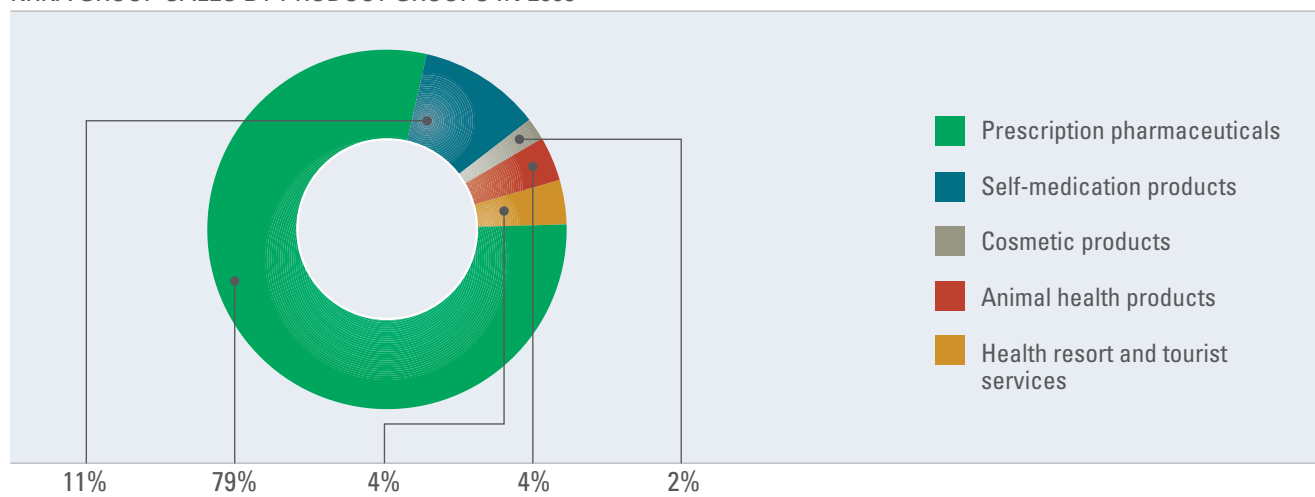
\* Sales of cosmetic products were recorded as consumer health products in 2005 due to organisational changes. The 2004 data has been adapted accordingly.

## KRKA COMPANY SALES BY PRODUCT GROUPS IN 2004 AND 2005

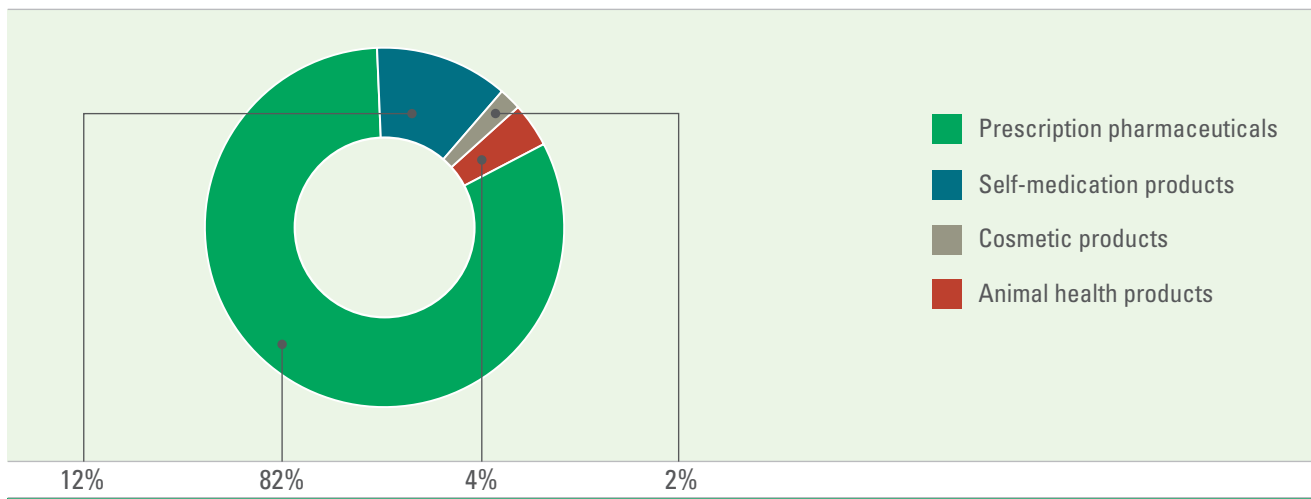
in million SIT	2005	2004	Index 2005/2004
Human health products*	111,762	93,947	119
– Prescription pharmaceuticals	95,974	79,848	120
– Self-medication products	13,826	11,363	122
– Cosmetic products	1,962	2,736	72
Animal health products	4,603	3,884	118
Other	205	147	139
<b>Total</b>	<b>116,570</b>	<b>97,978</b>	<b>119</b>

\* Sales of cosmetic products were recorded as consumer health products in 2005 due to organisational changes. The 2004 data has been adapted accordingly.

## KRKA GROUP SALES BY PRODUCT GROUPS IN 2005



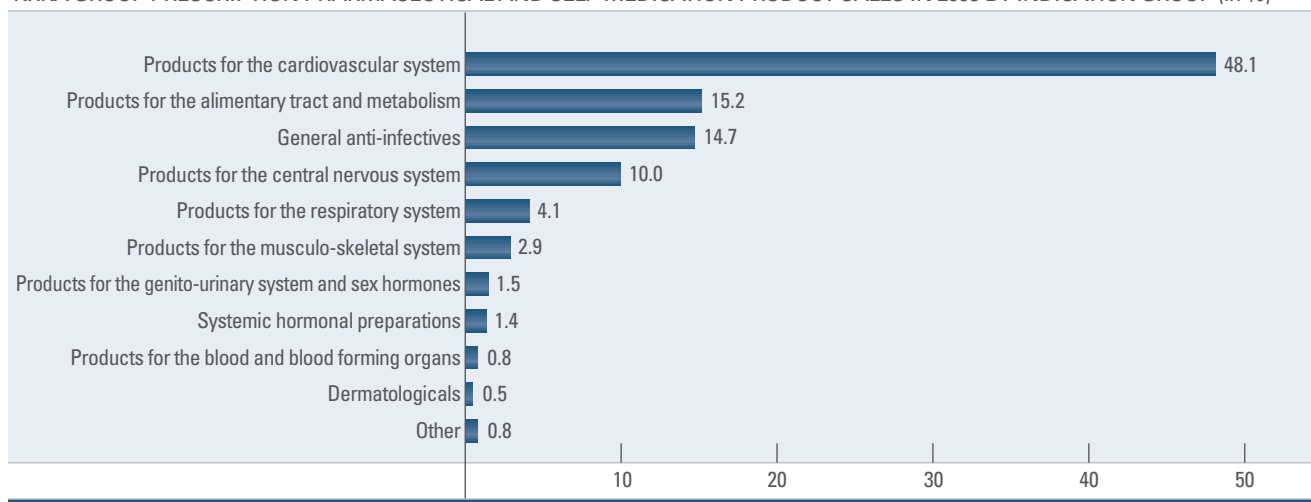
## KRKA COMPANY SALES BY PRODUCT GROUPS IN 2005



Krka produces a wide range of medicinal products for the treatment of human diseases, for the most important indication groups. The leading products are for treating cardiovascular diseases, representing almost 50% of

sales. Compared to 2004, the proportion of medicines for the treatment of the central nervous system sold increased again.

## KRKA GROUP PRESCRIPTION PHARMACEUTICAL AND SELF-MEDICATION PRODUCT SALES IN 2005 BY INDICATION GROUP (in %)

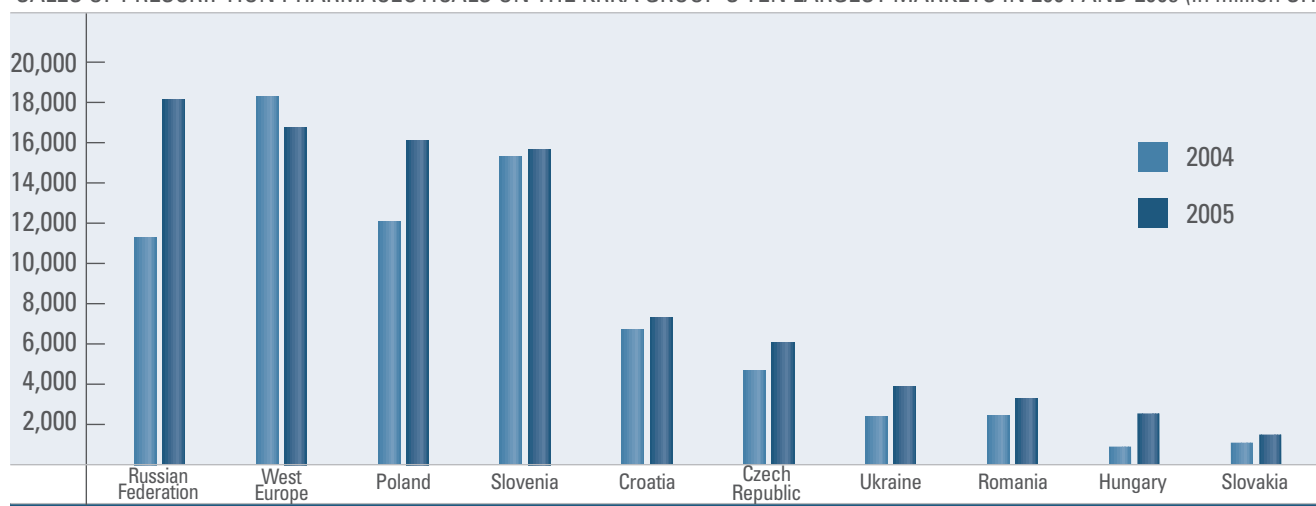


## Prescription pharmaceuticals

In 2005 the Krka Group sold prescription pharmaceuticals worth 105.7 billion SIT, 21% more than in 2004. The Krka Company sold 96 billion SIT of these products, 20% more than in 2004.

The highest growth on the Krka Group's top ten markets was in Hungary (index 283), followed by Ukraine (index 164), the Russian Federation (index 160), and Slovakia (index 149), while growth of over 30% was recorded in Poland, Romania and the Czech Republic.

SALES OF PRESCRIPTION PHARMACEUTICALS ON THE KRKA GROUP'S TEN LARGEST MARKETS IN 2004 AND 2005 (in million SIT)



## Medicines for the treatment of cardiovascular diseases

Statins form a class of important modern medicines for the treatment and prevention of cardiovascular disease. In 2005 Krka was the leading company in the field of statins in Central, East and South-East Europe. Furthermore, Vasilip® (simvastatin) was also the leading generic statin in 2005 on the central, east and south-east Europe markets. Atoris® (atorvastatin) is the fastest growing statin on these markets in terms of sales. Due largely to these two well-established products (Vasilip® and Atoris®), in 2005 Krka retained its position as the leading statin producer in Slovenia, with a market share of almost 50%, as well as a market share of nearly 30% in Ukraine, and around 20% in Poland and the Russian Federation. Krka is also the leading statin company in Lithuania, while in Croatia, Latvia and Kazakhstan it is the leading generic producer. Krka is also one of the leading suppliers of generic simvastatin on western Europe markets. In 2005, over one million patients placed their trust in Krka's simvastatin and atorvastatin tablets.

The importance of statins in clinical practice was further strengthened in 2005 by numerous clinical research works proving that intense treatment with larger doses of statins further reduces LDL cholesterol, lowering the risk of cardiovascular disease developing or progressing. Krka is also keeping pace with new trends in the field. At the end of the year, it started to market a new 40 mg form of Atoris® (atorvastatin) in Slovenia, which will also be launched on other markets in the coming year.

The company also has an impressively wide range of medicines to reduce high blood pressure. The best selling product in 2005 was again Enap® (enalapril), with a large range of fixed combinations of enalapril with hydrochlorothiazide Enap®-H, Enap®-HL and Enap®-HL 20, which enables the more effective treatment of patients with more resistant forms of arterial hypertension. Enap® is still the leading enalapril in the Russian Federation, Slovenia, Czech Republic, Slovakia, Lithuania, Croatia, Bosnia and Herzegovina, Macedonia, Kazakhstan and Albania.

The range of medicines affecting the renin-angiotensin-aldosterone system was expanded at the end of 2004 with the addition of Ampiril® (ramipril). During its first year on the market it had already acquired a market share of over 10% of the total ramipril market in Slovenia and the Czech Republic.

We added a new angiotensin-converting enzyme (ACE) inhibitor, Prenessa® (perindopril) to the existing brands at the end of 2005, which is the result of Krka's innovative synthesis and formulation work. Prenessa® is available in Hungary and in Slovenia, where it is the first generic perindopril on the market.

Angiotensin II receptor inhibitors (sartans) are a contemporary medicine group for the treatment of hypertension, and have a very good patient response. Lorista® (losartan) has a share of over 30% of the losartan market in Slovenia, the Czech Republic, Slovakia, Bulgaria, Lithuania, Macedonia and Poland. The Polish

market promises to offer the highest growth in the future, following the relaxation of restrictions on the prescription of these medicines in the second half of 2005. Krka expanded its range of Lorista® products to include Lorista® H and Lorista® HD, fixed combinations of losartan and diuretics.

Amlodipine is the world's leading medicine for the treatment of arterial hypertension, and is available on nearly all Krka markets. Krka has offered Tenox® (amlodipine) anti-hypertensive since 2002. In 2005 it was placed on the markets of the Russian Federation, Ukraine, Latvia, Romania, Hungary, Croatia, Kosovo and Albania. Huge success was achieved in Croatia, where despite fierce competition, Tenox® managed to achieve a 9% share of the amlodipine market in its first year. Sales were also very good in Poland and Lithuania, where it is one of the leading amlodipines with a market share of over 20%. Krka's excellent sales of amlodipine tablets in Region West Europe continued, where it remains the leading generic amlodipine producer.

Coryol® (carvedilol) is an excellent medicine for the treatment of high blood pressure, angina pectoris and heart failure. In 2005 Krka retained its position as the leading carvedilol producer in Slovenia, Ukraine and Lithuania, with a very high market share (over 70%). In autumn we placed Coryol® on the Hungarian market, where we also expect a high market share in the coming years. The excellent sales of Krka's carvedilol tablets continued in its Region West Europe where Krka holds the highest market share for generic carvedilol on several markets.

Krka expanded its already wide range of anti-hypertensive medicines with the new product Rawel® SR (indapamide). Rawel® SR is a modern diuretic in prolonged-release tablet form, which ensures 24-hour control of high blood pressure. It is ideal for treating high blood pressure in combination with Krka's other anti-hypertensive products. In 2005 Krka started to sell Rawel® SR in Slovenia, where it achieved an 18% market share, and on the markets of Lithuania and Slovakia.

Zyllt® (clopidogrel) is a modern thrombocyte aggregation inhibitor that prevents the aggregation of platelets and formation of blood clots, providing cardiovascular patients with additional protection. Krka Farma Zagreb, which produces and markets the product, launched Zyllt® in Croatia, becoming the first company to offer doctors the choice of clopidogrel treatment on that market. Within two months (by the end of September) Zyllt® had attained a 5% market share of the entire platelet aggregation inhibitor market, and a 21% share of the market for platelet aggregation inhibitors with the same function.

### Medicines for the treatment of infections

Clarithromycin is the leading macrolide antibiotic in Europe and is the first choice drug for empiric treatment

of respiratory infections. Its great importance means it has been included in Krka's antibiotic range for several years. To date it has been used to treat over five million patients. Krka has achieved large market shares in most clarithromycin markets with Fromilid®: up to 10% in Belarus, up to 20% in the Czech Republic and Hungary, 20 to 30% in Russian Federation and Lithuania, and 30 to 40% in Bulgaria, Romania and Ukraine, 45 to 55% in Croatia and Latvia and as high as 85% in Slovenia.

Fromilid® uno is a pharmaceutical product with an innovative formulation – it is the first generic clarithromycin on most markets to offer prolonged release, which means it only needs to be taken once a day. In 2005 Krka launched Fromilid® uno in Ukraine, Poland, the Czech Republic and Romania.

In Poland we expanded our range of antimicrobials to include azalide antibiotic Azibiot® (azithromycin), the main feature of which is simple and short administration. Azibiot® has now been available for over a year in Slovenia.

There was further growth in sales of Nolicin® (norfloxacin), the only fluoroquinolone that acts locally in the urinary and digestive tract, which is used mainly to treat urinary infections. Last year was an anniversary for Nolicin® in a number of countries, including 20 years of use in Croatia and Slovenia. Nolicin® remains the leading norfloxacin in Slovenia, Croatia, Poland, Hungary and Bulgaria, with a market share of over 90%, while its market share in Slovakia is over 75%, and over 65% in Romania and the Russian Federation. It has retained its position as the leading generic norfloxacin in western Europe.

The systemic fluoroquinolone Ciprinol® (ciprofloxacin) is holding and even increasing its market share, which ranges between 35 and 60% in Croatia, Slovenia, Ukraine, Latvia, Lithuania, and the Czech Republic. The parenteral forms of Ciprinol® – intended for treatment of particularly serious infections – have a leading position on the market in Romania, Bulgaria, Latvia and Lithuania (all over 85% market shares), in Croatia (65%) and Ukraine (50%).

In the field of treatment for fungal infections Krka produces Diflazon® (fluconazole), for the treatment of candidal infections, and Atifan® (terbinafine), which treats skin infections caused by dermatophytes. Atifan® was first released in Slovenia in 2004 in tablet form, and a year later was launched as a cream. In 2005 the oral administration form had already achieved a 30% market share.

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

Proton pump inhibitors are among the most important medicines for the treatment of gastrointestinal and



metabolic diseases. Krka offers two medicines in this group: Ultop® (omeprazole) and Lanzul® (lansoprazole). Lanzul® is a modern proton pump inhibitor with a rapid and powerful effect on stomach secretion. It is a leading proton pump inhibitor in Poland, with a market share of around 10%. It is also successfully marketed in Croatia where its market share is over 15%, while in Slovenia and the Czech Republic it has a 4 to 5% share of the overall proton pump inhibitor market. At the end of 2005, Krka enjoyed exceptional success with the start of sales of lansoprazole capsules on western European markets.

Ultop® – produced by Krka for over 15 years – remains an important proton pump inhibitor. In Slovenia its share is almost 75% of the omeprazole market, and almost half of the entire proton pump inhibitor market, making it the leading medicine in this group on the Slovenian market. In the Russia Federation sales increased considerably compared to 2004.

### **Medicines for the central nervous system**

In 2005 we continued the geographical spread of our anti-depressants, including primarily Asentra® (sertraline) which was launched in Russian Federation, Hungary, and Bosnia & Herzegovina, while Mirzaten® (mirtazapine) was launched in the Czech Republic, Hungary, Poland, Slovakia and Romania.

Asentra® is the leading generic sertraline on Krka's traditional markets, with a total market share of over 20% for overall sertraline sales. In Poland its share of the sertraline market is over 70%, in Slovenia and Lithuania almost 50%. Asentra® is one of the best selling anti-depressants in Lithuania, Slovenia, Poland and the Czech Republic.

Mirzaten® is also very successful, although it has only been present on most markets for a few months. Its total share of the mirtazapine market on Krka's traditional markets is already around 9%. Less than half a year after

its launch it represented over 10% of mirtazapine sales in Poland, and over 14% mirtazapine sales in Slovakia.

Krka has had a market presence in the treatment of schizophrenia for over a year with olanzapine, which is the leading antipsychotic and one of the world's best selling medicines. Zalasta® (olanzapine) achieved a market share of almost 25% (of all olanzapines) in its first nine months on the Polish market.

Since 2002 Krka has also offered medicine to treat Alzheimer's in the shape of Yasnal® (donepezil). In 2004 Krka achieved the highest growth and occupied seventh place in the world for products to treat Alzheimer's and fourth on the donepezil market. In Slovenia Yasnal® has an 85% share of the donepezil market, while its market share was over 75% in Slovakia, over 40% in Poland, and over 35% in Lithuania. In less than a year since its launch, Yasnal® has reached one fifth of sales for all Alzheimer's disease medication in Lithuania and Slovakia.

In 2005 Krka supplemented its range of medicines for the central nervous system with the launch of Trignet® (lamotrigine), an anti-epileptic medicine. It is a modern medicine that is used to treat a number of different forms of epilepsy in children and adults, and to treat adults suffering from bipolar disorder. Lamotrigine is one of the best selling anti-epileptic medicines in the world. Trignet® went on sale in Slovenia, Poland and Lithuania in 2005.

### **Medicines for the treatment of benign prostatic hypertrophy**

Krka added to its medicines for benign prostatic hypertrophy, supplementing Kamiren® (doxazosin, which also reduces high blood pressure) with Kamiren® XL (doxazosin in prolonged-release tablet form), which came onto the market in Slovenia, Latvia and Lithuania. The success of Kamiren® XL tablets in Slovenia is confirmed by the fact that it achieved a 30% market share among prolonged-release doxazosins in just six months.

## Self-medication products and cosmetics

In 2005 the Krka Group sold 14.1 billion SIT worth of self-medication products, 13% more than in 2004. Of this, the Krka Company sold products worth 13.8 billion SIT, 22% more than during the previous year.

On Krka's 10 largest markets, the highest growth was achieved in Ukraine (index 169), the Czech Republic (index 130) and Romania (index 123), while double-digit growth was also achieved in Kazakhstan and Macedonia.

The most successful self-medication brands were Bilobil<sup>®</sup>, Pikovit<sup>®</sup> and Septolete<sup>®</sup>.

Bilobil<sup>®</sup> is the leading product with ginkgo biloba extract in Romania. In Poland, the Russian Federation and Ukraine it lies in second place. Bilobil<sup>®</sup> forte has significantly contributed to sales growth.

The Pikovit<sup>®</sup> brand includes five different products for different age groups and has a leading market share among vitamins for children (between 20 and 85%) in the Russian Federation, Ukraine, Kazakhstan, Romania and Slovenia.

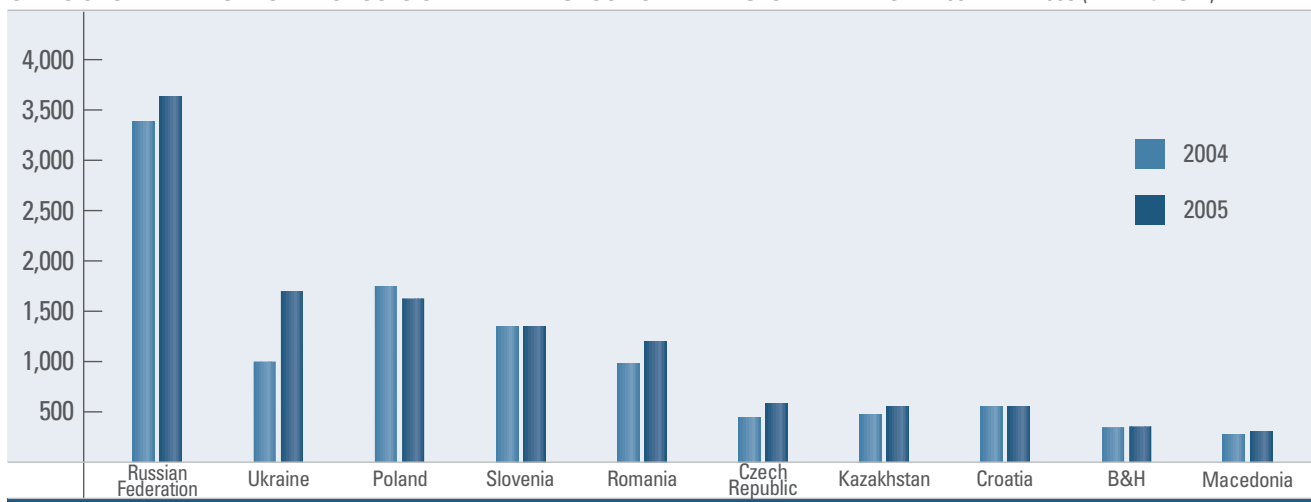
Septolete<sup>®</sup> is a leader among self-medication products. Septolete<sup>®</sup> plus, responsible for very good sales in Poland, will be joined by some new products in the first half of 2006.

The new products Duovit<sup>®</sup> for men and Duovit<sup>®</sup> for women are now being sold in the Russian Federation, Romania, and Ukraine, as well as Duovit<sup>®</sup> memo in the Russian Federation, Bilobil<sup>®</sup> forte in Slovenia and the Russian Federation. There are also new products under the Pikovit<sup>®</sup> umbrella brand in the Czech Republic, Slovakia, the Russian Federation and Ukraine.

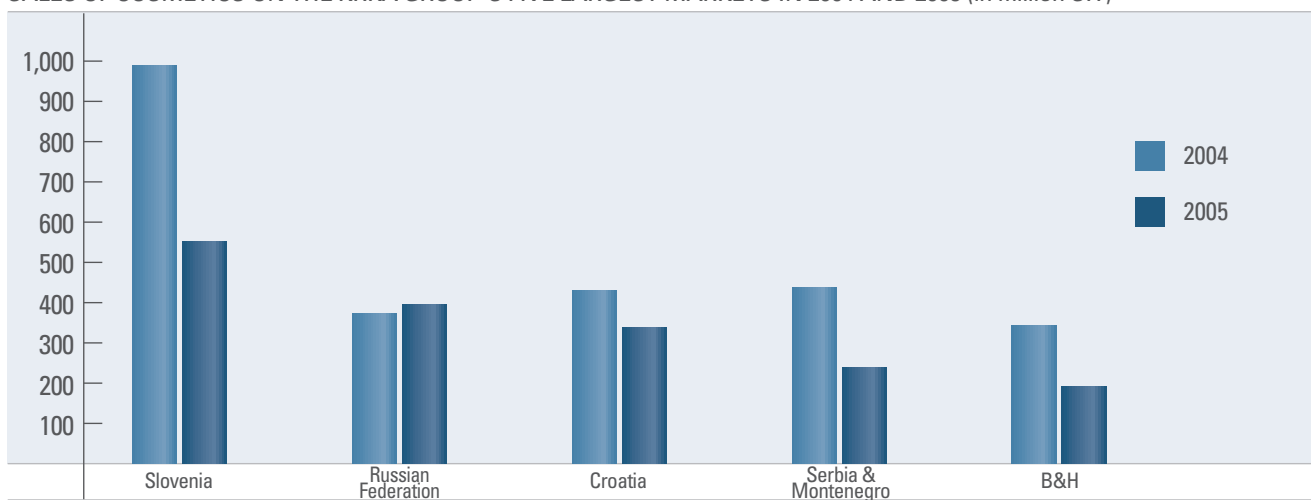
In 2005 the Krka Group sold cosmetics worth 2 billion SIT, around 30% less than in 2004.

Krka's reorganisation of its own cosmetics sector was completed in May 2005. Marketing activities for cosmetics were re-organised and united under Self-Medication and Cosmetics. The future development will be to offer cosmetics to consumers in points-of-sale where Krka already has a presence with other products. The focus of the product range was on Krka's key brands Vitaskin<sup>®</sup>, Fitoval<sup>®</sup> and Sun mix<sup>®</sup>.

SALES OF SELF-MEDICATION PRODUCTS ON THE KRKA GROUP'S TEN LARGEST MARKETS IN 2004 AND 2005 (in million SIT)

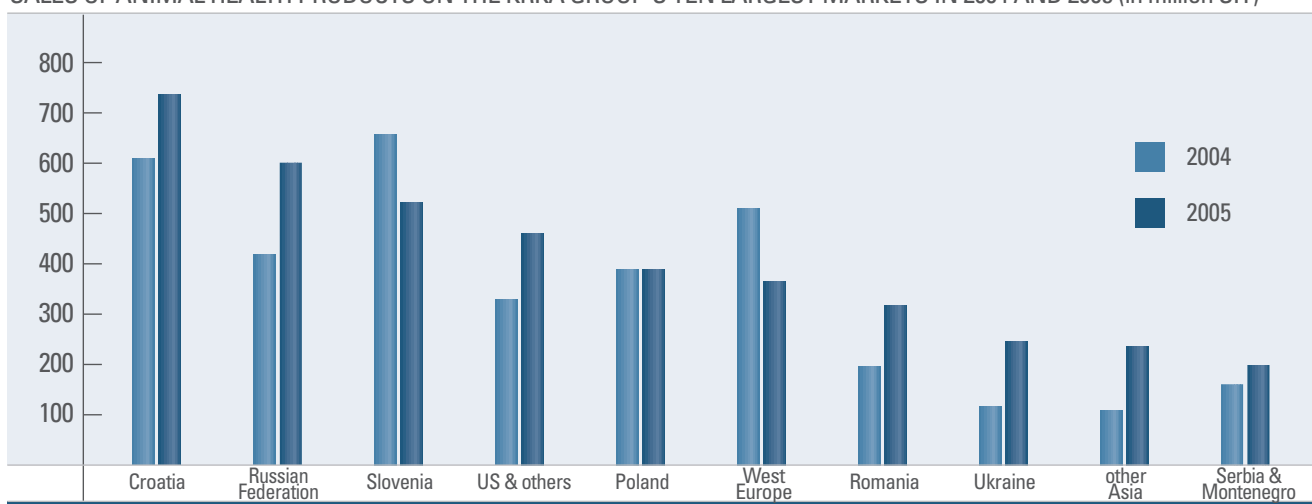


SALES OF COSMETICS ON THE KRKA GROUP'S FIVE LARGEST MARKETS IN 2004 AND 2005 (in million SIT)





SALES OF ANIMAL HEALTH PRODUCTS ON THE KRKA GROUP'S TEN LARGEST MARKETS IN 2004 AND 2005 (in million SIT)



## Animal health products

In 2005 the Krka Group sold 4.8 billion SIT worth of animal health products, 16% more than in 2004. Of this, the Krka Company sold products worth 4.6 billion SIT, 18% more than the previous year.

The highest growth in the sale of animal health products on Krka's ten largest markets was in Ukraine where sales doubled, Romania (index 160) and the Russian Federation (index 143), and in the US and Canada (index 139).

Krka's two key animal health products are the anti-microbial medicines Enroxil® (enrofloxacin), and Floron® (florfenicol). Compared to 2004 sales of zinc bacitracin increased, as did sales of the Virkon® S disinfectant due to the avian flu situation.

## Health resorts and tourism

The company Krka Zdravilišča combines business units of the health resorts (spas) and hotels Zdravilišče Dolenjske Toplice, Zdravilišče Šmarješke Toplice, Hoteli Otočec and Hotel Krka in Novo mesto. It also has majority ownership of the company Krka Zdravilišče Strunjan. Its consolidated sales revenues for 2005 were worth 5.8 billion SIT.

The Krka Zdravilišča group recorded 316,969 overnight stays, of which 104,164 were sold to foreign guests, around one third of all overnight stays. The average occupancy of accommodation capacity was 68%, while the average occupancy of our health resort capacity was 81%.

# Research and development

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

## Vertical integration – competitive advantage

Krka's excellent performance in carrying out the research work and applying the specialist know-how required by API synthesis and pelleting technology, is reflected in achievements such as the receipt of regulatory approval of lansoprazole capsules. Lansoprazole was placed on the market in capsule form in western European countries the very next day after the original patent expired. Vertical integration and overall product management from the active ingredient and formulation phases to the documentation and marketing authorisation management processes, once again proved to be the key to achieving set objectives. Total product management was also a major advantage in Krka's success with the tablet Prenessa® (perindopril), for which we gained marketing authorisation in Hungary, the Russian Federation, the Czech Republic and Slovenia. Krka was the first generic producer to successfully launch perindopril tablets in Hungary. Another of Krka's vertically integrated products is Zyllit® (clopidogrel) in tablet form, which was granted marketing authorisation in Croatia at the end of 2004. In 2005 we became the first generic producer with a clopidogrel on this market.

In 2005 we successfully concluded 13 MRPs (Mutual Recognition Procedures). Krka's high quality of work on marketing authorisation procedures and continual

strengthening of partnerships and trust with regulatory agencies in countries throughout central, eastern and south-eastern Europe have enabled Krka to become the first pharmaceutical company to successfully conclude MRP for registration of a product (Losartan tablets) from new EU member state, Czech Republic, to some countries of western and central Europe.

Krka was also the first company to successfully register the product through an MRP from Slovenia in the other new EU member states.

Another successful marketing authorisation in western European countries came in 2005 with the approval of Krka's first animal health product there. In Ireland and the United Kingdom, we gained a marketing authorisation for enrofloxacin in oral solution dosage form.

The Krka subsidiaries continue to successfully obtain marketing authorisations, which represents a significant time saving in getting products onto the market. In 2005 the Krka-Rus company gained marketing authorisations for Rawel® SR (indapamide) tablets, Prenessa® (perindopril) tablets and Zyllit® (clopidogrel) tablets, while Krka-Farma in Zagreb received authorisations for Laaven® (lisinopril) and Laaven® HCTZ tablets (lisinopril and hydrochlorothiazide) tablets.

In 2005 Krka obtained marketing authorisations for 272 products in 552 pharmaceutical forms on its traditional markets. On behalf of the Krka Company and its partners, Krka Sverige AB – Krka's Swedish based subsidiary – obtained 113 marketing authorisations for 12 products in 41 forms in the countries of western Europe.

## Prescription pharmaceuticals

In 2006, six new products were granted marketing authorisations. The most important first marketing authorisations for vertically integrated products were for Prenessa® (perindopril) 2 mg and 4 mg tablets in Hungary,

NUMBER OF NEW MARKETING AUTHORISATIONS FOR KRKA BY REGIONS 2003–2005

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



the Russian Federation, in Slovenia and in the Czech Republic and for lansoprazole capsules on western European markets. We continue the procedures for gaining marketing authorisation for Zyllt® (clopidogrel) tablets in the Russian Federation, Serbia & Montenegro and Bosnia & Herzegovina.

Development work is another facet of fulfilling one of Krka's major objectives – to offer a range of pharmaceuticals covering our key therapeutic groups. In Slovenia and Finland we have added Torendo® (risperidone) to our range of pharmaceuticals for the central nervous system. In addition to 0.5 mg, 1 mg, 2 mg, 3 mg and 4 mg tablets and oral solution (1mg/ml), in Slovenia we also gained authorisation for Torendo® Q-Tab®, an orodispersible tablet, available in 0.5 mg, 1 mg and 2 mg strengths. This concluded one of our first projects realising new orodispersible tablet technology, which is based on Krka's proprietary knowledge and production. Orodispersible pharmaceutical forms are intended for patients who have problems swallowing. The tablets dissolve very quickly in the mouth so patients can take them without having to drink any liquid. This significant advantage means that managing the development and production of oral dispersible tablets is not only important for pharmaceuticals that work on the central nervous system, but also for pharmaceuticals in other therapeutic areas. This presents a key advantage for generic products.

Triginet® (lamotrigine) tablets, for which we obtained a marketing authorisation in Slovenia in 2004, were authorised in 2005 in all the new EU member states.

In Krka's cardiovascular range, in addition to Prenessa® (perindopril) tablets, new marketing authorisations were granted for Ampril® (ramipril) and Ampril® HCTZ (ramipril + hydrochlorothiazide) tablets in the new EU member states. In the Czech Republic, Hungary, Latvia, Slovakia and Slovenia, we gained marketing authorisations for 40 mg Atoris® (atorvastatin) tablets.

In 2005 Krka obtained a marketing authorisation in Finland and Sweden for a new product with the active ingredient glimepiride (in 1 mg, 2 mg, 3 mg, 4 mg, and 6 mg tablets), to expand its range of products for treating diabetes.

The granting of marketing authorisations for Rawel® SR tablets, which contain the active ingredient indapamide, and their launch on the markets of all the new EU member states, clearly demonstrated Krka's high level of know-how about special delivery systems from their development to the grant of marketing authorisations and production.

Using the Cadreac marketing authorisation procedure also significantly reduced the time needed to obtain marketing authorisations in Romania and Bulgaria. This was used in 2005 to gain marketing authorisations for Tenox® (amlodipine maleate) tablets, Coryol® (carvedilol) tablets and Mirzaten® (mirtazapine) tablets in Romania and Vasilip® (simvastatin) tablets in Bulgaria.

#### NUMBER OF PRESCRIPTION PHARMACEUTICAL MARKETING AUTHORISATIONS BY REGIONS 2003–2005

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

### Self-medication products

We expanded the number of marketing authorisations for Septotele® brand products on individual markets. In Slovenia and Latvia, we received authorisations for Septotele® Lemon, Septotele® Cherry and Septotele® Apple.

We were also successful in gaining marketing authorisations for dietary supplements. These include the vitamin products Duovit® for men, Duovit® for women, Kalcinova® Osteo, and Pikovit® plus.

#### NUMBER OF SELF-MEDICATION PRODUCT MARKETING AUTHORISATIONS BY REGIONS 2003–2005

	Slovenia		South-East Europe		East Europe		Central Europe	
	No of products	No of forms	No of products	No of forms	No of products	No of forms	No of products	No of forms
2005	2	4	24	31	15	19	15	23
2004	6	6	67	67	37	43	10	10
2003	1	1	12	18	14	17	5	5



### ***Animal health products***

A key marketing authorisation granted in 2005 in the field of animal health products was for a 100 mg/ml enrofloxacin oral solution in the United Kingdom and the Republic of Ireland. Marketing authorisations have been granted for six products in eight forms on eastern Europe markets. Special mention should be made of the authorisation gained for the Floron® range.

### ***Protecting our know-how and intellectual property***

Krka devotes special attention to research and development and achieving patent protection for the results of its work in key fields. In 2005 the company submitted patent applications for 14 new products, and 17 international patent applications on the basis of prioritised applications from 2004.

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

### ***Cosmetics***

In 2005 there was a new focus on developing cosmetic products. The biggest innovations came in the Vitaskin® skin care line. We expanded the brand to include products to moisturise young skin, Vitaskin® Hydra. We updated

the face cleaning product range and increased the number of depilation products. We added a dermatological shampoo and anti-dandruff lotion, effective against persistent dandruff, to our range of Fitoval® active hair and scalp care products.

The Sun mix® line, which includes skin care and protection products for before and after exposure to sun, was expanded to include a further three products: fast-tanning milk, and sun protection milk which also fortifies the skin and helps reduce fat deposits, and moisturising milk for extended tanning.

We have gained approvals for the new products and renewed those for existing products, in accordance with European legislation.

### ***Health resorts and tourism***

In the coming year, we will continue to pay particular attention to the programmes for relaxation and improving quality of life. To maintain its market share in the health institution sector within the public health system, Krka will continue to invest in its health treatment and rehabilitation programmes, which are very highly rated by both medical specialists and guests.

At Otočec, the castle complex will be upgraded and the range of products and services extended. A new "castle programme" will be introduced, featuring programmes targeted at golf players and weddings, and increasing the range of sporting activities and wellness programmes.

# Product supply

Product supply entails process management from demand planning, purchasing of materials, manufacturing active pharmaceutical ingredients (APIs) and finished products, and quality control to storage and customer supply.

## Purchasing

Krka is working towards replacing traditional buyer-seller relationships in favour of supplier partnerships. It is creating a system with two to three suppliers for key incoming materials, to ensure safety, reliability and competition in supplies. In 2005, we purchased 33 billion SIT worth of raw materials, packaging materials and finished products.

## Logistics

One of our major logistics tasks was continuing to adapt to operating within the European Union. We opened a modern new solvents warehouse and concluded the finished product storage facility. Logistically, this will optimise the supply chain and ensure the faster distribution of finished products.

## Production

High quality, efficient and rapid-response production are all prerequisites for any company wanting to participate in the global market and achieve outstanding business results.

Krka's quality is confirmed by its business partners and by numerous international inspections. Production, storage and quality control takes place in all Krka's plants according to the requirements of best practice in production, storage and laboratory work, and in compliance with European and international standards and the provisions of other technological and technical regulations.

The majority of our production capabilities for production of APIs and finished products is located in the central location in Ločna in Novo mesto. Krka produces its medicines in three other locations in Slovenia: Bršljin, Ljutomer and Šentjernej, and also manages the production capabilities of Krka's subsidiaries in the Russian Federation, Poland and Croatia.

## *Active pharmaceutical ingredient production*

Production remains directed towards producing active ingredients for our own finished products. The focus of our fermentation production is lovastatin, which is partly added to Krka finished products and partly chemically transformed into simvastatin, which was one of Krka's leading products in 2005 and is an example of a completely vertically integrated product. The first quantities of pharmacopoeial quality zinc bacitracin were sold. An important part of the fermentation process is the production of feed grade products, for which Krka retained its status as one of the leading European manufacturers.

## *Chemical production*

API production meets the demands of our own pharmaceutical production, in terms of both quantity and quality. Most of the chemical production capacity was used for established APIs, such as enalapril, simvastatin, atorvastatin, amlodipine, carvedilol and lansoprazole. We successfully carried out transfers to pilot testings, and the first synthesis of 12 new active pharmaceutical ingredients. This helped create the data required for marketing authorisations, and partially for launching new products too.

Intense work continued on the construction of the new chemical synthesis plant, which will start production in 2006.

## *Finished product production*

At the Krka Company's central location, the production of finished products takes place in six production facilities, where solid, semi-solid, and liquid dosage forms are produced. Tablets and coated tablets are the most common solid dosage forms, but we also produce capsules and granules. Our range of liquid dosage forms includes syrups, solutions and sterile solutions or suspensions for injection of small (up to 10 ml) and large (up to 100 ml) volumes. The semi-solid pharmaceutical dosage forms include ointments, creams, gels and sterile ointments for the eyes.

Our locations in Bršljin and Ljutomer produce animal health products, powder pharmaceuticals and self-



medication pharmaceuticals, while the Šentjernej plant is intended for low volume runs of solid dosage forms.

The largest increase in production quantity has been for solid dosage forms over the past few years. In 2005 we produced 27% more solid dosage forms (tablets, film- and sugar-coated tablets and lozenges) than over the previous year, and 23% more capsules containing APIs in powder form. There was a sharp rise in the production of pellets and capsules containing APIs in pellet form, due to the successful launch of a new product.

We are continually working to provide sufficient production capacity and optimise the utilisation of existing capacity and preparing technological plans for the construction of additional capacity to produce pellets, capsules and packaging for solid dosage forms. We are also cooperating in planning and selecting technological equipment for a new injection production plant, construction of which has started in 2006.

## Laboratory quality control

This takes place in eight departments on the Ločna and Bršljin sites and includes quality control of incoming materials and intermediate products and the finished products released to the market for human and animal

use as well as self-medication products. Testing in accordance with prescribed pharmaceutical standards constitutes quality control over products and the production environment in all production locations.

The growth in the production of APIs and finished products has led to an average increase in laboratory controls of 20%, which presents a significant challenge to the Krka laboratories.

## Supply chain management and control

The management and control of the supply chain is managed from the Logistics Centre, which coordinates material operations and plans production across all of Krka's production plants, in Slovenia and abroad.

If specific products are incompatible with existing production and if bottlenecks occur then production is transferred to contracted partners.

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



# Investments

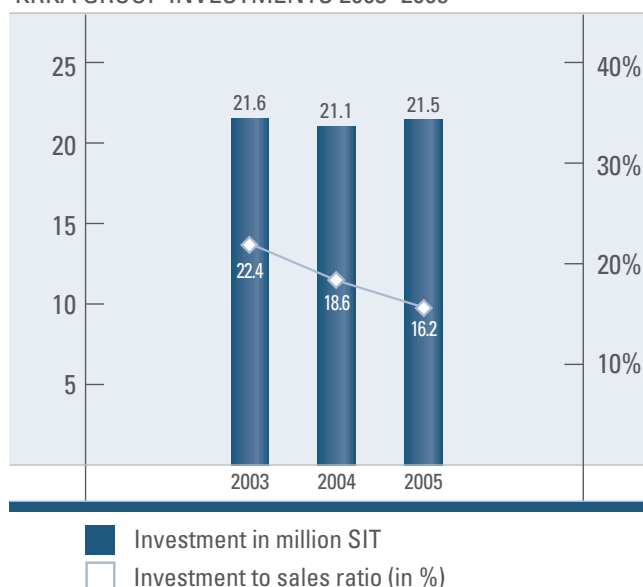
In 2005, the Krka Company allocated 18 billion SIT to investment projects. At the Krka Group level, the investments totalled 21.5 billion SIT. The higher amount invested by the Group is primarily the result of investments in the Krka Zdravilišča company and construction of the production and distribution centre in Croatia.

In 2005, the Krka Group designated 16.2% of its net sale revenue for investment, while the Krka Company designated 15.4%.

The most important investment project was the construction of the new chemical synthesis plant (Sinteza 4) for the production of active pharmaceutical ingredients. Work is progressing at pace and should be completed in autumn of this year.

A new liquid raw material storage facility was constructed at the company's central Novo mesto site, while production capacity was increased in one of the existing plants, and the capacity of the finished product warehouse was almost doubled. Krka was a co-investor in the project to upgrade the municipal water treatment plant in Ljutomer, while Krka was also responsible for the modernisation of the technology at the Novo mesto water treatment plant. The construction of a production and distribution centre in Croatia was completed, and all the permits required to produce pharmaceutical in solid dosage form were obtained.

KRKA GROUP INVESTMENTS 2003–2005



## API production plant

Intense work on the construction of the new API production plant, which started in 2004, continued all year long. Work was on schedule and in accordance with the financial plan. In 2005 the major construction work was completed and most production equipment was delivered and installed. The final phase started, including machine installation, electrical installations and the set up of a clean environment. IQ (installation qualification) testing was carried out for the automation processes. In 2006 we will continue and conclude the work on the Sinteza 4 plant, and regular production should start in autumn.

## Liquid raw material storage facility

A new liquid raw material storage facility was built to store fresh and waste organic solvents as an auxiliary facility to Sinteza 4. A direct pipe connects the storage facility to the chemical synthesis plants – the largest solvent users – enabling safer and more effective solvent transport.

## Pelete III

The upgrade and equipping of new production premises in the Specifika plant increased production capacity by around 75 tonnes per year. The pelleting system and suspension preparation system is connected by pipes in a closed system. We arranged and equipped premises for weighing and preparing raw materials, pellet drying, cleaning and storing mobile containers and small scale equipment, as well as intermediate storage and an in-process control laboratory. The project started in the final quarter of 2003, while production started on schedule at the start of 2005.

## Finished product storage facility

This investment built in technological equipment and a computer system for warehouse control and management increased storage capacity by almost 100%. The increase in physical handling work and high-bay warehouse work led to the phased installation of a new automatic transport system within this project between 2001 and 2005, the set up of a link between the Notol solid dosage form production plant and the Pharmaceuticals section, and the set up of a system for automatic receipt from other plants. New lifting devices were installed and existing lifting



devices replaced by traversers and a new loading platform installed.

### ***New injection production plant***

Preparations began to produce all the requisite documentation for the construction of a new injection production plant, which will be linked to existing capacity. The new plant will be used for production from the preparation of solutions, ampoule filling, and autoclaving, while the present plant will be renovated and used for optical control and packaging. Construction has started in 2006, on a phase by phase basis and will conclude in autumn 2007.

### ***Ljutomer waste water treatment plant***

We continued and concluded co-investment in the town waste water treatment plant and input channel, which is currently undergoing testing.

### ***Upgrading the Novo mesto waste water treatment plant***

We completed the technological upgrade for the Novo mesto waste treatment plant, which will improve the quality of treated waste water and reduce the burden on the Krka river.

### ***Production and Distribution Centre in Jastrebarsko***

The construction of a production and distribution centre in Croatia was completed, and all the permits required to produce pharmaceutical in solid dosage form were obtained. The production and storage capacity of the new centre is in line with planned production levels for the future.

### ***Krka Zdravilišča – Health Resorts***

The Krka Zdravilišča Group carried out a number of large-scale investment projects in 2005. The capacity and range of services of the Balnea wellness centre at the Dolenjske Toplice resort was expanded. At the Šmarješke Toplice we built the four star Hotel Vitarium with 72 rooms, and a Spa&Clinique medical wellness centre and expanded the complex of thermal pools, saunas and Vitarium Aqua baths. A nine-hole golf course was built near Otočec.

The key investment in the coming year will be the construction of an extension to Hotel Kristal and a connecting corridor between the Hotel Kristal and the Balnea wellness centre at the Dolenjske Toplice health resort. This will enable us to provide separate accommodation and treatment for people with health insurance attending for rehabilitation purposes within the national health service, and for guests using wellness programmes. Otočec castle will undergo restoration work. This will meet the prescribed operating conditions for the Otočec castle hotel and enable it to retain its five-star status.

# Quality

As a generic producer, Krka is responsible for medicines that can take their place alongside the best-known pharmaceutical companies in the world in terms of quality, effectiveness and safety. In the broadest sense of the word, quality is something created by, maintained by, and the responsibility of all employees. Quality transcends standards, regulations and instructions, becoming a part of everyday tasks and a constant companion in working life at Krka.

## Integrated management system

The complete system is described in Krka's Quality Manual, which covers various aspects of operations with the same principles (quality – GMP, ISO 9001; environment – ISO 14001, workplace security and health protection – OHSAS 18001, foodstuffs safety – HACCP). The constant improvements dictated by pharmaceutical and other standards and Krka's commitment to such standards, is the force behind progress and the continuous increase in quality throughout every phase of Krka operation. In 2005 we successfully upgraded and improved the existing management system and implemented it in our subsidiaries abroad (the Russian Federation, Poland, and Croatia).

## Change management in production and control processes

The change management process was upgraded by being set up and installed in a Krka produced computer application, enabling standard management and control of approved proposals for changes at Krka. The program makes the change management process more transparent (planning, implementation, control and taking action).

## Inspections and certifications

The quality system was again checked through internal control measures such as internal audits, supplier assessments, and external audits by our business partners. The suitability of the quality assurance system is also reviewed and confirmed by regular inspections by domestic and foreign state regulatory bodies.

Inspectors from the Agency for Medicinal Products and Medical Devices of the Republic of Slovenia carry out regular follow-up inspections on the quality management system, warehouses, production plants and quality control laboratories and confirm our compliance with the GMP EU requirements which form the basis for issuing the GMP certificate and manufacturing licence. The success of Krka's integrated management system was reconfirmed by successfully passing an inspection that was performed in autumn 2005 by SIQ of Ljubljana (Slovenian Institute of Quality and Metrology) based on the following standards: ISO 9001: 2000, ISO 14001: 2004, Codex Alimentarius: 1997 (HACCP) and OHSAS 18001:1999. A new feature of this audit was the final certification of the occupational health and safety management system (OHSAS). The inspectors did not find any compliance failures in the field of health and safety. They stated that Krka's health and safety management system could function as an example to other organisations in Slovenia.

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

Krka's Croatian subsidiary, Krka-Farma Zagreb acquired permits from the Croatian Agency for Medicinal Products and Medical Devices to produce pharmaceuticals at the Jastrebarsko production and distribution centre.

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

# Information support development

## Introduction of the SAP information system and PAS production administration system

After intense preparations in 2004, on 1 January 2005 Krka started to operate the SAP information system for finance, control and monitoring, treasury operations, production, logistics, purchasing, sales, quality management, foreign trade and maintenance. The introduction of the SAP system replaced a large number of systems that had been developed both inside and outside Krka. It significantly improved the integration of existing systems and ensured compatibility with the GxP regulations. At present, the PAS production system and NAS warehousing system form the backbone of the Krka information system, alongside SAP. They were both upgraded at the start of the year to ensure they linked into the SAP system properly.

After the successful start to use of the SAP, PAS and NAS systems, a period of stabilisation followed during the first half of the year. In the second half of 2005, we started to add extra functionalities to the SAP system. We developed an interface between quality management within the SAP system and the Documentum documentation system for process analysis, and also started to run a system for records on working hours, salary calculations and a business intelligence system within the SAP system. These systems will come online at the start of 2007.

## Information technology

Krka's information infrastructure has also undergone intense upgrading. We upgraded the e-mail and active directory servers. The new ISA servers offered better firewall protection and new services such as safe access to e-mail from the internet without using Citrix. We set up video conference systems, and implemented our first IP telephony projects.

We continually update our operating systems and applications, taking special care about security adjustments.

The first phase of the intranet project, known as Krkanet, was concluded at the start of February 2006 and involves a modern information intranet portal.

We successfully completed the project to move most of our infrastructure from Zagreb to Jastrebarsko, and carried out an information systems overhaul in Poland and the installation of the SV application in Slovenia and Croatia. The help desk has for some time been a key support feature in the finding, recording and correcting of errors in all systems.

## Information support in associated companies and representative offices

Krka's information technology has expanded alongside its production capacity. We have completed a full information system overhaul at Krka-Farma Zagreb, where we upgraded the business system and introduced the PAS production system. The system overhaul was in compliance with all GxP requirements and in accordance with the controlling company's information system development guidelines. A similar information system overhaul is already underway in Krka Polska.



# Investor information

## Share return

In 2005, the Krka share price increased by 22%, while the Slovenian Stock Exchange Index (SBI 20) fell 6% over the same period.

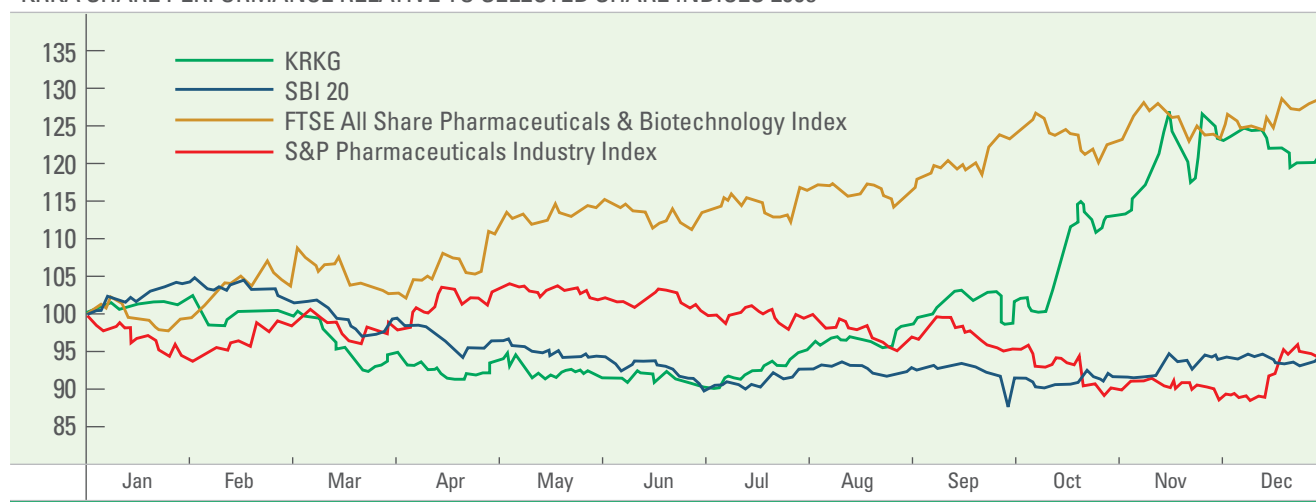
### KRKA SHARE PRICE

in SIT	2005	2004
On 1 January	84,200	52,024
Year high	107,503	87,418
Year low	75,912	52,024
31 December	102,342	84,482
Growth	22%	62%

In 2005 the Krka share outperformed most of the selected share indices. Krka's share performance was significantly better than the Slovenian Stock Exchange Index (SBI 20) and Standard & Poor's Pharmaceuticals Industry Index. In

the final quarter of the year the growth in the share performance caught up with the performance of the FTSE All Share Pharmaceuticals & Biotechnology Index.

### KRKA SHARE PERFORMANCE RELATIVE TO SELECTED SHARE INDICES 2005



Source: Reuters

## Dividend policy

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

The 2006 dividend proposal by the Management Board and Supervisory Board is included in the Annual General Meeting notice. The General Meeting makes the final decision on the dividend.

in SIT	2005	2004	2003
Earnings per share <sup>1</sup>	6,890	4,627	3,113
Gross dividend per share <sup>2</sup>	1,400	1,200	1,050
Dividend pay out <sup>3</sup>	30%	39%	32%
<b>Dividend yield<sup>4</sup></b>	<b>1.4%</b>	<b>1.4%</b>	<b>2.0%</b>

<sup>1</sup> Net profit of Krka Group majority shareholders/average number of shares issued in the period (no own shares)

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

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

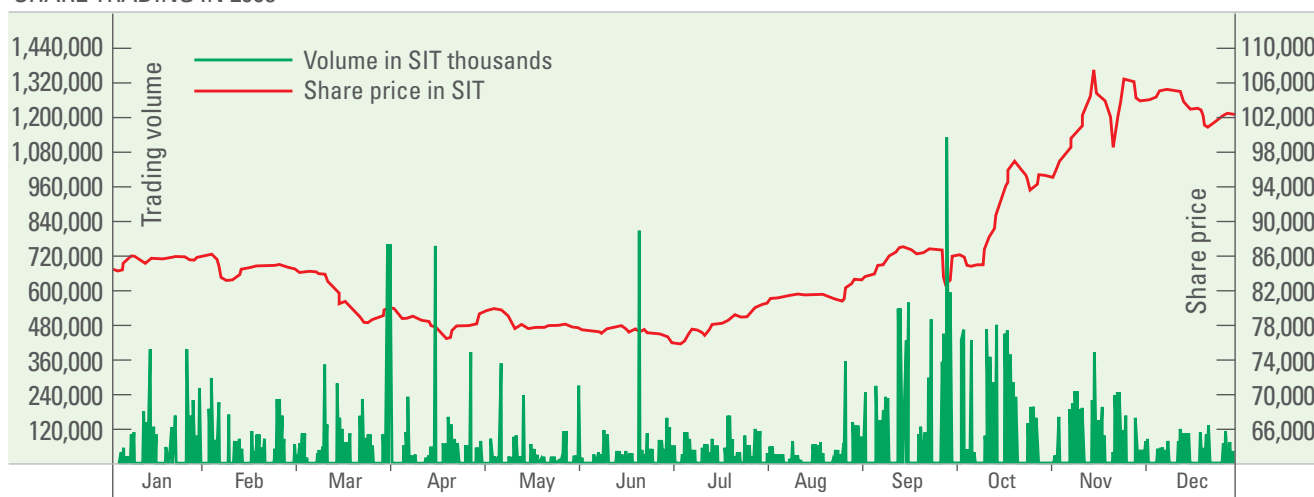
<sup>4</sup> Applying share price on 31 December of year

## Share trading and shareholding

Krka shares have been listed on the Ljubljana Stock Exchange since 1997 and are quoted under the trading code KRKG. All issued shares are in the same class

(ordinary, transferable without limitations). Each share enables one vote on the General Meeting of shareholders. Resident and non-resident investors can trade the share without limitation through brokerage firms and banks that are members of the Ljubljana Stock Exchange.

### SHARE TRADING IN 2005



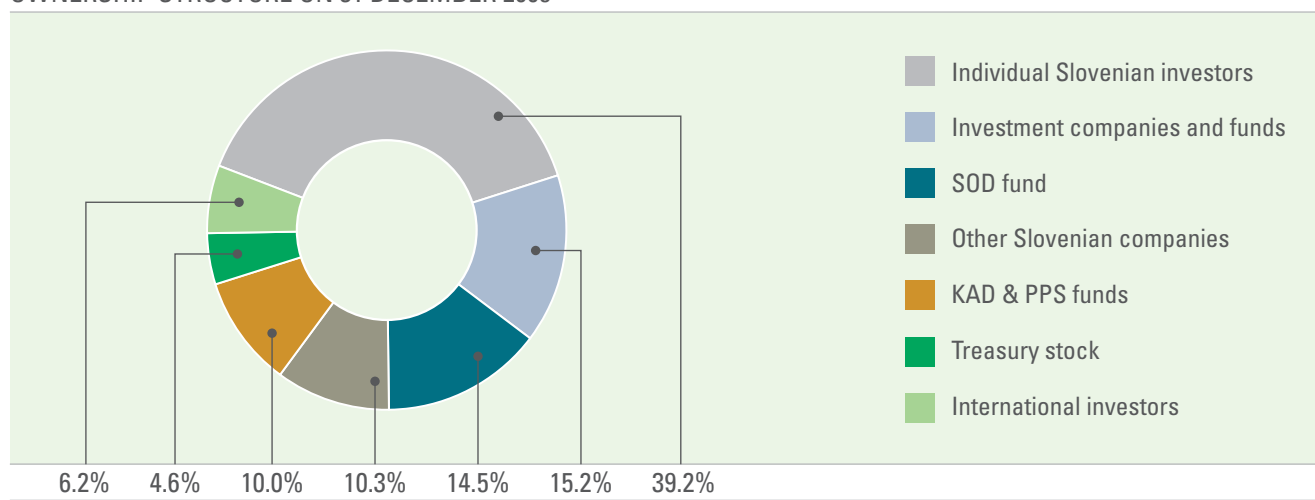
Source: Ljubljana Stock Exchange

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

14% of Krka's average market capitalisation over the same period (2004: 16%).

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

## OWNERSHIP STRUCTURE ON 31 DECEMBER 2005



At the end of 2005, Krka had 53,635 shareholders (2004: 54,911), so the ownership of the company became slightly more concentrated. This reversed the trend towards dispersion of previous years. In 2005 the proportion of international investors rose to 6.2% (2004: 2.8%), largely due to a reduction in the ownership stake of Slovenian investment companies and funds, which

represented 15.2% (2004: 17.6%) at the end of the year. The ownership share of Slovenian state financial companies (SOD and KAD with PPS) did not change significantly in 2005 and stood at 24.6% (2004: 24.5%). The proportions held by other shareholder groups also remained more or less constant in 2005.

## 10 LARGEST SHAREHOLDERS ON 31 DECEMBER 2005

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

## Shareholder information

### Reporting by the company

Krka has published its financial calendar on its corporate web pages ([www.krka.si](http://www.krka.si)). The calendar contains provisional dates of business performance reports releases and other important investor events.

The business performance reports are available in Slovene and English on the Ljubljana Stock Exchange portal – SEOnet (<http://seonet.ljse.si>). The business performance reports are also available on corporate web pages. The summary of the Annual Report and semi-annual report is published in the Delo newspaper.

All business performance reports, financial statements and other relevant information releases are submitted to the Securities Market Agency of the Republic of Slovenia in due time, according to the relevant regulatory provisions.

For further information, shareholders should contact:

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☎ +386 7 33 12 287  
☎ +386 7 33 21 523  
✉ [peter.skubic@krka.biz](mailto:peter.skubic@krka.biz)

Shareholders are also welcome to submit questions directly by e-mail to the following address:  
[finance@krka.biz](mailto:finance@krka.biz).



safety







# Social responsibility



*Krka works responsibly to make life,  
and environment in which we live,  
better and safer.*

# Social responsibility

Reporting on sustainable development is now a constituent part of the annual report, in line with the realisation of our business strategy. In 2005 we issued a Sustainability Report for 2004 in the form of an independent publication, which deals with the subject in detail. We also plan to produce detailed reports on sustainable development in the future.

Sustainable development is implemented by creating a balance between social responsibility, responsible management of the natural environment and economic competitiveness. We manage this balance according to ethical operating principles.

## Employees

Krka's business performance is closely linked to its employees and how their knowledge and skills are activated.

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

At year-end, the Krka Group employed 5,224 people, 2,954 of those in the Krka Company in Slovenia, 1,024 in representative offices abroad, 620 in companies abroad and 626 in the Krka Zdravilišča company. This was an increase of 443 or 8.4% in the number of employees on the previous year.

A total of 1,644 employees worked in companies outside Slovenia, representing 31% of all employees in the Group.

### **Educational structure**

In order to perform well on markets at home and abroad, research and development of new products and investing

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

### **Health and safety**

Having a safe environment enables employees to produce efficient and high quality work. The preparation of new projects and introduction of new technology always incorporates improvements to working conditions.

Everything that can efficiently contribute to taking care of employee health is included in processes that involve the heads of individual organisational units, general practitioners, specialists in occupational medicines, and the Health and Safety at Work Service. Krka has health teams to deal with wider social and health issues, organised by organisational unit. These work together with



specialist services to make an effective contribution to the resolution of health and social problems experienced by Krka employees.

Recognising the importance of a healthy environment and positive atmosphere among employees has led Krka to set up an integrated system of employee health care and well being for the workplace and outside the workplace too. The Reciprocal Relations and Sick Leave project led by the Human Resources division has had an impact on reducing absence due to illness, as good reciprocal relations and care for fellow employees encourages employees to return to work more quickly. Since the project started there has been a significant decrease in sick leave, which is just above 5% in recent years.

The health and safety at work system is organised in accordance with the OHSAS 18001 standard. This area is fully covered by the integrated management system. The health and safety at work management system involves active health and safety at work working groups for each organisational unit, which include an authorised health and safety officer. At the company level, there is a health and safety team that prepare key objectives and programmes that are submitted to the management board for approval.

Pursuant to the Health and Safety at Work Act and with the consent of the workers' council and the two representative unions, the President of the Management Board and CEO issued an audited Safety Declaration in the second half of 2005.

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

objective in the coming years is to halve the number of accidents, as well as the number of days lost due to accidents, through employee training.

Employee satisfaction with working conditions is one of the higher scoring statements in measurements of our organisational culture. The score for employee satisfaction with working conditions was significantly higher for Krka than for other Slovenian companies included in the project entitled Comparative Measurements of Organisational Culture organised by the Slovenian Chamber of Commerce and Industry.

Despite the direct vicinity of the Novo mesto Fire Station, the nature of Krka's work means it has its own Fire Safety Department and volunteer industrial fire service crew.

### ***Training and education***

To realise strategic objectives and technologically demanding work and development, the company must use large-scale investment targeted towards developing knowledge and abilities of its employees. Using Krka's own training centre and other training institutions in Slovenia and abroad, each employee participated on average in at least four different forms of education.

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

Last year each Krka employee spent on average 28 hours updating their knowledge; 92% of that time was spent at internal seminars, 6% in Slovenia and 2% abroad.

The main fields of education are quality, management and personal development, health and safety at work, specialist subjects (pharmacy, veterinary science, health, chemistry and chemical technology, engineering,



## EMPLOYEE EDUCATION STRUCTURE 2001–2005

Level of Education	2005	2004	2003	2002	2001
Doctorate	51	48	47	39	34
Master of Science	153	137	130	117	109
University education	2,018	1,664	1,393	1,240	1,004
Higher professional education	221	151	130	96	71
Vocational college education	206	206	213	221	225
Secondary school education	1,104	1,080	1,055	1,034	1,017
Other	1,471	1,495	1,554	1,585	1,599
<b>On 31 December</b>	<b>5,224</b>	<b>4,781</b>	<b>4,522</b>	<b>4,332</b>	<b>4,059</b>

electrical engineering and construction), foreign languages and information science and technology.

### **Human resource development**

The human resource development project involves monitoring and directing the selection and development of key and prospective employees at the level of organisation units and the entire Krka Group. The focus on education and training and complex projects and tasks develops the skills of potential candidates for the most demanding specialist and management posts. To increase their effectiveness, managers from different levels take part in education and training at Krka's leadership school for high level, middle and operational managers, and in other forms of education.

### **Krka appraisal interview**

Krka's appraisal interview between managers and employees has become an important part of the jointly creating key tasks and objectives to achieve strategic objectives, and to direct the professional and personal development of the individual.

### **Attracting talent**

An important part of the training and education programme is attracting the best new employees, which is the reason the company offers scholarships to potential future specialists during their studies (we currently offer scholarships to 62 pharmacy and chemistry students). We also have a wide range of links and contacts that enable student to get to know the company through internships or preparing thesis research. A special form of encouragement for the most creative is the Krka Prizes for young researchers and scientists, which have been awarded 35 times already. To date we have presented awards to over 2000 young researchers and organised symposia where world-renowned experts and scientists have shared their knowledge.

### **Encouraging inventive work**

We have continued to promote large-scale inventive work and inventive work by employees, directing individuals and groups towards areas they consider the most important in achieving our business objectives. These activities have doubled the number of proposals for innovations and improvements and useful proposals that have received appropriate material reward and other forms of encouragement.

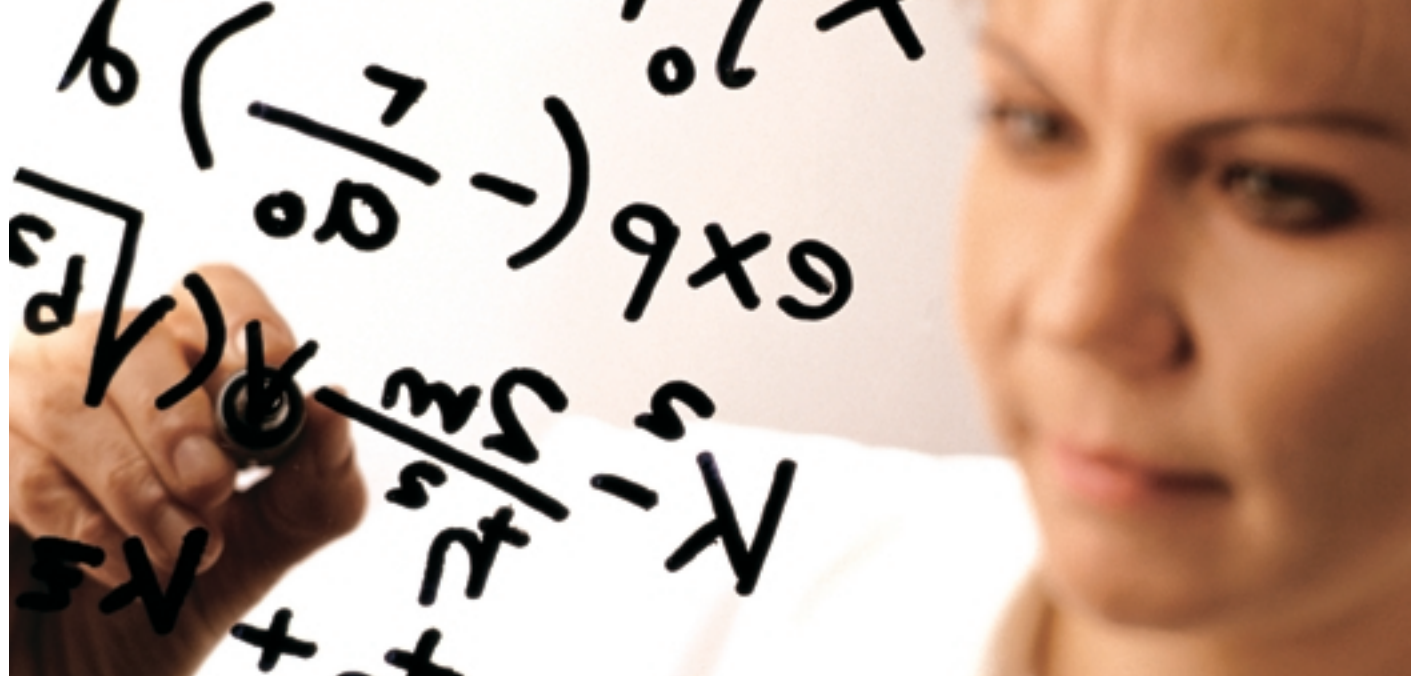
### **Employee care**

The high level of employee satisfaction is evident from the low employee turnover level. This is confirmed by the fact that last year 476 employees celebrated long service anniversaries of 10, 20, 30, 35 and 40 years of work with the same company. We are well aware of the importance of preventive, recreational and social programmes, which is why we offer a variety of sports and cultural events to our employees. Trim Klub Krka encourages employees to partake in preventive sporting activities, which have been very popular. All sports activities attract a great number of participants. The cultural events organised by Krka's Culture and Arts Society are also very popular, and include gallery activities, a choir, a drama club, creative workshops and organising visits to events.

We support different types of socialising between our employees. Once a year we hold a "Krka Day" picnic for all our employees. We organise New Year's celebrations for every organisational unit, and sports days are held to provide year round sports activities for employees. Meetings for retired employees are also organised every year.

There is a club for recovering alcoholics led by Krka's social worker, which enables employees that have successfully overcome alcoholism to produce quality work and enjoy a high quality of life at work and at home.





## **Management-employee relations**

Two unions are organised within the company, which are representative at the national level in Slovenia: the KNG Krka Novo mesto and the Krka Sindikat. Approximately half of all employees are union members.

In 2005 the Management Board and the unions amended the agreement on union operation in the company, which sets out a tripartite set of rights and obligations. The most important document agreed between the Management Board and the unions is the enterprise collective contract, which sets out the rights and obligations of employees and the employer. By 2005 it had been amended 37 times since first being signed in 1996, including five amendments in 2005, all with the full consent of all three parties.

A works council has functioned in Krka since 1996, when over half of Krka's employees voted to introduce co-determination to Krka. In 2005 a new 15-member works council was elected, whose task was to appoint three workers' representatives to the Krka Supervisory Board. Amendments to the company's articles of association by the General Meeting, led to the number of workers' representatives on the Supervisory Board being halved to one third of the members.

The Works Council last year held 12 meetings. Its most important work is ensuring that council members actively work with the employees in the working environment. Workers' representatives are well aware that they are part of the internal employee information system, as they have access to a great deal of information on events within the company. When required they also draw up and submit initiatives and questions.

As yet the participation agreement between the Management Board and Works Council has not been concluded, but is in preparation. The Works Council operates in accordance with its Rules of Procedure, while the duties of the Works Council and Management Board

in relation to co-determination are defined by a law, the provisions of which are respected by both sides.

Each year worker assemblies are organised where the management presents its business strategy, strategic company plans, major objectives and other issues of importance to the employees. Sixteen such worker assemblies were held in 2005.

On his own initiative, the President of the Management Board has already taken numerous questions from the assemblies and publicly responded to them. The President of the Board actively participated at the annual conference of the KNG Krka union and seven meetings of the workers' council. He also invited the workers' representatives to informal meetings to analyse cooperation to date, and to exchange views on future cooperation. They covered issues such as communications, information procedures, remuneration, promotion, management, safety at work, sick leave, the work of health teams, disability issues, and similar.

## **Ensuring equality**

Concerning possibility of employment and height of salary, in Krka there is no discrimination whatsoever on grounds of sex, race, colour, age, health condition or disability, religion, political orientation or other belief, trade union membership, national or social origin, familial status, property status, sexual orientation or other personal matters. On this basis, everyone has an equal opportunity of promotion and other employment rights. We respect all elements of positive employee discrimination relating to young people, mothers with young children, as well as older employees, and attempt to find them appropriate work.

In the field of human rights we consistently respect national legislation, which is in line with the international conventions that are incorporated into Slovenian law.

# Communications

Krka plans internal and external communication strategies to target employees, financial spheres, shareholders, customers, the media and the social environment. We keep all interested parties informed about Krka's work, products and operations, and the impact of its operations on the environment and similar. Krka's internal rules include provisions on communications and making information public.

## **Communications with employees**

Employee satisfaction is as important as the satisfaction of customers and other target groups and is part of any organisation's mission. At a time of rapid change, company results are increasingly dependent on employee capacity and motivation. Effective communication is one of the most important factors in ensuring employees work well – a vital factor in company success. The main aims of Krka's internal communication programme include ensuring positive relations between the management and employees and between employees themselves (see page 66), increasing the sense of belonging to the company, and creating an organisational culture, as well as increasing its competitiveness.

When important events occur the President of the Management Board communicates with employees via letters sent to all employees that are prepared in the languages of all the different countries in which Krka has subsidiaries and representative offices. Employees can also write to the President and CEO about individual difficulties, proposals and solutions to improve working conditions, either by traditional post or by e-mail.

Krka also issues a monthly review called Utrip (Pulse), which is aimed at all employees and Krka's retired workers. The review regularly covers Krka's business strategy, events within the Krka Group, on its markets, and sales results and investments. It informs employees about business decisions and company policies, and is also an educational tool, providing people with information on general and specialised professional knowledge. Internal communication also takes place via the weekly bulletin Bilten, which is printed for employees that do not have access to computers, and is available to others via Krka's intranet pages.

Krka's internal web pages offer employees various information, forms, documents, and records from the quality system, internal acts and other. In 2005 Krka's

internal web pages were upgraded and updated, and put back online in February 2006.

## **Communications with customers**

The extent, concentration and frequency of communications with customers and monitoring customer satisfaction depend on the importance of individual groups of customers, products and markets.

We divide our customers into a number of different groups: institutions (health, regulatory, industrial property services, health insurance etc.), direct customers (distributors, other pharmaceutical companies), indirect customers (pharmacies, hospitals, pharmacists, and doctors) and final consumers (patients, customers). Products and services are divided into the following groups: prescription pharmaceuticals and self-medication products, animal health products, and cosmetics. We divide the markets as follows: domestic market, foreign markets, and after entry to the European Union also the EU single market. Based on the ABC analysis we have defined priority customers, products and key markets.

We carry out various opinion surveys in order to monitor and implement improvements in customer communication strategy, to ascertain customer satisfaction at home and abroad. We also find out customer opinions via personal contact, at conferences, symposia, and other professional meetings.

Regular personal contact is a vital way of ensuring our direct and indirect customers are satisfied. The diversity of our network abroad facilitates this process, enabling meetings with customers to take place at least quarterly on every Krka market. We are aware of the importance of direct customers, so in recent years we have expanded our network of subsidiaries and representative offices abroad, and increased the number of employees.

In 2005 we first carried out a survey to measure the satisfaction of our direct customers. We asked customers to rate their satisfaction with our products, sales teams, how we deal with orders, how we deal with complaints, and general satisfaction with Krka. The general customer satisfaction scores are very high, which indicates that Krka is operating very well. On the basis of these findings we set key objectives intended to further improve customer relations in the future.

Since 2000 we have kept statistics on doctors and pharmacists in the Krka database to ensure we keep in regular contact with them. We also regularly collect and record numerous individual visits and participation in larger meetings.

Conference, symposia and other professional meetings are a very important part of Krka's post-sales activities. Since 2000 we have been accurately following the most important group meetings, which we also evaluate on the basis of opinion surveys. We adapt our promotion and information strategies according to the results of these opinion surveys. The Quality Committee, chaired by the President of the Management Board and CEO, meets twice a year to review the customer relations report, check on the implementation of measures introduced in response to prior findings, and to set objectives to improve quality in this field.

### **Communications with the community**

Society at large is very important for Krka, and we support it through our sponsorship and donation programmes. Because Krka's overall mission is summed up by the words "Living a Healthy Life". Most of our donation and sponsorship work goes to projects relating to the health and quality of life. We primarily target health and humanitarian causes, however, we also support science, culture, education, environmental protection programmes, sporting activities, and various one-off projects of national or international importance. Krka makes a clear distinction between its sponsorship and donation activities.

Nearly all of Krka's sponsorship and donations for non-profit activities are directed to our community at the local and national level. We also support individual activities outside our borders in our key markets.

The amount of funds set aside for these purposes are decided each year within the company's business plan. Krka has made some considerable donations in recent years, and in 2005 the Krka Company allocated 0.7% of its overall sales revenue to sponsorships and donations, approximately the same as for the previous year.

### **Health care donations**

The development of medical profession in the future will continue to depend on money gathered from a range of different sources. Krka is well aware of this situation, so every year it contributes significant sums to individual healthcare organisations.

In 2005 instead of issuing New Year's greetings cards we donated two incubators, five heated cots, and three phototherapy beds to the Paediatric Clinic and seven Slovenian maternity hospitals, equipment that is urgently required to care for premature and sick babies.

One of our most important actions was the purchase of 16 semi-automatic and 18 automatic defibrillating machines, which can interrupt life-threatening heart rhythms in the case of heart attack. The semi-automatic machines have been installed in remote health centres or stations, while the automatic machines have been located in public areas where a large number of people gather.

Krka has contributed one third of funds required to purchase a Reanimobile ambulance from the Novo mesto Health Centre. We also provide support to the Europa Donna association, not only financially, but also by permitted to operate in our business premises in Ljubljana.

On 14 May, World Hypertension Day, we organised an action measuring people's blood pressure in Ljubljana, Novo mesto and Maribor, in cooperation with the Arterial Hypertension Section of the Slovenian Medical Association and the Clinical Hypertension Department at the University Medical Centre, Ljubljana (Klinični Center). Visitors to our stands could find out information on the dangers of high blood pressure, and about healthy lifestyles that can prevent arterial hypertension or successfully reduce high blood pressure. We measured the blood pressure for 800 passers-by.

### **Sport**

Each year significant sponsorship funds are allocated to sport. At the local level we support school sports clubs, and clubs and societies that focus on young people and various local sporting events. We also collaborate with clubs that support large scale sporting participation, as well as successful individual local athletes. The clubs we support include the Krka Trim Club, Krka basketball club, Krka men's volleyball club, Krka women's football club, Krka men's handball club, Krka karate club, Krka Otočec tennis club, Krka cycling club, Krka athletics club, and Krka table tennis club.

We also support sporting events at the national and international levels. In 2005 we continued to support the ski-flying events at Planica, Slovenia's prestigious ski-jumping and ski-flying venue.

### **Culture**

Some of the larger cultural events that Krka has sponsored include the Sergey Prokofiev opera *The Love for Three Oranges*, which had its premiere in January 2006 on the main stage in the Gallus Hall at the Cankarjev Dom cultural and congress centre in Ljubljana.

In May 2005 we sponsored a concert entitled *Melodies for the Heart*, which also took place in Cankarjev Dom for members of the Slovenian Heart Foundation. In August we supported a concert by the Glinka College Boy's Choir from Saint Petersburg, Russia.



To mark the 15th anniversary of the Novo mesto Symphony Orchestra we organised a project with the Marjan Kozina Music School in Novo mesto. We also supported an exhibition at Cankarjev Dom to mark the 100th anniversary of the birth of Boris Kobet, architect and academy painter. We regularly collaborate on projects with the Dolenjska Museum, the Brežice Festival, and the Slovenian Octet ensemble, as well as many other smaller projects. Since 1971 Krka has had its own Culture and Arts Society, which has organised numerous art and photographic exhibitions by local artists in the Krka galleries in Novo mesto and Ljubljana. We also support the Krka choir, which is well known even outside Slovenia, a traditional book fair held in the Krka gallery in Novo mesto with accompanying cultural events, and the well loved Ljubljana Theatre Club and others.

### ***Communications with the media***

Throughout the year we were in continual communication with the media, preparing a large number of press releases that were sent out to national and local media. We regularly organise business press conferences as we want our business to be transparent and for the public to be aware of our activities via the media.

An overview of media reporting on Krka indicated that from 1 January to 31 December 2005 Krka was mentioned in 4427 reports, 17% more than last year. Overall media reports about Krka were favourable over the year as a whole.



# Environmental responsibility

Environmental protection has been part of Krka's development since the very beginning. This has been proved by numerous projects continually improving the state in all areas relating to protecting the environment.

## *Environmental protection*

Krka's basic document on environment protection is its Environment Policy Quality Manual. The provisions of this manual relating to environmental protection are based on legal requirements and the ISO 14001 standards. The environmental management system means environmental protection is included in all the company's activities, and it is the responsibility of the Environment Protection Service within the Engineering and Technical Services.

The Environment Protection Service's work relates to employees, the natural environment, and the local and wider community. We continually work to reduce the load our activities place on the environment. A vital part of this support is the environmental management system, which is in compliance with the requirements of the ISO 14001 standard. The principal objective of environmental policy, which was adopted at the same time as the standard was implemented in 2001, is continual improvement of the environment. Thanks to many years of specialised work and large-scale investment we are successfully implementing this policy. Our annual plans, objectives and programmes always include improvements to existing actions and the launch of new projects aimed at sustainable improvement. The impact of Krka's activities on the environment is measured by means of emission monitoring in line with legal norms and internal regulations. The measurements are carried out by an authorised external organisation. The results of annual measurements are published in reports submitted to the relevant administrative institutions.

Regular process controls implemented in our laboratories monitor the effectiveness of all technologies with a potential environmental impact. We also monitor data on the utilisation of natural resources. All data is statistically analysed and published in internal reports that are used in defining objectives and preparing programmes and measures to improve the environment.

## *Environmental policy*

At Krka we are well aware that only environmentally friendly companies can create both a pleasant working environment and good relations with their neighbours. This is only possible if we respect all the environmental standards the company has committed itself to upholding.

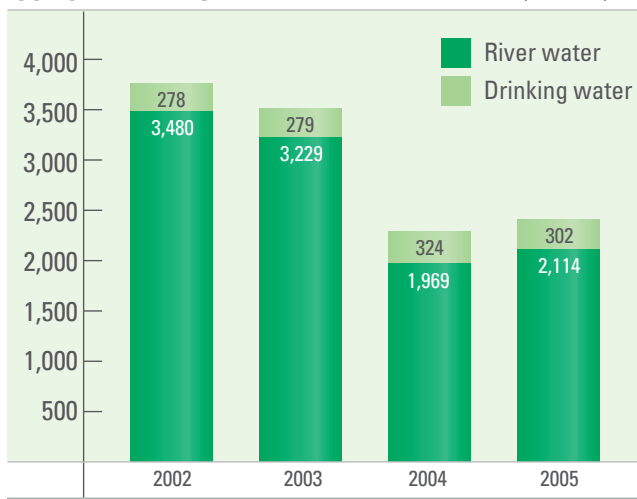
To achieve these objectives we have undertaken to continue to pursue the following policies:

- including environmental management in our development strategy and individual investments and projects, and in that way preventing as much as is possible the occurrence of any negative environmental impact;
- continually reducing emissions, in line with the technical possibilities available;
- reducing the risk of accidents and improving response procedures in such cases;
- ensuring the efficient utilisation of energy supplies and reducing waste;
- where technologically possible, replacing hazardous substances with safer replacements;
- educating, training, and providing refresher courses for employees to improve their awareness and attitudes to environmental protection;
- informing employees and the public about the state of the environmental management and our achievements;
- consistently monitoring and respecting legal regulations and following the development of new legislation and guidelines for the pharmaceutical industry;
- improving the environment through systematically setting environmental objectives and programmes.

## *Careful use of natural resources*

### **Water**

In order to reduce the consumption of our most important natural resource – water, we use closed cooling system with cooling towers, wherever their use is feasible. Despite large physical increases in production in 2005, the numerous measures applied to ensure the more efficient use of water (closed circuits, replacement of old equipment, improving technological procedures) led to Krka using 4% less river water. At the end of the year we completed the water reuse project which inputs process water from open cooling systems into closed systems. This will lead to further reductions in the use of river water.

USE OF DRINKING WATER AND RIVER WATER (1000 m<sup>3</sup>)

By updating the procedures to prepare pharmaceutical water and our drinking water network, we reduced our use of drinking water by 7%, despite increased production levels.

### Energy

The main energy sources at Krka are natural gas and electricity, with extra light fuel oil used as a back up fuel. Due to continual investment and energy efficiency measures, energy consumption is growing at a slower rate than production. We have a range of very diverse products with very different amounts of energy used in their production, which means we cannot monitor the specific energy use per production tonne. We do, however, monitor specific use against sales revenues generated by these products.

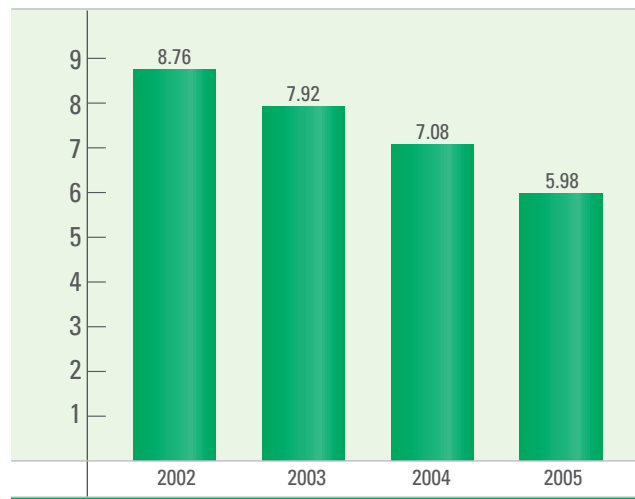
Specific energy use is being reduced each year, due to the efficient utilisation and large-scale investment in energy efficient processes.

The proof that our policy is the right one and that we have been successful in this field, is the energy efficient company award we won in 1998 and the energy efficiency project award we won in 2002. Waste heat generated by the production of compressed air is used in the technological process of drying fermentation broth. We reduced our use of natural gas by approximately 320,000 Sm<sup>3</sup>/year, and with that our CO<sub>2</sub> emissions by 608,000 kg/year, which are two significant contributions to environmental protection.

In 2005 we joined the Modra energy project (Wise Energy) committing the company to purchasing a specific proportion of its electricity from renewable sources. Purchasing these forms of energy is more expensive than normal forms of energy, but includes contributions to a fund intended to promote research and development and construction of new renewable sources of electricity in Slovenia.

SPECIFIC ENERGY USE

(in kJ/SIT)



### Packaging and raw materials

The main purpose of packaging in the pharmaceutical industry is to maintain the quality of the finished product throughout its lifespan. The composition and form is largely defined by law and by pharmaceutical production and sales standards, so great care is taken to ensure rational purchasing and use of packaging.

Raw material use at Krka depends very much on the type of production. Fermentation production for animal health products and chemical synthesis of API use the most raw materials. We have successfully reduced the use of raw materials, despite the continual increase in production, by optimising technological processes, increasing efficiency and selecting high quality suppliers.

### Waste water management

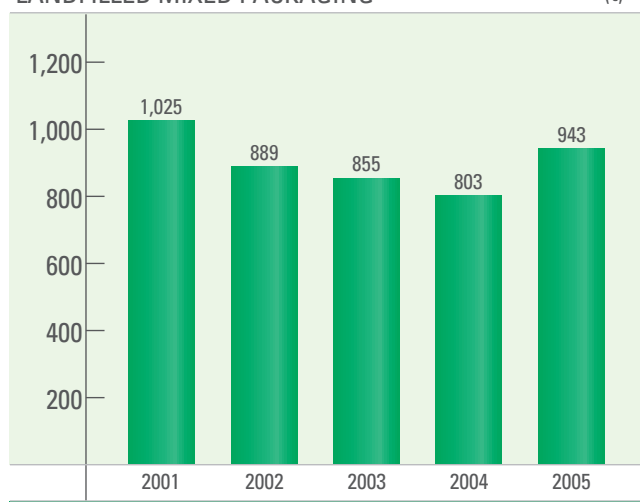
Over the period 1978 to 1998 we continually reduced the load on the Krka river through co-financing the construction of the central waste water treatment plant in Novo mesto, the construction of our own waste water treatment plant and the introduction of cleaner technology to isolate basic antibiotics, the modernisation of processing for waste treatment plant sludge and the modernisation of the waste water treatment control system.

Because of environmental protection legislation with more stringent restrictions for the removal of nitrogen compounds from waste water, and most of all because of our commitment to continually improve the quality of our environmental protection work, we have developed modern technologies together with outside collaborators to meet the issues in this field. This means the more efficient removal of nitrogen compounds in existing plant and that we meet the limit values for outflow, in line with legislative requirements.

We tested new technology at the beginning of 2005, and after a year-long trial found that the increase in efficiency

## LANDFILLED MIXED PACKAGING

(t)



using a two-phase cleaning of waste water was far in advance of the old technology, as we achieved a 37 percent reduction compared to 2004 in the outflow load from the waste water treatment plant (calculated in accordance with the Decree on Water Pollution Tax).

The upgrading of the waste water treatment plant and installation of new technology has a double purpose: by removing nitrogen and phosphorus compounds, it will reduce long-term pollution of the Krka river by eliminating the compounds that stimulate eutrophication and second, by enclosed pre-cleaning and cleaning air with a biological filter, unpleasant odour emission will be reduced.

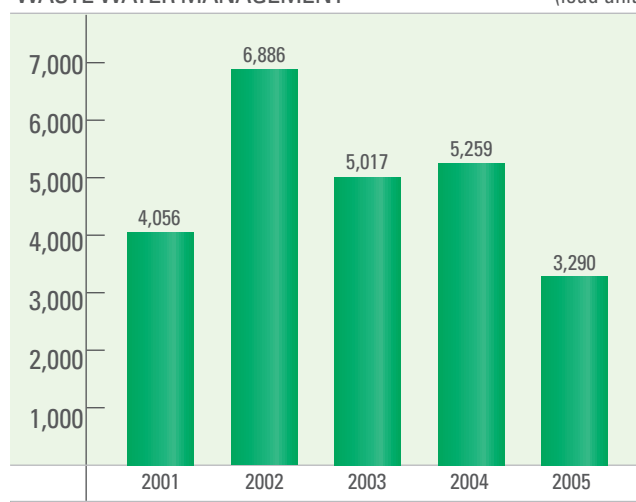
We have also been actively involved in resolving the problems of cleaning waste water in the municipality of Ljutomer having co-financed the construction of the central waste water treatment plant in Ljutomer (which started to operate in August 2005) in partnership with representatives of the municipalities of Ljutomer and Križevci and industry representatives. The new waste water treatment plant will ensure the long-term operation of Krka's Ljutomer plant will be in compliance with environmental standards and legal requirements. It will also lead to the Ščavnica river finally getting rid of its reputation as the most polluted river in Slovenia.

## Waste

We have two main objectives in the management of waste produced from industrial processes: reducing the quantity of waste landfilled, and increasing the quantity of separately collected packaging. The company has set up its own system for separated collection, waste management and waste packaging management. We consistently separate waste packaging throughout the entire production process, and we have a contract with a certified waste packaging management company for retrieval of waste wholesale packaging sold together with our products on the Slovenian market.

## WASTE WATER MANAGEMENT

(load unit)



We removed hazardous waste stocks many years ago, and any new waste has been handed over to certified collectors that ensure its safe destruction.

Special attention is paid to waste sludge from waste water treatment and waste occurring in the biosynthetic production of APIs. We have carried out wide-ranging laboratory and pilot processing tests and proven that composting is a suitable way of processing this form of waste. Composting will take place at the new Dolenjska central waste landfill. We are also studying alternative, more modern methods of processing organic waste (e.g. drying or incineration).

In 2005 we managed to increase the quantity of useful waste collected by 8%, by organising a waste sorting facility, purchasing containers for waste separation, raising employee awareness and consistently separating waste.

## Noise

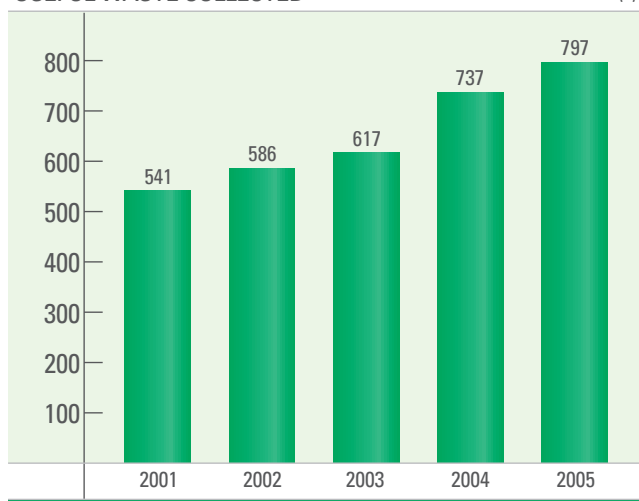
Noise does not represent a grave threat to the wider environment, but is very disruptive to employees and local residents. Krka is well aware of this fact and by installing modern equipment and using preventive measures to correct some sources of noise it has reduced noise below the legally permitted limits, and to levels that do not disturb local residents. This was confirmed by the results of noise emission testing carried out in 2005.

## Air emissions

The location and favourable wind conditions mean that air pollution is low in the Novo mesto area, so the municipality has not passed any special ordinances on air protection. Krka is conscious of the importance of clean air to the wider community, and by installing filtration devices on all particle outlets, installing air filtration systems on fermentation production outlets, the waste water treatment plant and the pharmaceutical and

## USEFUL WASTE COLLECTED

(t)



chemical production plants we have significantly reduced the emission of all substances into the air.

Special care is taken to reduce emissions with an unpleasant odour, which often occur around the waste water treatment plant, and which are the most disturbing source of air pollution for local residents. The emission of unpleasant odours has been reduced by efficient air filtration systems, a closed pre-cleaning process, and inserting biofilters in the waste water treatment plant, as well as by co-financing pre-cleaning facilities at Novo mesto's central waste water treatment plant. Ensuring communication channels with our neighbours are always kept open has helped us to act quickly and effectively to reduce such emissions.

## Hazardous substance storage

A high level of environmental protection was an essential part of plans to construct the liquid raw material storage facility at the Krka Company site in Novo mesto, which is one of the most modern facilities of its kind in this part of Europe. It meets the most demanding ecological and safety requirements. The building plan and in-built safety equipment vastly reduce the danger of a fire or explosion occurring, while the possibility of substance leakage is also prevented.

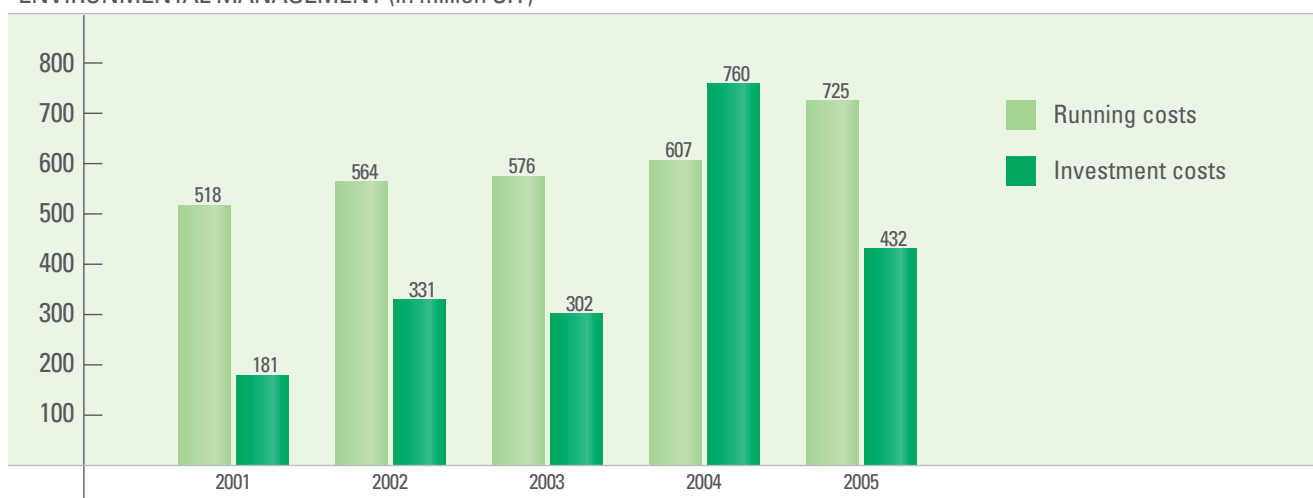
*Environmental protection costs*

In 2005 the running costs for environmental management came to SIT 724.5 billion, a 19% increase on the 2004 figure. This is due to increased production and the directly related environmental impact, the end of tax relief for payment of water pollution charges, and increased depreciation costs after the treatment plant upgrade. The ratio of environmental management costs to net sales revenue fell from 0.59% to 0.54%.

In 2005 Krka spent SIT 432 billion on its environmental programmes (investment-based maintenance, investments and fixed assets). Most of these funds were used in the upgrade of the Ločna waste water treatment plant, co-financing the central waste water treatment plant at Ljutomer and the waste sorting arrangements.

We will ensure that the growth in costs is moderate in future by ensuring that environment protection measures function consistently in all areas, and by implementing the planned environmental programmes.

## ENVIRONMENTAL MANAGEMENT (in million SIT)







### ***Environmental protection in Krka's foreign subsidiaries***

We are using our know-how and considerable experience in this field to extend our responsible environmental protection measures to all our companies abroad.

The Krka operating plants in Croatia, Poland and Russia are only involved in production of solid form pharmaceutical products, so lower quantities of process water are required for equipment cleaning in those plants.

The relatively low load of waste water is expelled into the public sewerage system, though the Krka-Rus company also carries out pre-cleaning of waste water in its own waste water treatment plant. We monitor and keep records on the pollution levels of waste water, in accordance with local legislation.

The same guidelines and objectives apply to waste management throughout the Krka Group. All its subsidiaries abroad have applied the separated waste collection system, ensuring relatively low quantities of landfill waste. Hazardous waste is collected separately and sent to appropriate destruction facilities, again in accordance with local legislation. Particle emissions are being reduced using the latest, very efficient filtration systems that completely eradicate particle emissions.

### ***Environmental protection objectives and programmes for 2006***

Our environmental objectives and programmes are determined every year, in accordance with the ISO 14001 environmental management system and our environmental policy. They all contribute to our basic objective: continual improvement in the field of environmental protection.

Our major environmental objectives and programmes for 2006 are:

- maintaining the low pollution levels already achieved for waste water and reducing the number of contraventions of legal requirements
- maintaining the quantity of landfilled waste at the level already achieved within a plus or minus 5%
- increasing the quantity of useful separated waste by 5% (consistent separation of waste, purchase of new containers, extending work with contractors, increased control)
- setting up a multi-phase cleaning system for waste air from the new Sinteza 4 plant with adsorption, cleaning and thermal oxidation
- installing a new granulator with a condenser for volatile organic compounds in waste air from pharmaceutical production.