Unaudited Interim Report for Krka, d. d., Novo mesto and the Krka Group (January to June 2006)

August 2006

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INTRODUCTION

Semiannual financial statements for the Krka, d. d., Novo mesto (hereinafter: the Krka Company) and the Krka Group in this report have been prepared in accordance with International Financial Reporting Standards and are unaudited.

The company regularly makes public any significant change to the data contained in its listing prospectus via the Ljubljana Stock Exchange's electronic information system (SEOnet) and/or the Delo newspaper.

Unaudited semiannual report for the Krka Company and the Krka Group can be reviewed at Krka's registered office at Šmarješka cesta 6, 8501 Novo mesto, Slovenia, every working day from 8am to 3pm and on the company website: www.krka.si.

Unaudited semiannual report of the Krka Company and the Krka Group was discussed by the company's Supervisory Board at its regular session of 2 August 2006.

Significant achievements

- In the first sixt months of this year the Krka Company generated an operating profit of 18.1 billion SIT, which is 26% higher than the first half 2005, while the Krka Group generated 19 billion SIT (45% growth).
- The net profit was 12.7 billion SIT (26% growth) for the Krka Company, and 12.4 billion SIT (23% growth) for the Krka Group.
- The Krka Company recorded sales of products and services worth 72.7 billion SIT, while the Krka Group sold products and services worth 82.3 billion SIT.
- The Krka Company recorded 23% growth in sales and the Krka Group 25%.
- The highest growth in sales and the highest proportion of overall sales for both the Krka Company and the Krka Group was recorded in the Region East Europe.
- The proportion of sales on foreign markets was increasing: it was 85% for the Krka Group, and 87% for the Krka Company.
- Based on the resolution adopted by the11th General Meeting of the Krka Company, Krka pays a dividend of 1,650 SIT (gross) per share.
- The Krka share price quoted on the Ljubljana Stock Exchange increased most in April and then in May reached its highest value of 159,670 SIT per share.
- The Krka Group allocated 10 billion SIT to investments, 8.1 billion SIT of which by the Krka Company and 1.9 billion SIT by subsidiaries.
- The number of employees increased by 5.1% The new jobs created were primarily abroad. The number of employees in the Krka Group at the end of June 2006 was 5,489.
- The Krka Company and the Krka Group succesfully implemented all main plans for half year.

Significant data on operations

	Krka, d. d., Novo mesto		Group Krka	
	1-6/2006 Unaudited	1-6/2005 Unaudited	1-6/ 2006 Unaudited	1-6/2005 Unaudited
Net sales in million SIT	72,734	59,200	82,292	65,680
EBIT in million SIT	18,099	14,407	18,972	13,083
Share in net sales	*24.9%*	*24.3%*	*23.1%*	*19.9%*
EBITDA in million SIT	22,480	18,628	24,829	17,304
Share in net sales	*30.9%*	*31.5%*	*30.2%*	*26.3%*
Net profit in million SIT	12,695	10,100	12,441	10,118
Share in net sales	*17.5%*	*17.1%*	*15.1%*	*15.4%*
R&D costs in million SIT	6,055	4,679	6,137	4,723
Share in net sales	*8.3%*	*7.9%*	*7.5%*	*7.2%*
Investments in billion SIT	8.1	7.1	10.0	8.7
	30 Jun 2006 Unaudited	31 Dec 2005 Audited	30 Jun 2006 Unaudited	31 Dec 2005 Audited
Non-current assets in million SIT	123,320	116,589	125,677	120,455
Current assets in million SIT	70,095	65,351	73,149	68,394
Capital in million SIT	126,828	114,141	126,953	114,897
Non-current liabilities in million SIT	37,624	33,058	40,817	36,048
Current liabilities in million SIT	28,964	34,741	31,057	37,904
Number of employees (year end)	4,083	3,908	5,489	5,090
RATIOS				
Net profit/ Revenues	16.8%	16.6%	14.7%	14.8%
Return On Equity (ROE)[1] - converted to annual basis	21.1%	20.2%	20.6%	20.3%
Return On Assets (ROA)[2] - converted to annual basis	13.5%	12.8%	12.8%	12.5%
Liabilities / Capital	0.525	0.594	0.566	0.644

EXCHANGE RATES	1-6/2006	1-6/2005
USD (average)	195.11 SIT	186.47 SIT
USD (30 June)	191.29 SIT	198.63 SIT
EUR (average)	239.59 SIT	239.70 SIT
EUR (30 June)	239.63 SIT	239.57 SIT

SHARE INFORMATION (Krka Group)	1-6/2006	1-6/2005
Total number of shares issued	3,542,612	3,542,612
Earnings per share in SIT[3]	7,345	5,983
Dividend per share in SIT	1,650	1,400
Share price at the end of the period in SIT	145,643	76,560
Price/Earnings ratio per share (P/E)	19.8	12.8
Carrying value of share[4] in SIT	35,836	32,433
Market capitalisation at period end in million SIT	515,957	271,223

1 Net profit, converted to annual basis / average equity balance in the period
2 Net profit, converted to annual basis / average assets balance in the period
4 The calculation of carrying value takes into accaunt the total number of shares issued by the Company.

Significant Events

- On 24 January 2006, during an official two-day tour of the Dolenjska and Bela Krajina regions, the Slovenian Prime Minister Janez Janša visited Krka, accompanied by the Minister for the Economy Andrej Vizjak, the Minister for Health Andrej Bručan, and the Minister for Reform Jože P. Damijan.

- Krka's umbrella brand Septolete®, which includes a wide range of medicines for a sore or pain throat marked 25 years this year. In February the anniversary was celebrated by presenting new products: NeoSeptolete® - green apple flavour, NeoSeptolete® - lemon flavour, and NeoSeptolete® - wild cherry flavour.

- On 7 March the company received notice that Pfizer Inc from New York, had withdrawn its actions relating to Yasnal®. The action was worth 10 million SIT.

- In April Krka received two awards in Poland for its Bilobil® and Septolete® brands. Bilobil® was given the product of the year award in the category of memory improvement products, while the Septolete® Plus won the gold OTIS award for reliability in the oral antiseptic category.

- On 12 April 2006, the President of the Management Board and CEO Jože Colarič was awarded the director of the year award at the 2006 Kapital finance conference, voted for by business journalists. On 25 May 2006 he was awarded the grand prize for excellence and craftsmanship at the 18th Forum of Excellence and Craftsmanship organised by the Dolenjska and Bela Krajina Association of Economists.

- On 14 April 2006 the president of the Krka's Supervisory Board informed the company of a notice issued by the Securities Markets Agency on 5 April 2006, in which it stated there the suspicion he had traded Krka shares in August 2005 on the basis of insider information was unfounded and he had not commit an offence, and no charges would be made. He therefore withdrew the resignation from the position of president of the Supervisory Board that he had offered on 14 September 2005.

- On 26 April the company received notice that the Schering Corporation, Kenilworth, New Jersey, USA had filed a suit against Krka’s subsidiary GmbH, Munich, Germany and Krka in Germany. The lawsuit related to the alleged violation of Schering Corporation patents in Germany in relation to Krka’s product Floron®. The lawsuit was for 1 million EUR.

- On 2 June, 391 employees received long-service awards for completing 10, 20, 30, 35 and 35 years of loyalty to Krka. We also presented awards for inventive work and awards for best Krka employees and best Krka managers. A total of 55 staff and 20 managers were put forward at organisational unit level, with nine staff and five managers winning special awards recognising their achievements.

- On 19 June the company Les Laboratories Servier, 12, Place de la Defense, Courbevoie Cedex, France filed a claim at the Ljubljana District Court against the company Salus, d. d., Mašera Spasičeva ulica 10, Ljubljana and a request for a temporary injunction prohibiting the marketing of the Prenessa® product due to alleged patent infringements relating to use of the active ingredient perindopril in Slovenia. Salus, d. d. markets Prenessa®, which is produced by Krka-Polska Sp. z o. o., Warsaw, Poland, a 100%-owned subsidiary of Krka d. d., Novo mesto. If the temporary injunction is issued the loss of earnings from the sale of Prenessa® for Krka-Polska Sp. z o. o. would amount to around 0.5 million EUR by the end of the year.

- In June the company Sanofi Aventis, 174, Av. de France, Paris, France filed a request for temporary injunction due to alleged patent violation relating to the use of the active ingredient clopidogrel in Serbia. On 30 June 2006, after an appeal by Krka-Farme d. o. o. Novi Sad the Higher Court of Commerce in Novi Sad cancelled the temporary injunction and returned the case to the court of first instance to be heard again.

Events after the accounting period

- Krka’s 11th Annual General Meeting took place at Otočec on 6 July. The shareholders present represented 37.18% of capital. This year the share dividend was set at 1,650 SIT gross per share.

- The AGM also passed a resolution according to which all financial statements given in the Company’s Annual Report for the company and the Group will be in accordance with the International Financial Reporting Standards (IFRS), because the IFRS will be the standard used for annual reports from 1 January 2006 onwards.

- The claimants Les Laboratoires Servier, 22, Rue Garnier, Neuilly sur Seine, France and Servier Laboratories Limited of Fulmer Hall, Windmill Road, Fulmer, Slough, UK, filed a lawsuit on 28 July 2006 at High Court of Justice, Chancery Division, Patents Court, London, UK, against the defendants Krka, d. d., Novo mesto, Slovenia and Krka-Polska Sp. z o. o., Warsaw, Poland, which is under 100% ownership control by Krka, d. d., Novo mesto, Slovenia. The claimants claim that the defendants infringed the patent for the production process of one of intermediate substances for the production of perindopril activepharmaceuticalingredient(API). Krka-Polska Sp. z o. o. is a holder of marketing authorization for UK for products with perindopril API. So far, Krka-Polska Sp. z o. o. has not been selling products with perindopril API in the UK. However, Krka-Polska Sp. z o. o. has been planning to sell these products in August 2006 in the value of 450,000 GBP. Krka-Polska Sp. z o. o. has temporarily withheld its sales activities relating to these products and is investigating the matter together with its parent company, Krka, d. d., Novo mesto.Krka, d. d., Novo mesto and Krka-Polska Sp. z o. o. are assessing that the claim is completely unfounded. Krka's products with perindopril API are manufactured under independent production process and have the characteristics which are not infringing the above mentioned patent in the UK.

The Krka Group's business objectives for 2006

- A 13% sales growth generating total sales of 150 billion SIT.

- Generating over 80% of sales revenues on foreign markets.

- The Russian Federation should be the largest single market for sales.

- The highest sales growth forecast in Region Central Europe and Region East Europe.

- Products for human consumption (prescription pharmaceuticals and self-medication products, and cosmetic products) 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 ampoule production plant.

- At the end of 2006, the Krka Group will employ an estimated 5700 people, over 2000 of which will be working in representative offices and companies outside Slovenia.

Business operations analysis of the Krka Company and the Krka Group

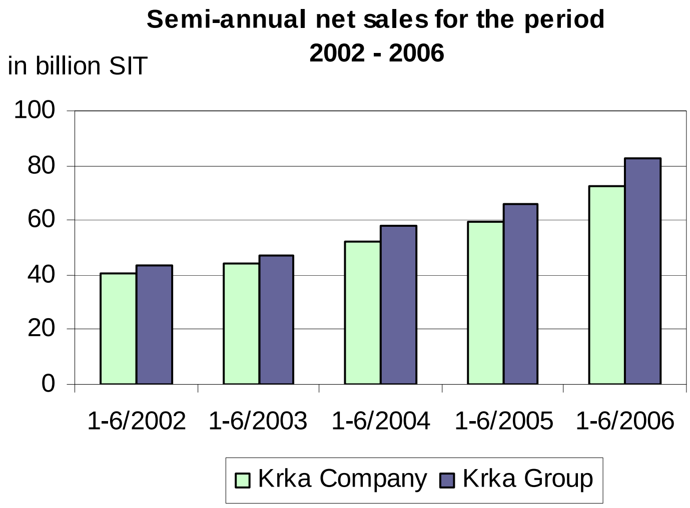
In the first six months of this year both the Krka Company and the Krka Group have performed successfully. The good results were due not only to increased sales revenues, but were also significantly affected by lower growth in operating expenses. Most of this half-year's operating results are better than last year and the planned results for the period.

Key operating data for the first half of 2005 and 2006

in million SIT	Krka Group			Krka Company		
	1-6/2006	1-6/2005	Index	1-6/2006	1-6/2005	Index
Net sales	82,292	65,680	125	72,734	59,200	123
Operating profit	18,972	13,083	145	18,099	14,407	126
Profit before tax	18,270	13,343	137	18,063	13,149	137
Net profit	12,441	10,118	123	12,695	10,100	126

Revenues

Net sales increased by 25% for the Krka Group, and 23% for the Krka Company. The Krka Company generated 72.7 billion SIT in net sales of prescription pharmaceuticals, self-medication products and animal health and cosmetic products, while the Krka Group generated 82.3 billion SIT net sales of these products plus sales of health and tourist services. The major contribution to the Krka Group net sales (at 82%) came from sales of prescription pharmaceuticals, which with a 28% increase also recorded the highest growth in sales of any product group. Most of the net sales was generated from the sale of products, services and goods outside Slovenia. The growth differs from market to market, with the highest growth achieved in the Russian Federation. In the first half of the year we have achieved 55% of this year's planned sales. A more detailed analysis of the sales results achieved by individual market and product group is given in the section Marketing and Sales.



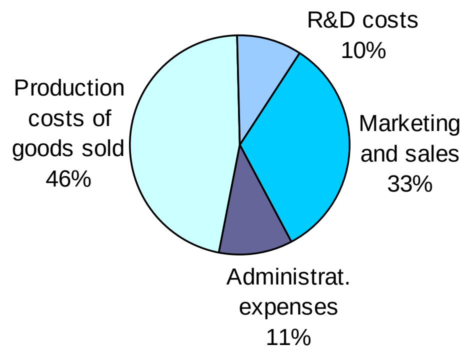
The Company generated revenue of 75.4 billion SIT and the Krka Group 84.8 billion SIT, a 24% increase on the first half of 2005. Net sales represented most of the revenue generated by the Krka Company and the Krka Group (96% and 97% respectively).

Expenses

The Krka Group incurred expenses of 66.5 billion SIT, 21% higher than in the first half of 2005. Excluding newly formed provisions, the growth in Group expenses was 14%, which is 11 percentage points less than the growth in sales.

The Krka Group's operating expenses of 63.7 billion SIT included 29.9 billion SIT in production costs of goods sold, 20.9 billion SIT in marketing and sales, 6.1 billion SIT in R&D costs and 6.8 billion SIT in administrative expenses.

Structure of operating expenses in the half year 2006 - Krka Group

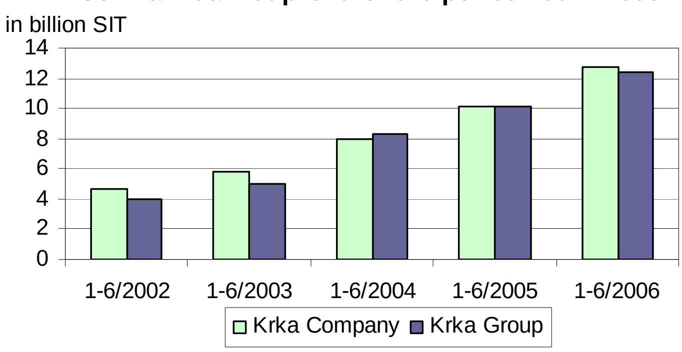


Compared to the same period last year, production costs of goods sold increased for the Krka Group slightly less than the growth in sales at 5%. The change in marketing and sales and R&D costs was different, where greater market demands and ever sterner competition mean more investment is needed every year. Expanding the Krka marketing network on all Krka's major markets led to an increase in these costs. They increased by 33% on the same period last year (excluding newly formed provisions). When including provisions formed by the controlling company in the first half of the year primarily due to an action relating to alleged patent violations for atorvastatin, distribution and sales costs represented 33% of all operating expenses. The Krka Group's R&D costs were 30% higher than in the same period in 2005 and were mainly incurred by 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 for the Krka Group were 4% lower than for the first half-year of 2005.

Operating result

The Krka Group recorded an operating profit of 19 billion SIT, which is 45% higher than for the first half of 2005. Profit before tax increased by 37% to 18.3 billion SIT. Income tax amounted to 5.8 billion SIT, 6.4 billion SIT of which being taxes levied and 0.6 billion SIT being deferred taxes. The effective tax rate for the Krka Group increased from 24.2% for the first half of 2005 to 31.9%. The increase is due to a higher corporate tax rate and above all reduced tax relief facilities.

Semi-annual net profit for the period 2002 - 2006



Note: SAS applied for data for the period 2002-2003 and IFRS for 2004 and 2005.

The Krka Group's net profit was 12.4 billion SIT, up 23%, while the Krka Company recorded 12.7 billion SIT, which is 2.6 billion SIT or 26% more than the previous year.

Assets

The Krka Group's assets were worth 198.8 billion SIT on 30 June 2006, growing by 5% from the start of the year. The ratio of current to non-current assets remained almost unchanged compared to the start of the year.

Of the non-current assets, worth a total of 125.7 billion SIT, the most important item is property, plant and equipment at 112.4 billion SIT, which has increased by 4% or 4.3 billion SIT in the last six months due to new investments, and now represents 57% of total assets.

Current assets increased by 7% to 73.1 billion SIT. The main contribution to growth came from increased financial investments (purchase of shares and bonds), which increased by 69% in the first six months of this year to 5.7 billion SIT. Inventories remained almost at the same level as the start of the year (28.9 billion SIT), while operating receivables increased along with the increased sales by 6% or 35 billion SIT.

Equity and liabilities

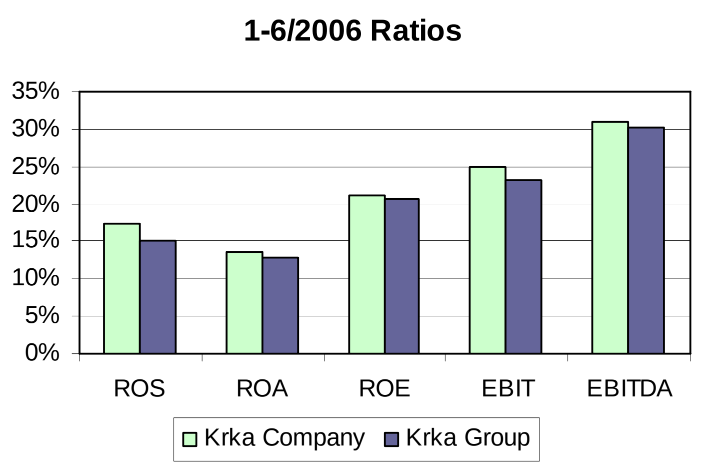
The Krka Group's equity increased by 10% and now represents 64% of total liabilities. The main factor in the growth was the net profit of the Krka Group in the first half of the year, which was 12.4 billion SIT.

Non-current provisions increased by 19%, which is the amount of newly formed provisions for lawsuits, primarily in relation to medicines for the heart and cardiovascular diseases.

Long-term borrowings remained unchanged compared to the balance at the end of 2005. The Krka Company did not increase its borrowings. The subsidiaries Terme Krka and Krka-Farma Zagreb did increase their borrowings, though only a small amount.

Current liabilities fell by 18% and at 31.1 billion SIT represent 16% of the balance sheet total. This includes trade payables, which totalled 11.9 billion SIT at the end of June, a decrease of 2.2 billion SIT or 15%. The main impact on the reduction in current liabilities came from the fall in income tax liabilities, which were extremely high at the end of 2005, mainly due to tax liabilities relating to Krka's net provisioning in 2005 (release and formation of provisions). Short-term borrowings of 8.3 billion SIT showed a reduction of 9%, while long-term and short-term borrowings together fell by 4% over the six-month period.

Ratios



All the Krka Group's operational indicators were in line with its strategic guidelines and objectives, and were better than in the first half of 2005. The net profit margin (ROS) for the Krka Group was 15.1% (the Krka Company: 17.5%), return on assets 12.8% (13.5 %), return on equity 20.6% (21.1%), operating profit 23.1% (24.9 %) and EBITDA share in net sales 30.2% (30.9%)

Profile of the Krka Group

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

Data on the controlling company:

Registered office: Šmarješka cesta 6

8501 Novo mesto

Slovenia

Telephone: 07 331 21 11

Fax: 07 332 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

Tax number: 82646716

Registration 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 code KRKG.

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

	Ownership share (in %)
Subsidiary in Slovenia	
TERME KRKA, d. o. o., Novo mesto	100
Subsidiairies abroad	
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	100
DP »KRKA Ukraina«, Kiev, Ukraine*	100
HELVETIUS-S. R. L., Trieste, Italy**	80

* company not operated
** company being wound up

Abbreviated company names are used in the text below.

The production of products for human consumption takes place at the controlling company and in three production and distribution centres, located in Croatia, Poland and the Russian Federation.

In mid-June 2006 the subsidiary Krka Zdravililišča d.o.o. Novo mesto was renamed as Terme Krka, d.o.o. Novo mesto. Its business activities will remain the same: health spa, tourism and catering and hospitality services.

The Terme Krka subsidiary holds a participating interest in the following companies:

- Terme Krka – Strunjan d. o. o. (51%) and
- Golf Grad Otočec d.o.o. (43.8%).

All companies in the Group have the controlling company as founder or co-founder. Investments by the Krka Company in subsidiaries are valued using the equity method.

BUSINESS REPORT

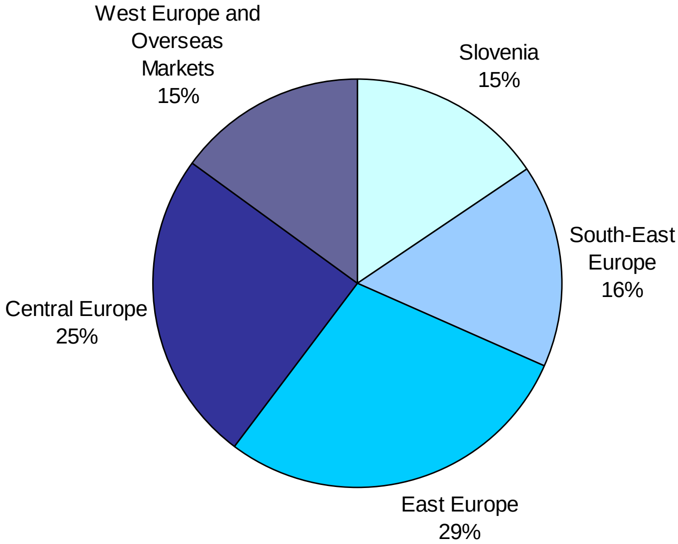
Marketing and sales

In the first half of this year, the Krka Company and Group operated in line with their plans and exceeded last year's half-year sales figures. The Krka Group, with sales of 82.3 billion SIT, exceeded last year's half-year sales by 25%, and generated 55% of planned annual sales. The Krka Company generated 72.7 billion SIT in sales, a 23% growth, and achieved 55% of planned sales for 2006. Group sales were 9.6 billion SIT or 13% higher than sales by the Krka Company. The higher sales of the Group are largely due to sales by the subsidiaries Terme Krka and Krka-Polska, which generate the highest proportion of sales revenue of all the subsidiaries in the Krka Group. Sales outside Slovenia continue to increase in importance, and the proportion of exports in overall sales is already 85%. Region East Europe recorded the highest growth in sales compared to the same period last year, as well as the highest proportion of sales in overall sales by the Krka Company and Group, followed by Central Europe in the proportion of sales, while Western Europe and Overseas Market was second in terms of sales growth. The leading market in Region East Europe is the Russian Federation, which is Krka largest individual market, and where sales of 17.6 billion SIT were achieved in the first six months of this year, or 44% more than the same period last year. In Slovenia sales remained at the same level in the first six months last year.

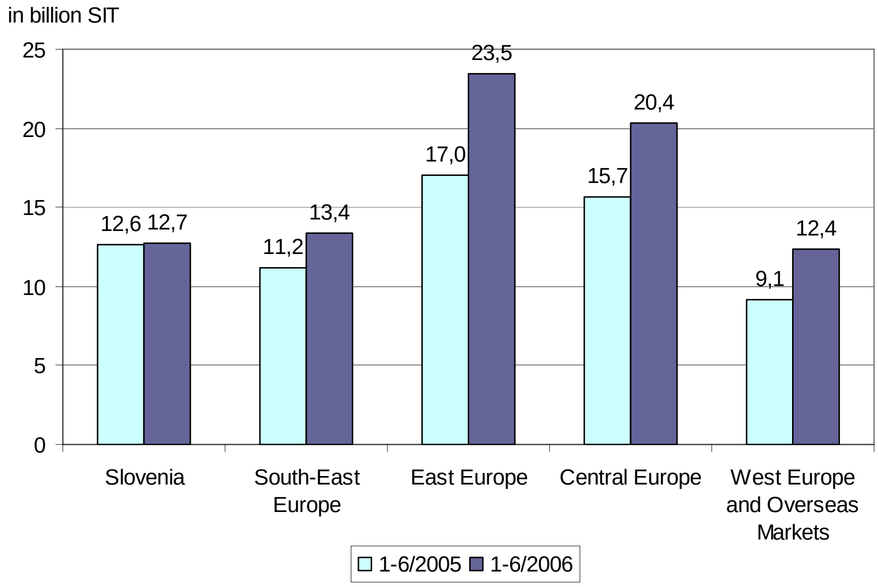
Krka Group and Krka Company sales by region in the first half year of 2006

in million SIT	Krka Group			Krka Company		
	1-6/2006	1-6/2005	Ind.	1-6/2005	1-6/2006	Ind.
Slovenia	12.687	12.648	100	9.452	9.900	95
South-East Europe	13.392	11.197	120	11.683	10.253	114
East Europe	23.462	17.013	138	23.120	16.629	139
Central Europe	20.359	15.697	130	16.094	13.244	122
West Europe and Overseas Markets	12.392	9.125	136	12.385	9.174	135
Total	82.292	65.680	125	72.734	59.200	123

Structure of Krka Group and Krka Company sales by regions in the first half year of 2006



Krka Group and Krka Company sales by regions in the first half year of 2005 and 2006



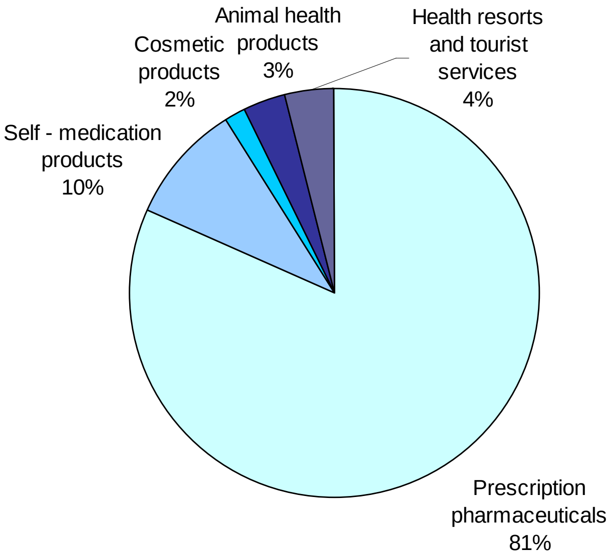
Sales by product groups

Prescription pharmaceuticals represent by far the largest proportion in the structure of sales by product groups, which together with self-medication products and cosmetics form the human health product range.

Krka Group and Krka company sales by product groups in the first half year of 2006

in million SIT	Krka Group			Krka Company		
	1-6/2006	1-6/2005		1-6/2006	1-6/2005	
Human health products	76.261	60.478	126	69.850	56.796	123
- Prescription pharmaceuticals	67.121	52.558	128	60.803	49.176	124
- Self - medication products	7.890	6.869	115	7.829	6.588	119
- Cosmetic products	1.250	1.051	119	1.218	1.032	118
Anmial health products	2.831	2.366	120	2.798	2.322	120
Health resorts and tourist services	3.117	2.748	113			
Other	83	88	94	86	82	105
Total	82.292	65.680	125	72.734	59.200	123

Structure of Krka Group and Krka company sales by product groups in the first half year of 2006



Prescription pharmaceuticals

Prescription pharmaceuticals in the first half of 2006 generated sales of 67.1 billion SIT, which exceeds last year's half-year sales by 28%.

Of Krka's larger markets, the highest growth in the first half of the year was achieved in Hungary (by 103%), Romania (66%), Russian Federation (45%), Poland (41%) and Ukraine (20%), while it is also worth mentioning high sales growth on some of Krka's smaller markets such as Serbia (75 %), Uzbekistan and Lithuania (both at 44%) and in Bulgaria (39 %). Be it higher or larger, sales growth was recorded on practically all markets except Slovenia, Macedonia and Georgia.

The leading prescription pharmaceuticals are Enap®, Vasilip®, Atoris®, Lanzul®, Tenox®, Fromilid®, Lorista®, Nolicin®, Coryol®, Asentra® and Zalasta®. Half of them are relatively new, having being launched after 2000. Zalasta®, which was launched as recently as the end of 2004, is the highest ranked of the newest products at tenth.

Preparing and carrying out launching new products is one of Krka's most important tasks, and this year has already seen a large number of launches. For the first time we launched new products almost simultaneously on most markets (e.g. Tanyz®). This was due to accelerated registration processes using MRP procedures in EU member states.

In 2006 we started marketing five completing new Krka products: the anti-psychotic Torendo® (risperidone), a pharmaceutical for treatment of benign prostatic hyperplasia Tanyz® (tamsulosin), the antidiabetic Meglimid® (glimepiride), the antihypertensive Laaven® (lisinopril) and the hypnotic Zolsana® (zolpidem).

The range of existing products was expanded with new combinations and pharmaceutical forms: the combination of ramipril and the diuretics Ampril® HD and HL and with Ultop® (omeprazole) in parenteral form.

The leading therapeutic group for Krka's prescription pharmaceuticals is medicine for reducing blood pressure (antihypertensives). In this field we were the leading producer in all of Central and East Europe, ahead of every other producer. We have the widest range of products, offering the most appropriate products for every patient. There are now over six million patients using Krka anti-hypertensives in Europe. The highest levels of marketing activities also involve products for treating high blood pressure.

The leading hypertensive, and also one of Krka's leading products, remains Enap® (enalapril). Sales of Enap® increased by 10% in comparison to the previous year, and by as much as 35% on the markets covered by Krka's Region East Europe. This region offers the greatest opportunities for further growth through the continued training of doctors and further information provision for patients. Marketing activities for Enap® are part of overall activities to support sales of the entire product range.

On the fifth anniversary of marketing the antihypertensive Lorista® (losartan) we prepared a major symposium for over 300 guests from five countries. Lorista® is producing excellent results this year, with twice as many sales compared to the first six months of 2005. The growth was particularly strong in Poland, where the Angiotensin II antagonist field is less developed, as well as on other Central Europe markets.

Two antihypertensives also recorded high sales compared to last year. Those are Tenox® (amlodipin), which recorded high growth in all regions, and Ampril® (ramipril), which was launched last year on most Central Europe markets and was joined this year by the combination with the diuretic Ampril® HD and HL.

Krka is also a market leader for products to reduce plasma lipids on its traditional markets. We offer the widest range of products: Atoris® (atorvastatin), Vasilip® (simvastatin) and Holetar® (lovastatin), and also lead the market in sales. Our marketing activities are primarily focused on Vasilip® and Atoris®, where the organisation of symposiums, lectures and training on lipids are offered to help improve diagnostics and treatment of patients. We also offer education books for patients that increase awareness about the importance of treatment. During the first half of the year, we achieved excellent results with Atoris®, sales of which almost doubled. We managed to increase sales of Vasilip® by 8%, despite continual pressure to reduce prices.

In the field of cardiovascular treatment mention must be made of Zyllt® (clopidogrel), which was first launched last year in Croatia, and this year in Bosnia, Serbia, Macedonia and Poland, and by the end of the year in Russian Federation as well. This Zyllt® sales passed the million euro threshold in just a few months, and it is a very promising product for the future.

Products to treat diseases of the central nervous system are increasingly important, and we have expanded our product range with two completely new medicines: Torendo® (risperidone) and Zolsana® (zolpidem), while the marketing of Asentra® (sertraline) and Zalasta® (olanzapine) was expanded from Central Europe to other markets, particularly in south-east Europe, where these two products rank as Krka's ninth and tenth best selling products overall. The antidepressant Mirzaten® (mirtazapine) has also returned excellent sales growth figures, while price reductions and new competitors has led to sales of Yasnal® (donepezil) falling.

The anti-microbial field is starting to stagnate, primarily in the developed world, but also on Krka traditional markets. Our marketing activities are therefore aimed at increasing our market share and outdoing competing products, while the growth in absolute sales is lower than in other rapidly expanding areas. We increased sales of our leading anti-microbial Fromilid® (clarithromycin) by 5%, Nolicin® (norfloxacin) sales were up 25% and Ciprinol® (ciprofloxacin) maintained its sales level from last year.

The planned activities for Ultop® (omeprazole) and Lanzul® (lansoprazole) were successful, significantly exceeding last year's figures. Lanzul sales grew by 110%, due to the successful launch of the lansoprazole product on the markets of western Europe.

This year we paid particular attention to practical training for management staff in the marketing teams in our companies and representative offices. This covered our field and regional managers, local product managers and internal trainers, whose work has a decisive impact on specialist staff, ensuring that their visits and presentations to business partners are effective in terms of sales. In the first half of the year we organised meetings and training for each of these management groups. The groups were organised internationally to ensure the best possible exchange of experiences, while the training was very practical, with numerous case studies and computer simulations.

Self-medication products

In the first half of the year we achieves sales of self-medication products worth 7.9 billion SIT, a 15% growth on compared to the same period last year. Regional highlights included East Europe (4.3 billion SIT, a 34% growth) and South-East Europe (1.8 billion SIT, a 27% growth).

Sales in Slovenia were 12% lower than for the same period last year, and sales were also down in Central Europe. The poor sales on these markets was due to sales being extremely dependent on seasonal products such as Septolete, Herbion, Panatus, and the mild winter led to lower sales. The highest growth on the larger markets was recorded in the Russian Federation (41%), Romania (55%) and Ukraine (21%).

The highest sales were achieved with the products Bilobil®, Pikovit®, Duovit®, Septolete® and Panzynorm®, which recorded the highest growth at 126%.

Promotional activities backed by appropriate investment were targeted at priority products (Pikovit®, Duovit®, Septolete®, Bilobil®, Nalgesin®) and the most promising potential markets (Russian Federation, Ukraine, Kazakhstan), with sufficient growth also being achieved on other markets (such as Poland, and Croatia). New product launches mainly involved adding new products to umbrella brands (new flavours of Septolete®, Duovit® for men, Duovit® for women, Duovit® memo).

Cosmetic products

In the first half of 2006, cosmetic products generated sales of 1.3 billion SIT, exceeding last year's sales figures by 19%.

Taken region by region, we achieved positive sales trends compared to last year in the regions of South-East Europe (22 %), East Europe (44 %) and Central Europe (15 %). Sales in Slovenia were 4% lower than last year.

Animal health products

Sales of animal health products in the first half of 2006 were up 20% on the same period in 2005. Sales in Central Europe contributed most to growth, with sales there up by 42%.

In Poland Krka maintained or improved sales in traditional segments of veterinary care for poultry and pigs, despite a fall in demand for poultry meat due to avian flu. There was a noticeable increase in sales in other segments (injection solutions), due to increased market pressures on these segments, while the effects of drawing on EU agricultural subsidies were also felt. In our Region Central Europe, Hungary also achieved above average growth.

Region West Europe and Overseas Market was in second place by amount of sales, which reflects the changed strategic priority of these markets. Sound sales growth was achieved in the Russian Federation within East Europe, consolidating last year's high growth. In South-East Europe Romania with 36% growth and Serbia (47%) are worthy of mention. Sales in Croatia and Slovenia remained at the same level as the previous year.

The best selling brand is still Enroxil®, though sales are no longer growing. It is closely followed by Floron® which offers significant potential for growth, and will probably become the leading brand in the second half of this year, while the licensed products Virkon® S and Egocin® are also growing.

The leading product in veterinary care for pigs is Floron®. It represents over 17% of animal health product sales, and holds a sound second place in the best-selling animal health product rankings. Veterinary protection for pigs is becoming more important due to the growth in animal stocks in some key markets. There is great potential in Russia in particular, where we anticipate launching Floron® premix in the second half of the year.

In the field of veterinary care for poultry, the negative trends caused by avian flu in numerous European countries abated during the first half of 2006. This lead to lower sales of Enroxil® solution, but higher sales of Virkon®. Poultry production on traditional markets is continuing to grow, so we anticipate growth in sales of Enroxil®, Kokcisan and Mondolar.

Health resorts and tourism

The sales of health and tourism services reached 3.1 billion SIT in the first six months of 2006, which is 31% more than the same period last year. They now represent 4% of the Group's overall sales. The total number of overnight stays was 161,633 an increase of 8% on the first half of last year, while the proportion of foreign guests increased by two percentage points to 30%. The highest number of overnight stays within the Terme Krkak company was recorded at the Terme Krka Strunjan resort with a third of all stays, while the highest growth compared to the first six months of last year (19%) was achieved in the Šmarješke Toplice resort.

Research and development

The first half of 2006 was marked by an increase in the number of new development projects, with the aim being to ensure the continued competitiveness of the Krka product portfolio. At present research and development work at Krka includes around 100 projects in various developmental phases and across a wide range of fields.

The successful conclusion of development work is the successful completion of registration procedures. In the first half of 2006, we acquired the first marketing authorization for seven new products in 14 different strengths. We also acquired 315 marketing authorizations for a whole range of products across a number of different markets. We obtained marketing authorisation for Prenessa® (perindopril), a product from cardiovascular range. A new product was added to the cardiovascular range when Valsacor® gained marketing authorization in Slovenia, with the active ingredient valsartan in 40, 80 and 160 mg film-coated tablets. The first marketing authorization for new strengths of Lorista® in the forms of 12.5mg, 25mg and 100mg tablets in Slovenia consolidated the brand as a key product for treatment of cardiovascular disease. We successfully concluded the MRP for Losartan® 50mg tablets and Losartan/hydrochlorothiazide tablets, expanding the registration of the product to some western European markets. Obtaining marketing authorization for the product Zyllt® (clopidogrel) in Russia was an important national registration.

Krka range of products to treat the central nervous system expanded with the acquisition of marketing authorization in Slovenia for the product Zolsana® with the active ingredient zolpidem, in the form of 10mg and 5mg film-coated tablets. Another important achievement in the marketing of products for the central nervous system was obtaining the marketing authorization for the Zalasta® (olanzapine) tablet in Croatia.

The range of products to treat benign prostatic hyperplasia was expanded at the end of last year with marketing authorizations being obtained for Tanyz® (tamsulosin) and the new product Finpros® with the active ingredient finasteride in the form of a 5mg film-coated tablet.

In the self-medication product group we obtained new marketing authorizations for Norya® (probiotic bacteria) in the capsule form in Poland, the Czech Republic, Slovakia, Croatia, Russia and Ukraine and for the product Minart® with the active ingredient glucozamine in the strength 1500mg effervescent tablets in Romania.

Important results were also achieved in the animal health field. On western European markets, we were the first generic producer to obtain marketing authorization and launch an enrofloxacin product, which is used to treat infections in farm animals. Krka’s biocide range was developed with the notification of Ecocid® for human and veterinary medicine in Slovenia and the Czech Republic.

Special care in the development of new technologies is given to developing formulations in tandem with the delivery system, and the development of formulations in the form of orodispersible tablets. In 2006 we continued the process to obtain marketing authorizations for the risperidone orodispersible tablets on European markets. In the development of synthesis paths for active ingredient preparation, we confirmed the success of new innovative approaches to development by obtaining marketing authorization for a ciprofloxacin product in injection form in western Europe.

We intensified external cooperation in the first half of 2006 in research management through work with specialised development partners in the field of active ingredient synthesis and bio-synthesis, as well as in the field of pharmaceutical technology and ingredient and product evaluation.

We also increased staff and investment in the research field. New staff deepen and complement the knowledge available to us in the field of key pharmaceutical and chemical technologies. The most important investment in 2006 is the extension of developmental capacity in chemical R&D work.

Krka protects the results of its work in key fields through applications for patents. In 2006 the company submitted patent applications for 10 new products, and on the basis of prioritised applications from 2005 also submitted 8 international patent applications.

The company markets its products under its own trademarks, which further enhances the added value of Krka products. In 2006 Krka registered 18 trademarks in Slovenia, one in Hungary and submitted 18 applications for international registration.

Krka's investment in research and development again ranked it as an important European company, in 38th and the only Slovenian company from the field of pharmaceuticals and biotechnology (according to last European Commission publication: The 2005 EU Industrial R&D Investment Scoreboard).

Investments

In the first half of 2006, the Krka Group allocated 10 billion SIT to investment, with 8.1 billion SIT by the controlling company, and 1.9 billion SIT by subsidiaries. At present the Group is implementing over 25 projects mainly relating to the production of final products and raw materials and the modernisation of infrastructure to provide high quality support for the business functions of the entire group. Most of these projects take place in Slovenia, while the largest investments among the subsidiaries are being implemented by Terme Krka and Krka Farma Zagreb.

The Sinteza 4 Plant

In September 2006 we anticipate the start of test production in the new Sinteza 4 active pharmaceutical production plant, the largest investment project this year in terms of both technological complexity and financial commitment. The plant will be used for the production of active pharmaceutical ingredients (API), which can then be incorporated into our own pharmaceutical products. In addition to statins, which are incorporated into cholesterol-reducing products, Sinteza 4 will also be used to produce other APIs for products to treat cardiovascular diseases and pharmaceuticals in other therapeutic areas. Work on the plant is in the final phase, and process automatisation is now underway. In June a technical review was successfully passed, and a SIQ (Slovenian Institute of Quality and Metrology) inspection is underway. Once the permit is issued we will start with test operations.

Pelete IV

The construction of Pelete IV, with test production set to commence at the beginning of 2007, should double pellet production capacity. The new facility and spatial capacity required for R&D work will be located in the new extension to the Sinteza plant, which enable further expansion. The third construction phase of the facility has been completed, and at the start of July work began assembling installations and technological equipment, which will be completed by the end of September 2006.

New injection production plant

Work has started on the new injection production plant, which will be connected to the existing plant. The new plant will be used for production from the preparation of solutions, ampoule filling, and autoclaving, while the renovated current plant will be used for optical control and packaging. The start of test production is planned for the end of next year. Trades work has already started on the plant, and a large number of contracts for the delivery and assembly of technological equipment have been signed.

Capsule production plant

The expansion of the product range has raised the need to increase packing capacity for solid pharmaceutical forms. The first phase of modernising the capsule production and packaging plant is now underway, and will increase the production capacity of the plant. The work has largely been finished, and most equipment has already been acquired.

Notol III

In the third phase of the Notol project we will increase the packaging facility, which will allow six new packaging lines to be added. There will also be investment in additional capacity of the weighing, granulating and tableting facilities to coordinate the increased packaging capacity with intermediate product production capacity. The third construction phase is set for completion by August, and assembly and installation work will start in September. All packaging lines will be equipped during the coming year, with all work planned for completion by the end of the year.

Information technology projects

A wide range of IT projects are underway, including: a project on data consolidation and building a business intelligence system, which involves bringing in an information system that will update the reporting system for existing information systems; a project to improve the entire process from planning sales requirements to detailed production scheduling; a project for the euro changeover; and the introduction of the SAP information system module for salary calculation and work time records.

Other Group investments

The largest amount allocated to investment by a subsidiary in the first half of 2006 was 538 million SIT, by the Terme Krka company. The largest investment was the renovation of the Krka Hotel at Šmarješke Toplice and the overhaul of the heating system between the hot water well shaft and the hotel, while the associated company Terme Krka, and he company Golf Grad Otočec completed phase one of the golf course construction at Struga pri Otočcu. The Krka Farma Zagreb subsidiary is upgrading its central energy control system which will also direct control from Novo Mesto.

Employees

Given its ambitious sales plans for 2006, Krka has accelerated its staff recruitment, especially in the fields of marketing and sales, and research and development. In 2006 we planned an increase of 573 in the number of employees, 88% of which in companies and representatives abroad. In the first half of the year the number of employees in Slovenia increased by 31 while in companies and representative offices abroad the number of new employees over that period increased by 234, mainly with a university degree. On 30 June 2006 the Krka Group had 5489 employees, which was 5% more than at the end of 2005, with the Krka Company employing 4083, or 3% more than at the end of last year. More than half of employees in the Krka Group have at least a university or other further education qualification.

The technical and technological advances and expansion of the sales portfolio with new products demand careful and continual investment in new knowledge and training for employees. At present 144 Krka employees are involved in specialist, master's and doctoral studies, while a total of 380 employees have been involved in part-time studies alongside their work. We also provide 56 scholarships, mainly in collaboration with the faculties of pharmacy and chemistry. Our employees are also studying at home and abroad in the fields of specialist knowledge, management, personal development, foreign languages and information science. Most such education and training is organised by the Training Centre, which is part of the controlling company.

Since 2001 we have been carrying out testing and verifying knowledge via the certification system, which favours employees' practical knowledge. So far 134 certificates have been awarded to employees within this system, and 123 workers are currently in the process of training to acquire new vocational qualifications. Development planning for key and promising staff includes giving such staff demanding tasks and educating and training them in management and professional fields to ensure they are provided with all they need for the highest quality development. The development of key and promising management employees has been organised for some years with Krka's own management school, which involves directors and managers from Krka companies and representatives offices abroad and from the controlling company's organisational units. This also contributes to strengthening the international culture of the Krka Group.

Education structure of Krka Group employees

	30 Jun 2006		31 Dec 2005	
Level of Education	Number of Employees	Proportion in %	Number of Employees	Proportion in %
Doctorate	55	1,0	51	1,0
Master of Science	154	2,8	153	2,9
University education	2243	40,9	2018	38,6
Higher professional education	248	4,5	221	4,2
Vocational college education	217	4,0	206	4,0
Secondary school education	1115	20,3	1104	21,1
Skilled workers	1205	21,9	1219	23,4
Unskilled workers	252	4,6	252	4,8
Total	5489	100,0	5224	100,0
- Slovenia	3611	65,8	3580	68,5
- abroad	1878	34,2	1644	31,5

Share trading and shareholding

At the end of June 2006 Krka had 54,026 shareholders, which is 0.7% more than at the end of 2005. The total number of shareholders increased due to ownership share increase of individual Slovenian investors and international investors whose ownership share increased by over one percentage point to just over 7%. In the first half of 2006 the ownership share of investment companies and funds fell by 3 percentage points, while the ownership share of other shareholder groups did not change significantly.

Ownership structure (%)

	30. 6. 2006	31. 12. 2005
Individual Slovenian investors	40.2	39.2
Investment companies and funds	12.2	15.2
SOD fund	15.0	14.5
Other Slovenian companies	10.6	10.3
KAD & PPS funds	10.1	10.0
Treasury stock	4.6	4.6
International investors	7.3	6.2
Total	100.0	100.0

On 30 June 2006 the Krka Company held 162,662 treasury stock, which was 4.6% of the share capital. In the first half year of 2006 the company did not repurchase any treasury stock. The ten largest shareholders on 30 June 2006 held a total of 1,271,788 or 35.9% of total shares.

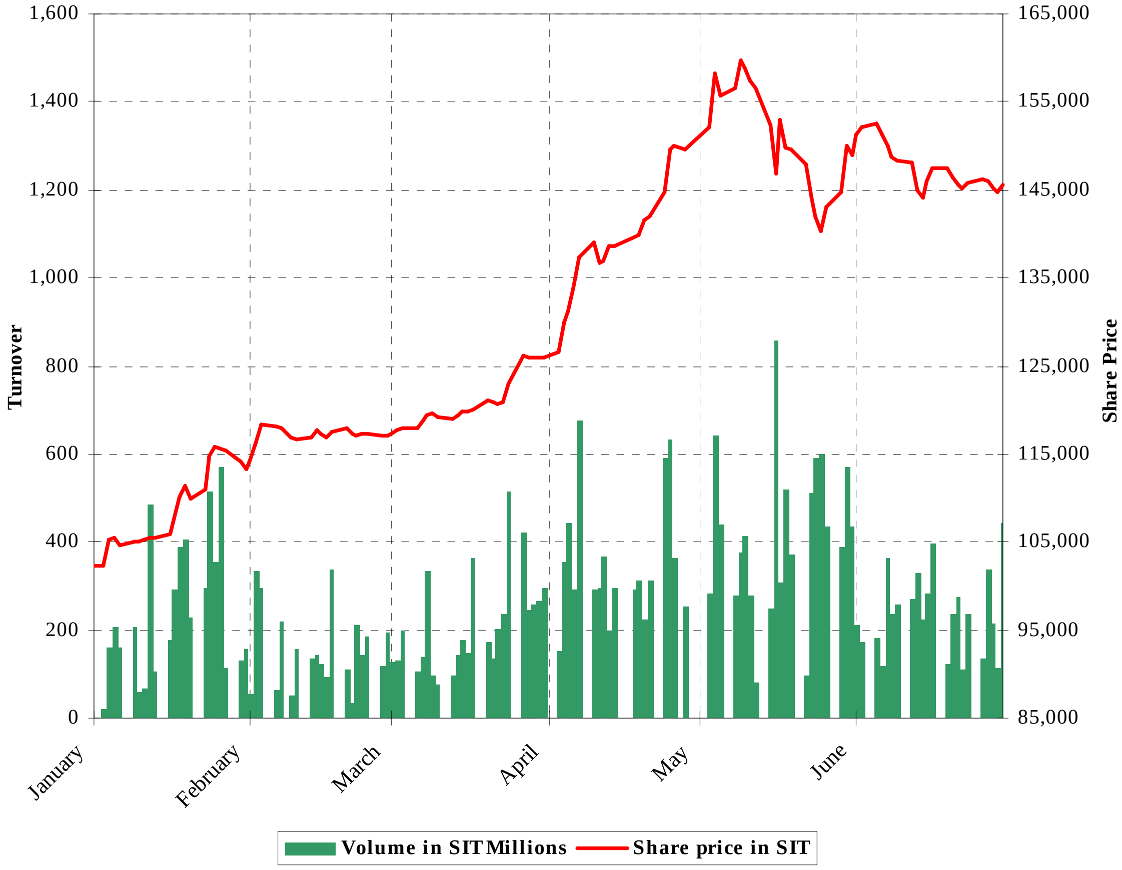
10 largest shareholders on 30 June 2006

	No. of shares	Proportion %
SLOVENSKA ODŠKODNINSKA DRUŽBA, D.D.	530,207	14.97
KAPITALSKA DRUŽBA, D.D.	347,549	9.81
NFD 1 DELNIŠKI INVESTICIJSKI SKLAD D.D.	104,702	2.96
DELNIŠKI VS TRIGLAV STEBER I	52,556	1.48
NEW WORLD FUND INC	52,500	1.48
BANK AUSTRIA CREDITANSTALT AG	46,166	1.30
ZAVAROVALNICA TRIGLAV, D.D.	38,830	1.10
LUKA KOPER, D.D.	37,067	1.05
KD GALILEO, VZAJEMNI SKLAD	32,211	0.91
MARIBORSKE LEKARNE MARIBOR	30,000	0.85
Total	1,271,788	35.91

As at 30 June 2006, members of the management board and supervisory board together held 6,061 shares or 0.17 per cent of total shares. Members of the management board held the following number of shares: Jože Colarič 1700 shares (0.048%), Janez Poljanec 2206 shares (0.062%), Aleš Rotar 1157 shares (0.033%) and

Zvezdana Bajc 110 shares (0.003%). Members of the supervisory board held the following number of shares: Gregor Gomišček 12 shares (0.0003%), Marko Kranjec 101 shares (0.003%), Alojz Zupančič 514 shares (0.015%), Sonja Kermc 211 shares (0.006%) and Tomaž Sever 50 shares (0.001%).

Share trading in first half of 2006



The Krka share price increased most in April and then in May reached its highest value of 159,670 SIT. On 30 June 2006 the share price was 145,643 SIT. The average daily trading in company shares on the Ljubljana Stock Exchange in the first half of 2006 was 267 billion SIT, and the market capitalisation on 30 June 2006 was 516 billion SIT.

Risk management

Foreign exchange risk

Operating in foreign currencies exposes Krka to risks relating to foreign exchange movements.

The net long position in USD was greater this year than in the same period last year, due to the increased sales at the end of 2005. Most of the net long position was hedged with derivatives in the past, so the USD depreciation against the EUR did not have a significant impact on the company's business. In the first half of the year we continued entering contracts to hedge the future value of the USD, as we assess that the probability of further USD depreciation against the EUR in the near future is relatively high.

The increased sales led to higher net long position in EUR during the first half of the year, but the stability of the EUR/SIT exchange rate translated into negligible effects on company's bottom line. Changes in the value of other key exchange rates (EUR/PLN, EUR/MKD, EUR/HRK and USD/RUB) did not have a significant impact on the company's business in the first half of the year.

Interest rate risk

At the end of the first half of the year, the Krka Company had four long-term loans linked to either the 6-month LIBOR for the USD or the 6-month EURIBOR. We hedged three long-term loans in 2004, two of which were denominated in USD and the other in EUR. Higher financing costs in the first half of the year because of the gradual increases in short-term interest rates were offset by net financial gains from hedging instruments.

In the first half of the year the Company did not take out any new long-term loans, so the interest rate risk did not increase over the period.

Credit risk

The Company uses credit risk management to reduce the risk of customers' default. In the first half of the year, 280 of the controlling company's customers to which it sells products worth over 24 million SIT (100,000 EUR) were subject to credit control.

During that period the credit control was extended to include the customers of subsidiaries in Poland, Croatia, Serbia and Montenegro, the Russian Federation, and Macedonia. At the end of the first six months of this year 100 customers in aforementioned subsidiaries were included in the credit control.

In the first half of this year, the Krka Group had no significant receivables write-offs.

Liquidity risk

Risks related to providing sufficient liquidity for the Krka Group are managed through short-term and long-term cash flow planning. We manage short-term liquidity through rolling weekly, monthly, and longer-term cash flow plans, in conjunction with short-term credit lines and a portfolio of money market instruments and deposits. Occasional cash flow requirements are covered using short-term foreign currency and tolar revolving loans. No new long-term loans were taken out during the period.

The liquidity risk was low during the first half of the year.

Property, business interruption and liability insurance

The Krka Group manages its insurance and risk procedures in line with standardised requirements and internal standards for insurance in the controlling company and subsidiaries and representatives abroad. Group insurance provides compensation for damage to property, loss of earnings due to business interruption, and in case of third party claims for loss and injury.

Equipment and inventory insurance is taken out up for current price, buildings at acquisition price, which means that compensation is ensured for the entire value of the buildings and plant without depreciation. Deductibles have been introduced to machine breakdown insurance, cargo insurance and business interruption insurance. The sum insured for business interruption insurance covers labour costs, depreciation and other business expenses, and operating profit for a period of one year.

The Group cover it's liability to third parties for material and immaterial loss by means of insurance covering general civil liability, environment impairment liability, product liability, and clinical trials.

In addition to existing insurance the Company has arranged insurance for construction and erection in investment projects in course, which binds contractors to taking out insurance in line with the Company's requirements. This insurance covers loss arising from liability for personal injury and damage to property, damage to neighbouring buildings and risks during construction and assembly.

The most common loss events by number of claims are damage to motor vehicles and damage to goods during transport or storage. There were no losses or claims for damages exceeding SIT 1 million during the first half of 2006.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements for the first half of the year 2006 have been prepared for the Krka, d. d., Novo mesto and the Krka Group. Krka, d. d., Novo mesto is the controlling company of the Krka Group with its registered seat at Šmarješka cesta 6, 8501 Novo mesto in Slovenia. The consolidated financial statements of the Krka Group for the period ended 30 June 2006 comprise the Company, its subsidiaries in Slovenia and abroad (hereinafter referred to as Group) as well as Group's interests in associated companies.

Statement of compliance

These interim financial statements of the Company and the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) IAS 34 Interim Financial Reporting. In comparison with the annual financial statements these half-year financial statements do not include all of the information required for full annual financial statements. That is why these condensed interim financial statements should be read in conjunction with annual financial statements for the year ended 31 December 2005. The comparable half-year financial statements for 2005 of the Krka Company and the Krka Group are prepared in compliance with IAS 34 Interim Financial Reporting.

The condensed half-year financial statements were authorised for issue by the Management Board on 24 July 2006. The financial statements are unaudited.

Basis of preparation

The financial statements are presented in Slovene tolar (SIT), rounded to the nearest thousand. They are prepared on the historical cost basis, while derivative financial instruments, financial instruments held for trading, and financial instruments classified as available-for-sale are stated at their fair value.
The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.
The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.
The Group and the Company apply the same accounting policies in all periods, presented in the enclosed condensed half-year financial statements.

Basis of consolidation

Subsidiaries

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

Associates

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

Transactions eliminated on consolidation

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

Foreign currency

Foreign currency transactions

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

Financial statements of foreign operations

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

Derivative financial instruments and hedging

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

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

- At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk.
- The hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship.

- For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss.
- The effectiveness of the hedge can be reliably measured i.e. the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured.

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

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

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

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

Property, plant and equipment

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

Certain items of property, plant and equipment that had been revalued to fair value on or prior to 1 January 2004, the date of transition to IFRS, are measured on the basis of deemed cost, being the revalued amount at the date of that revaluation. Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Subsequent costs

The subsequent cost of an item of property, plant and equipment is recognised in the carrying amount when that cost is incurred if it is probable that the future economic benefits embodied with the item will flow to the Group. All other subsequent costs are recognised in the income statement as an expense as incurred.

Depreciation

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

The estimated useful lives are as follows:

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

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

Intangible assets

Research and development

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

Other intangible assets

Other intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses (see accounting policy ‘Impairment’).

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

Subsequent expenditure

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Amortisation

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

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

Investments

Investments in subsidiaries

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

Investments in debt and equity securities

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

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

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

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

Trade and other receivables

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

Inventories

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

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

Cash and cash equivalents

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

Impairment

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

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

Calculation of recoverable amount

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

The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

Reversal of impairment

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

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

An impairment loss in respect of goodwill is not reversed.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

Equity

Repurchase of share capital

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

Dividends

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

Interest-bearing borrowings

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

Provisions

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

Provisions for lawsuits

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

Provisions for termination pay and anniversary bonuses

Pursuant to the local legislation in countries where the controlling company and its subsidiaries are located, the Group is liable to pay to its employees anniversary bonuses and termination pay upon retirement. For these obligations, long-term provisions are formed. There is no other obligation in respect of pension.

Provisions are determined by discounting, at the balance sheet date, the estimated future benefits in respect of termination pays and anniversary bonuses paid to employees in those countries, where this legal obligation exists. The obligation is calculated by estimating the costs of termination pay upon retirement and the costs of all expected anniversary bonuses until retirement. The selected discount rate is 2.75% p.a.. The calculation is performed by a certified actuary. Actuarial gains and losses are recognised in the income statement.

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

Trade and other payables

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

Net sales

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

Net financing costs

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

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