

Report on compliance with the Corporate Governance Rules of the Warsaw Stock Exchange for 2013 by Krka, tovarna zdravil, d. d., Novo mesto

Introduction

In accordance with the Warsaw Stock Exchange Rules and the Code of Best Practice for WSE Listed Companies, Krka, tovarna zdravil, d. d., Novo mesto (the '**Company**' and, where applicable, the '**Group**' since the Company is the controlling company of a group of companies) hereby presents a report on compliance with the Warsaw Stock Exchange Corporate Governance Rules set forth in the Code of Best Practice for WSE Listed Companies.

For information on the Company's compliance with the Slovenian Corporate Governance Code, please see the Company's 2013 Annual Report.

I. RECOMMENDATIONS AND RULES THAT WERE NOT FULLY COMPLIED WITH BY THE COMPANY IN 2013

Pursuant to the Best Practices defined in sections I, II, III and IV of the Code of Best Practice for WSE Listed Companies, the Company hereunder presents the rules and recommendations that were not fully complied with in 2013.

I.5.

A company should have a remuneration policy and rules of defining the policy. The remuneration policy should in particular determine the form, structure, and level of remuneration of members of supervisory and management bodies. Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC) and Commission Recommendation of 30 April 2009 complementing that Recommendation (2009/385/EC) should apply in defining the remuneration policy for members of supervisory and management bodies of the company.

The Company has a remuneration policy for the members of the Management Board which complies with both EC recommendations to the best extent, whereas the remuneration of the members of the Supervisory Board is subject to government guidelines. In addition, pursuant to the Company's Articles of Association, the payment, remuneration and other benefits of the Management Board members are stipulated by the Supervisory Board.

II. 1.14.

Information about the content of the Company's internal rule of changing the company authorised to audit financial statements or information about the absence of such rule.

The President of the Supervisory Board makes his proposal for appointing the auditor at the Annual General Meetings. The proposal is based on auditors' references, their knowledge of the industry, quality of the audit team, and price. The Slovenian legislation and market practice, however, do not provide for any provisions which would require the rules on selecting auditors to be disclosed, thus the Company discloses them only verbally at Annual General Meetings.

III.3.

A General Meeting should be attended by members of the Supervisory Board who can answer questions submitted at the General Meeting.

The members of the Company's Supervisory Board are authorised to take part in the Annual General Meeting. The Slovenian legislation, however, does not provide for any provisions which would require the mandatory presence of Supervisory Board members. Although the Supervisory Board members make their best effort to attend the Annual General Meetings, one out of nine members was absent due to justified reasons in 2013.

IV.1.

Presence of representatives of the media should be allowed at General Meetings.

The general practice of many Slovenian companies and of the Company is that only shareholders attend Annual General Meetings. Thus, the representatives of the media have been present as *shareholders* of the Company at the 2013 General Meeting and previous General Meetings. In the future, however, the Company will reconsider allowing members of the media to be present even if they are not shareholders.

IV.6.

The date of setting the right to dividend and the date of dividend payment should be set so to ensure the shortest possible period between them, in each case not longer than 15 business days.

Pursuant to the tax legislation in Slovenia, dividends are subject to a withholding tax. Thus, the Company requires certain data from its shareholders which takes more than 15 days to obtain and process. The Company, however, strives to make the payments as soon as practicable.

I.1., I.12., IV.10.

Recommendation to companies to provide, no later than 1 January 2013, its shareholders with the possibility to participate in a General Meeting using electronic communication means and to broadcast and record the Annual General Meetings.

The Company pursues a transparent information policy using many modern technologies to communicate with the capital market community. However, the Company does not provide on-line broadcasting of general meetings and does not record the general meetings and facilitate real-time bilateral communication with shareholders who are at a location different to that of the Annual General Meeting. The reason is that all the shareholders entitled to participate in general meetings may appoint proxies to act on their own behalf and vote at general meetings according to their instructions. So far, there was no need for such mechanisms.

II. GENERAL MEETING OF SHAREHOLDERS, ITS KEY POWERS, THE RIGHTS OF SHAREHOLDERS AND HOW THE RIGHTS ARE EXECUTED.

The section below should be read in conjunction with the Company's **Articles of Association** that are available on the Company's website www.krka.si.

Pursuant to the provisions of the Slovenian Companies Act, the Annual General Meeting is the company's highest body. This is where shareholders participate in the company's governance, and where all fundamental and statutory decisions are taken. Each share, except for treasury shares, represents one vote at the annual general meeting. The Company has one share class only, ordinary no-par value shares.

The Management Board convenes the Annual General Meeting once a year, issuing notice at least 30 days before it is to take place. The full material is available for viewing at the company's registered office, from the day the Annual General Meeting notice is issued.

All shareholders entered in the shareholder register on the date of record published in the notice have the right to attend the Annual General Meeting and vote, as do their representatives and proxies.

At the Annual General Meeting, the Management Board provides shareholders with all the information it requires to assess the content of the agenda, taking into account any legal or other restrictions on the disclosure of information.

The relevant paragraphs regarding the General Meeting are set out below from the Articles of Association.

6.18.

Shareholders shall exercise their rights relating to the Company at General Meetings, either personally or through their proxies.

A shareholder may attend the General Meeting and exercise his/her voting right if he/she announces his/her participation, and if the proxy presents his/her written Power of Attorney to the Management Board at least by the end of day four before the General Meeting date. In the General Meeting convocation notice the shareholders' attention should be drawn to this time limit.

6.19.

A General Meeting shall be convened when this is in the interest of the Company or when so required by law or these Articles of Association.

6.20.

A General Meeting shall be convened by the Management Board of the Company on its own initiative, at the request of the Supervisory Board, or at the request of shareholders of the Company jointly representing at least five percent of the share capital of the Company. The party requesting the convocation of a General Meeting shall submit to the Management Board the explanation and reasoning of the intentions and grounds for the General Meeting convocation. Such a request may also be sent to the Management Board by fax.

As a rule, the General Meeting takes place in the hall of hotel Šport in Otočec ob Krki; however, for substantive reasons the Management Board may decide for the meeting to take place at the company's headquarters.

6.21

The General Meeting is convened at least one month prior to the meeting by a notice published in the newspaper DELO or in any daily newspaper with a large circulation, specifying also the agenda and the time and place of the General Meeting. The notice convening the General Meeting is also published in the Company's bulletin or via the Company's electronic media, if available at the Company, and in the way as defined by the Financial Instruments Market Act. The notice convening the General Meeting is also published on the Company's website.

It should be stated in the notice convening the General Meeting that the party entitled to propose an extension of the agenda or a counter proposal may send this also by fax. Shareholders may also send to the Management Board by fax their application to the General Meeting and potential Power of Attorney. In the same manner

shareholders may at any time revoke such power. In the convocation notice the Management Board may also define other ways of use of electronic media.

6.22.

The shareholders each representing at least 5 (five) percent share in the total share capital, shall be informed in writing of the General Meeting convocation together with the agenda and the relevant materials (by registered post with a receipt confirmation slip), twenty-eight days prior to the General Meeting.

6.23.

The General Meeting shall adopt decisions with a majority of votes, unless otherwise provided by law or these Articles of Association. The General Meeting shall adopt decisions with a three-quarters majority, primarily on the following matters:

- amendments to the Articles of Association,*
- decrease of share capital (including conditional increase),*
- increase of share capital,*
- changes in status and the termination of the Company,*
- the exclusion of pre-emptive rights of shareholders in a new share issue,*
- the early removal of Supervisory Board members,*
- other cases determined by law or these Articles of Association.*

6.24.

The General Meeting shall adopt its Rules of Procedure with the majority of votes. The General Meeting shall be chaired by the President elected by the General Meeting with ordinary majority of votes for each meeting separately and for four years respectively.

III. THE MANAGING AND SUPERVISING BODIES AND THE COMMITTEES.

III. A. The Management Board

The Management Board has the following tasks:

- To manage the Company and make independent and direct business decisions
- To adopt the Company's development strategy
- To ensure risks are handled and managed adequately, and
- To act with the care of a conscientious and honest manager and protect the business secrets of the Company.

The Management Board consists of five members:

- President of the Management Board Jože Colarič,
- Members Zvezdana Bajc, Aleš Rotar PhD, and Vinko Zupančič PhD, and
- Worker Director Danica Novak Malnar, who represents the interests of employees in relation to human resource and social issues, but is not authorised to represent the Company.

The professional references of the Management Board members are set out at Company's web page www.krka.si.

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

The Management Board's operational function and separation of duties is defined by the Management Board Rules of Procedure. Its prevailing approach is to coordinate opinions, and make decisions by consensus rather than on the basis of votes. In line with the Rules of Organisation and the Rules of Procedure of the Management Board, Management Board members also have executive management tasks. Every member is in charge of a number of organisational units, which enables direct cooperation between the Management Board and the company's executive directors.

The Company has the following bodies to support the work of the Management Board:

- Board of Directors
- Sales Committee
- Development Committee
- Quality Committee
- Investment Committee
- Human Resource Committee
- Information Technology Committee
- Economics and Finance Committee, and
- Corporate Identity Committee.

The committees bring together experts from individual sectors of the Company. They prepare business policies and strategies for individual areas and also have certain decision-making responsibilities relating to implementing annual plans.

The payment, remuneration and other benefits of Management Board members are defined in work contracts drawn up between the Supervisory Board and individual Management Board members. Rules defining the remuneration are adopted by the Supervisory Board. In line with the Slovenian Corporate Governance Code, the Supervisory Board adopted a Management Board Remuneration Policy in 2010, and updated it in 2012 according to global market trends.

Management Board members are remunerated in cash. All the payments are presented in the Annual Report.

Members of the Management Board and persons related to them report any acquisition or disposal of shares in the company or associated companies to the Company and competent institutions. The Company makes this information public.

Management Board members must disclose the existence of any conflicts of interest to the Supervisory Board and also notify other members of the Management Board. No-one of the Management Board is a member of the supervisory bodies of companies outside the Group.

Below are the paragraphs regarding the Management Board from Articles of Association.

6.1.

The Management Board shall manage the Company independently and at its own responsibility and shall represent and act on behalf of the Company towards third parties without limitations. The President of the Management Board shall represent and act on behalf of the Company in all matters without limitations, whereas other members will represent it within the scope of competences defined for each member in the Rules of Procedure regulating the Board's functioning. Each member of the Management Board has a right to transfer authorization from his/her field of activity to the Company's employees who manage individual divisions within the Company or other employees of the Company.

6.2.

The Management Board shall be appointed and removed by the Supervisory Board.

6.3.

The Management Board of the Company shall comprise four members and a worker director.

One of the four members shall be both the President of the Management Board and the Chief Executive.

The term-in-office for members of the Management Board shall be six years, with the possibility of reappointment.

6.4.

The Workers' Director is a member of the Management Board and is appointed by the Supervisory Board upon prior consent by the President of the Management Board. The Workers' Director shall represent and act in the interest of employees relating to personnel and social issues. The Workers' Director is not authorized to represent the Company.

6.5.

The Supervisory Board may early remove the members of the Management Board.

6.6.

The Management Board shall adopt the Rules of Procedure to regulate its functioning; the decisions are adopted with an ordinary majority.

6.7.

Mutual rights and obligations between members of the Management Board and the Company shall be set out in detail by a separate agreement signed on behalf of the Company by the President of the Supervisory Board.

In accordance with a proposal of the Supervisory Board and a relevant decision adopted by the General Meeting the Management Board shall be entitled to participate in the Company's accumulated profit, however as a rule only if net profit of the current year to the total equity capital of the Company on the annual account date, gives a return that exceeds the return on one-year deposits.

The amount which may be used for participation of the Management Board in the Company's accumulated profit shall, as a rule not exceed five percent of the accumulated profit allocated for dividend payment to shareholders.

At least two thirds of the Company's accumulated profit allocated for participation of the Management Board in the Company's accumulated profit, is paid out in the form of shares, which are not transferable until expiry of a six-month period upon termination of the Management Board membership function. Only exceptionally the shares from Management Board's participation in the accumulated profit are transferable upon publication of a public offer for the Company takeover exceeding 50 (fifty) percent of the whole Company when the Management Board members are allowed to accept the offer.

III. B. The Supervisory Board and its Committees

The Supervisory Board oversees the Company's operations and how business is managed, and selects and appoints the members of the Management Board. The Supervisory Board meets at least four times a year, usually after each quarter.

Its composition is stipulated by the Company's Articles of Association. It is composed of nine members, six are elected by the Annual General Meeting, and three employee representatives are elected by the Company's Workers Council. The President of the Supervisory Board is always elected from the board members, who are appointed by the Annual General Meeting. Supervisory Board members are appointed for a five-year term and may be reappointed.

Shareholder representatives on the Supervisory Board include President of the Supervisory Board Jože Lenič MSc, Deputy President of the Supervisory Board Matjaž Rakovec, Prof. Julijana Kristl PhD, Vincenc Manček, Mojca Osolnik Videmšek and Assoc. Prof. Sergeja Slapničar PhD. Employee representatives on the Board are Deputy President of the Supervisory Board Franc Šašek, Mateja Vrečer PhD, and Tomaž Sever MSc.

The Supervisory Board complies with good practice recommendations, especially the Slovenian Corporate Governance Code.

The salaries, remuneration and other benefits of the Supervisory Board members are not directly dependent on the Company's performance and are set out in the Annual Report.

The members of the Supervisory Board and persons related to them report any acquisition or disposal of Company shares to the Company and competent institutions, and Krka publishes this information. In the Annual Report we are disclosing how many Company shares are held by members of the Supervisory Board.

Members of the Supervisory Board pursue the Company's objectives in their operations, and must subordinate any personal interests or interests of any third parties to those objectives.

The conduct of Supervisory Board members in the case of conflicts of interest is defined in the amended Rules of Procedure for the Supervisory Board, which is available on the Company website.

The Supervisory Board members meet within committees to discuss specialised areas of business. Pursuant to the legislation and good practice, the Supervisory Board established the Audit Committee and the Human Resource Committee, which deal in detail with accounting and financial issues, and human resource issues, and report and advise to the Supervisory Board. All decision-making regarding committee meetings remains within the powers of the Supervisory Board.

Below are the paragraphs regarding the Supervisory Board from Articles of Association.

6.8.

The Supervisory Board shall comprise nine members.

6.9.

One third of the Supervisory Board members shall be representatives of the employees of the Company, elected by the Workers' Council.

The provision of the first paragraph applies only for the period while the Worker Participation in Management Act is in force.

6.10.

The Supervisory Board shall be appointed by the General Meeting with an ordinary majority vote of shareholders present, except for members of the Supervisory Board referred to in paragraph 6.9. of these Articles of Association.

6.11.

Members of the Supervisory Board shall be appointed for a period of five years and may be re-appointed.

The Supervisory Board shall elect from its members a President and a Deputy President of the Supervisory Board. The President of the Supervisory Board is always elected from shareholders' representatives.

The President shall convene and head meetings of the Supervisory Board and is authorized to express the will and announce the decisions of the Supervisory Board.

The President of the Supervisory Board shall represent the Company in relations with the members of the Management Board, and the Supervisory Board in relations with the company bodies and third parties, unless otherwise determined in a specific case.

6.12.

Meetings of the Supervisory Board shall be convened by the President at his/her discretion, or on the initiative of any member of the Supervisory Board, or on the initiative of the Management Board.

6.13

The Supervisory Board shall adopt decisions at its meetings. The Supervisory Board may adopt decisions in writing, by telephone, telegraph or similar technical equipment, provided none of its members oppose such manner of decision-making.

6.14.

The Supervisory Board shall have a quorum if at least half of its members are present in a meeting, of which three on the part of shareholders' representatives and at least one on the part of employees' representatives.

The Supervisory Board may adopt valid resolutions even without the presence of the members who are employees' representatives if the President adopts a resolution that all of employees' representatives have been invited to the meeting in a proper and timely manner.

6.15.

A decision on the early removal of shareholders' representatives shall be adopted with a three-quarters majority of votes present at a General Meeting, while the conditions for the early removal of employees' representatives shall be determined by the Workers' Council in its Rules of Procedure.

6.16.

Supervisory Board members receive attendance fees and are reimbursed relevant expenses as determined by a General Meeting resolution. Supervisory Board members may receive additional payment for performing their tasks, which may be determined by a General Meeting resolution. Such payment should be in appropriate proportion to the tasks of Supervisory Board members and the Company's financial standing.

6.17.

The Supervisory Board shall regulate in detail the manner and conditions of its functioning in its Rules of Procedure.

IV. DESCRIPTION OF BASIC RULES OF THE RISK MANAGEMENT APPLIED IN THE PROCESS OF PREPARATION OF FINANCIAL STATEMENTS.

Internal auditing

Internal auditors carry out their mission within the Group on the basis of medium-term and annual work plans and in line with the International Standards for the Professional Practice of Internal Auditing (the Standards), which has been certified by an independent external assessment.

Internal audits are carried under the COSO ERM methodology (Committee of Sponsoring Organisations – Enterprise Risk Management). Internal audit work plans and reports are adopted and approved by the Management Board and the Audit Committee of the Supervisory Board.

The COSO ERM methodology is globally recognised and provides a basis for comprehensive risk management.

Internal auditors also work with external auditors, certified information system auditors and the Audit Committee of the Supervisory Board, to which they report directly.

Internal controls and risk management related to financial reporting

Internal controls are guidelines and procedures that the Group has put in place and implements at every level of operation to manage risk related to financial reporting. Internal controls are aimed at ensuring the reliability of financial reporting, and compliance with applicable legislation and other internal and external regulations. Implementing standard information systems in subsidiaries and the development of business information increases the efficiency of accounting data exchange between subsidiaries and the controlling company, and hence also control of that information.

Accounting controls are based on the principles of veracity and separation of responsibility, transaction controls, ensuring records are up-to-date, reconciling the balance disclosed in ledgers and the actual balance, separation of recording-keeping from payments, professionalism of the accounting staff and independence. Accounting controls are closely linked to information technology controls, which ensure, *inter alia*, restrictions and supervision of access to networks, data and applications, and the completeness and accuracy of data capture and processing. Authorised external agents also verify the compliance of operations and the existence of the requisite controls within information systems on an annual basis.

External auditing

In 2013 the auditing company Ernst & Young Revizija, poslovno svetovanje, d. o. o., Ljubljana, Dunajska cesta 111, 1000 Ljubljana, Slovenia audited the financial statements of the controlling Company.

In line with the Slovenian Corporate Governance Code recommendation, the Company changes its auditing partner every five years.

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

Transactions between the Company and the auditing company as well as transactions between Group companies and other auditing companies are disclosed in the Annual Report.

Date: 3 April 2014



Jože Colarič
President of the Management Board
and
Chief Executive