

Company Report

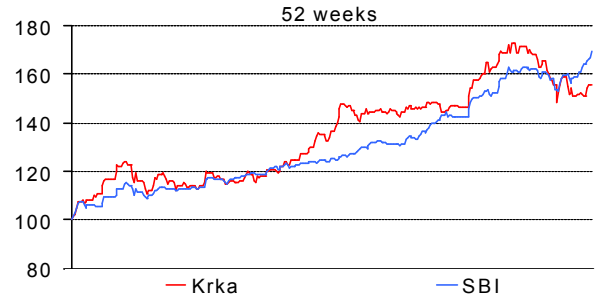
Krka

Slovenia, Pharmaceuticals

upgrade to Accumulate

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EUR mn	2005	2006p	2007e	2008e
Net sales	554.0	668.1	777.0	902.9
EBITDA	164.8	198.2	244.1	283.9
EBIT	119.0	150.5	192.1	227.2
Net profit	97.2	111.3	145.1	172.5
EPS (EUR)	27.4	31.4	41.0	48.7
CEPS (EUR)	53.8	51.6	51.3	60.2
BVPS (EUR)	135.4	161.0	195.1	234.2
Div/share (EUR)	6.9	9.6	11.7	14.6
EV/EBITDA (x)	18.4	15.1	12.2	10.4
P/E (x)	30.3	26.4	20.3	17.0
P/CE (x)	15.4	16.1	16.2	13.8
Dividend yield	0.8%	1.2%	1.4%	1.8%



Performance	12M	6M	3M	1M
in EUR	55.6%	14.0%	6.2%	-2.9%

Share price (EUR)	830	Reuters	KRKG.LJ	Free float	70.2%
Number of shares (mn)	3.5	Bloomberg	KRKG SV	Shareholders	Slov. Compensation
Market capitalization (EUR mn)	2,941.1	Div. ex-date	7/10/2006		Fund (15%)
Enterprise value (EUR mn)	2,975.6	Target price	960	Homepage:	www.krka.si

Demanding valuation warranted by Krka's competitive edge

12-month target price: EUR 960

Krka's 2006 report confirmed that the company continues to deliver a superb organic growth tempo, with some of the profitability parameters catching up with the region's long-term leader, Hungarian rival Richter. With Krka's results broadly in line with our forecasts, adjustments to our 2007 projections are minimal. Reflecting Slovenia's EMU entry as of January 2007, we have switched our model to EUR terms. We project Krka's top line tempo remaining solidly in double-digit terms, at 16.3% to EUR 777mn, and see a net profit target of EUR 145.1mn as realistic for 2007. Our revised 12-month DCF-derived target price arrives at EUR 960 per share (up from the earlier EUR 788 per share).

We continue to believe that Krka's London listing could still represent a trigger for the stock, as it would attract more foreign investors. Nevertheless, with the liquidity on its home Ljubljana bourse skyrocketing since January 2007, Krka's motivation to bring its earlier project to life is significantly reduced at the moment. While Krka's valuation parameters suggest that the stock is still traded at a premium to its peers, we think that this is justified by its above-average growth prospects, which could potentially be boosted by acquisitions. We believe that the recent stock price setback has created an interesting buying opportunity from the long-term perspective. We upgrade our recommendation from Hold to Accumulate.

Krka's 2006 consolidated sales advanced 20.6% y/y to SIT 160,069mn, propelled by sales to Russia/CIS (up 32.2% y/y) and Central European markets (up 22.4% y/y, both in SIT terms). The y/y more favorable sales mix and efficient cost control (namely in the area of G&A costs) more than offset the negative impact of provisioning, related in particular to atorvastatin litigation. The operating profit soared 26.4% y/y to SIT 36,065mn, while net profit went up by a solid 14.5% y/y to SIT 26,669mn (consolidated according to IFRS).

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2006 results at a glance

2006 progress impressive; Krka's tempo outpaced most of its peers'

As Krka published its consolidated sales performance highlights and its unconsolidated figures ahead of its 2006 consolidated results, the report did not bring any major surprises to market participants. With the exception of its home, Slovenia, Krka recorded very solid double-digit growth in all of its markets, with Russia/CIS maintaining its lead. Moreover, the improving sales mix and efficient cost containment measures, along with the y/y lower provisioning linked to Krka's patent lawsuits, backed Krka's further profitability progress. The firm's top line and EBIT growth tempo in 2006 was only outpaced by Zentiva, which was helped by one-off acquisition effects. With its 2006 EBIT margin of 22.5%, Krka kept a good grip on its No. 3 position among CEE-based pharma producers.

Krka's 2006 results: How they compare (growth in USD terms)

	Krka	Richter	Egis	Zentiva
Sales growth (USD terms)	21.6%	15.5%	6.5%	25.3%
Gross profit growth (USD terms)	25.2%	15.4%	3.6%	31.6%
Gross margin (%)	62.7%	61.3%	61.6%	64.7%
EBIT growth (USD terms)	27.5%	21.3%	-17.4%	35.7%
EBIT margin (%)	22.5%	27.9%	13.2%	23.6%
Net profit growth (USD terms)	15.5%	9.4%	-26.1%	24.3%
Net margin (%)	16.7%	29.3%	12.0%	15.7%

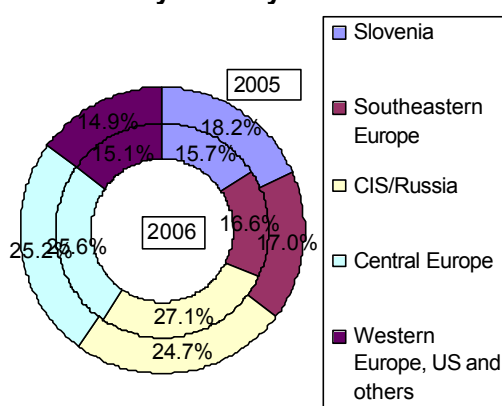
Source: Company data, Egis results restated for January-December 2006

Consolidated sales advanced by sound 20.6% y/y...

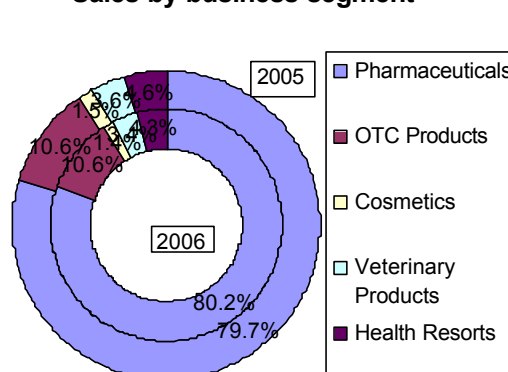
Krka's 2006 consolidated sales advanced 20.6% y/y to SIT 160,069mn (EUR 668.1mn), of which Krka Health Resorts contributed SIT 6,702mn (EUR 28mn). With sales rising 21.5% y/y to SIT 128,434mn (EUR 536.0mn), or 80.2% of 2006 consolidated sales, Krka's human prescription pharmaceuticals continued to dominate the sales structure by business area. OTC product sales grew by 20.6% y/y to EUR 71.0mn, to account for 10.6% of the total. Veterinary product sales went up by 14.1% y/y to EUR 22.8mn. Sales of cosmetics witnessed an ongoing recovery from the year-earlier depressed levels, increasing by a sound 12.9% y/y to EUR 9.6mn.

...fueled by prescription pharmaceuticals

Sales by territory



Sales by business segment



Source: Krka

Exports up hefty 24.3% y/y - 84.3% of 2006 consolidated sales

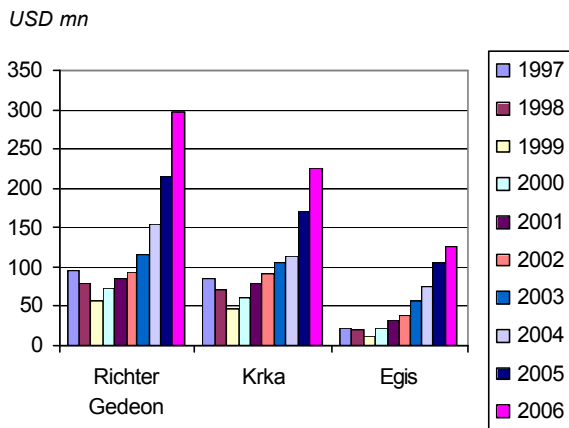
In spite of the 2H revival, the domestic sales tempo remained sluggish and lagged well behind exports in 2006. Krka's consolidated sales in Slovenia increased just 3.6% y/y to SIT 25,061mn (EUR 104.6mn). Consequently, the share of Krka's home market slipped further, to 15.7% of 2006 sales, down from the 18.2% recorded in 2005. As indicated by earlier interim results, Krka's exports remained the main engine behind the

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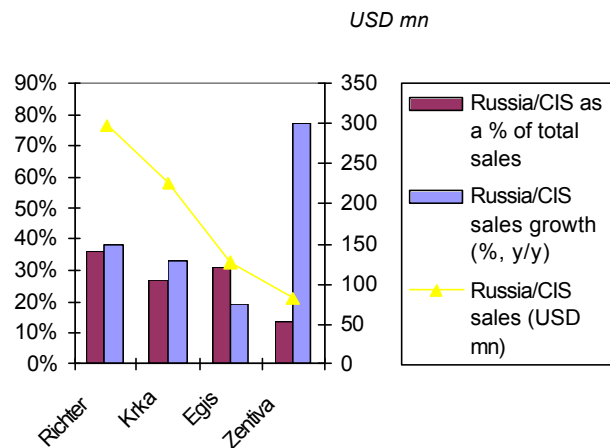
Sales to Russia/CIS remained most dynamic, surging 32.2% y/y in 2006

top line growth. Krka's exports advanced 24.3% y/y to SIT 135,008mn (EUR 563.5mn) in 2006 and their share was lifted to 84.3% of 2006 consolidated sales (up from 81.8% in the year-earlier period). As expected, Russia/CIS was one of the main factors behind these developments. Similarly to its peers, Krka benefited from the DLO drug subsidy program in Russia. Krka's Russian sales climbed 36.7% y/y to EUR 129.8mn, out of which the DLO program contributed around 20% of the total. Krka's Russia/CIS sales growth was at a dynamic 32.2% y/y to EUR 180.7mn in 2006. This translates into sales of USD 226.7mn (up by 33.3% y/y), assuring Krka second place among the CEE-based Russian pharmaceutical market players, after Richter (which recorded 2006 sales of USD 298.0mn there, up 38.1% y/y). The share of Russia/CIS in Krka's consolidated sales expanded from 24.7% in 2005 to 27.1% in 2006 and the company kept its third place in the regional ranking in this respect, behind Richter and Egis. (By comparison, Russia/CIS delivered 36.6% of Richter's sales and 31.1% of Egis' sales in 2006.)

Krka's sales developments in Russia/CIS in historical perspective...



...compared to regional peers in 2006



Source: Company data, Egis results for January-December 2006

Solid double-digit sales growth reported from CEE (up 22.4% y/y), South-East (up 17.5% y/y) and Western markets (up 22.5% y/y)

Krka also performed well in its other traditional export markets, South-East and Central Europe, with the sales tempo there safely in double-digit terms. In South-East Europe, Krka's sales grew 17.5% y/y to EUR 111.0mn. Sales to Central European markets advanced by a robust 22.4% y/y to EUR 170.8mn in 2006. With its sales of EUR 95.2mn, up 21% y/y, Poland remained the most important among Krka's CEE markets. Reflecting the boost from new product launches (in particular, lansoprazole in the UK), Krka's sales to the EU, US and other markets rose by a healthy 22.5% y/y to EUR 101.0mn in 2006. The main driving force behind the excellent 2006 Rx sales performance was Krka's cardiovascular drug portfolio, comprising anti-hypertensives (*Orista* [*losartan*], *Tenox* [*amlodipin*]), as well as lipid lowering agents (*Atoris* [*atorvastatin*] and *Vasilip* [*simvastatin*]). In 2006, Krka was granted first marketing authorizations for 11 new products in 24 different strengths, among them new products from the cardiovascular range, such as *Prenessa* (perindopril), and *Valsacor* (valsartan), as well as CNS products, such as *Alventa* (venlafaxine).

More favorable sales mix, efficient cost control led to further profitability improvements

Importantly, Krka's 2006 report provided compelling evidence that, despite the steep rise in profitability over the past three years, the company is not pausing in shoring up its margins. The y/y more favorable product and territorial sales mix, coupled with efficient cost containment measures in the G&A area, more than counterbalanced the negative impact from the still relatively high provisioning in 2006. The gross profit soared by 24.1% y/y to SIT 100,402mn (or EUR 419.0mn) and the gross profitability margin improved from 60.9% in 2005 to 62.7% in 2006. Reflecting the y/y decreasing provisioning (SIT 5bn of newly created provisions in 2006, vs. SIT 12.5bn provisions in 2005), sales and

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Despite provisioning toll, EBIT grew by excellent 26.4% y/y to SIT 36,065mn in 2006

marketing costs dropped 4.5% y/y to SIT 39,743mn, or 24.8% of 2006 consolidated sales, down from the 31.3% share of consolidated sales recorded in 2005. Excluding the provisioning, sales and marketing expenses rose by 19.4% y/y, still slightly lagging the top line tempo in 2006. Moreover, the strict cost control measures trimmed the company's administrative expenses by 4.1% y/y in 2006. Thus, despite the significantly y/y lower reversal of provisions (sending the other operating income from SIT 12.2bn in 2005 to SIT 0.85bn in 2006), the consolidated operating profit was up an excellent 26.4% y/y to SIT 36,065mn in 2006. The EBIT margin improved to 22.5% (from 21.5% in 2005) on the consolidated level.

	2006		2005			2006	2005	
	SIT 000		SIT 000		y/y (%)	EUR 000	EUR 000	y/y (%)
Net sales	160,068,654	100.0%	132,757,626	100.0%	20.6%	668,063	553,997	20.6%
Cost of sales	59,666,880	37.3%	51,847,673	39.1%	15.1%	249,026	216,360	15.1%
Gross profit	100,401,774	62.7%	80,909,953	60.9%	24.1%	419,037	337,637	24.1%
Marketing & sales expenses	39,742,948	24.8%	41,609,639	31.3%	-4.5%	165,871	173,637	-4.5%
R&D expenses	12,617,134	7.9%	9,611,856	7.2%	31.3%	52,659	40,110	31.3%
Administrative expenses	12,831,170	8.0%	13,386,461	10.1%	-4.1%	53,552	55,862	-4.1%
Other operating income	854,137	0.5%	12,221,261	9.2%	-93.0%	3,565	50,999	-93.0%
Operating profit	36,064,659	22.5%	28,523,258	21.5%	26.4%	150,520	119,027	26.5%
Financial result	-416,793	-0.3%	1,006,720	0.8%	n.a.	-1,740	4,201	n.a.
Pre-tax profit	35,647,866	22.3%	29,529,978	22.2%	20.7%	148,780	123,228	20.7%
Income taxes	8,892,336	5.6%	6,210,850	4.7%	43.2%	37,113	25,918	43.2%
Minority interest	86,621	0.1%	30,546	0.0%	183.6%	362	127	183.6%
Net income	26,668,909	16.7%	23,288,582	17.5%	14.5%	111,305	97,183	14.5%

Source: Krka. Consolidated results according to IFRS standards.

Although higher effective tax rate dampened net profit growth, this was still solid at 14.5% y/y in 2006

Weighed down by the y/y higher forex-linked losses, Krka's financial result switched into red territory in 2006, ending at a loss of SIT 416.8mn, vs. the year-earlier financial profit of SIT 1,006.7mn. The effective tax rate increased to 24.9% in 2006, somewhat above the year-earlier 21.0%. In summary, 2006 net profit growth remained at a solid 14.5% y/y to SIT 26,669mn. The net profit margin slightly deteriorated, from 17.5% in 2005 to 16.7% in 2006 (all numbers consolidated and according to IFRS).

Changes in forecasts/outlook

2006 consolidated results did not surprise, broadly matching expectations

As per tradition, Krka published its 2006 sales highlights as well as its unconsolidated report ahead of its full preliminary 2006 consolidated results announcement. Consequently, the room for surprises was rather minimal. In line with expectations, the consolidated report confirmed a slight margin dilution compared to the earlier-presented parent company data. Krka's 2006 consolidated sales were just 0.5% above our forecasts, while operating profit lagged behind our target of SIT 37.4bn by 3.6%. While the financial result was marginally worse than we envisaged, the effective tax rate was somewhat below our projections in 4Q, bringing the negative difference on the bottom line to just 1.3% in 2006. Krka posted consolidated net profit of SIT 26.7bn, while we had targeted SIT 27.0bn in 2006.

We opt for only slight fine-tuning of our forecasts, while switching from SIT to euro terms...

All told, Krka's 2006 results were broadly in line with our forecasts. Going forward, the main adjustments to our projections include (apart from minor fine-tuning of our model assumptions) the switch from SIT to EUR, in line with Krka's home country's EMU accession as of January 1, 2007. A closer look at Krka's actual 2006 sales structure by territory demonstrates that exports remain the driving force behind Krka's top line growth. We continue to envisage the domestic sales tempo staying in single-digit terms

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...reflecting faster than envisaged tempo in South-East Europe...

in 2007. Reflecting the slightly better 2006 performance, we raise our target for Krka's 2007 domestic sales from EUR 105.5mn to EUR 108.3mn, translating into a 3.6%/y/y rise. We believe that Krka has all prerequisites to notch healthy double-digit growth in its traditional CEE and South-East European markets, enjoying solid backing from its production-distribution centers in Poland and Croatia. With its 2006 sales pace broadly matching our original expectations, we increase our target for Central European sales only slightly, by 4.4% to EUR 212.7mn. The somewhat faster than envisaged 2006 tempo in South-East Europe prompts us to raise our forecast to EUR 133.1mn (up from the earlier forecast of EUR 125.2mn), corresponding to a 20% y/y rise.

...but more tempered dynamism in Russia/CIS...

Similarly to its regional peers, Krka saw its Russia/CIS sales slow down in 4Q2006, as a result of changes in the Russian DLO drug reimbursement list. The new revision of the DLO list (valid from November 2006) reduced the number of Krka items on the list to 43 (from the earlier 66); the company had estimated that this move would trim its sales within the program by around 20%. In fact, Krka's 4Q2006 Russia/CIS sales retreated by 13.5% q/q, but still ended 16.5% higher y/y. We continue to believe that Krka's efforts to rechannel part of its DLO sales into the private market will bear fruit and, along with its well established marketing network and own manufacturing facility in the Moscow area, will further support its sales tempo in Russia/CIS in double-digit terms in the coming period. Factoring in the slightly (by 1.2%) worse than originally projected 2006 results, but also the dampening impact from the recent DLO receivables collection problems on the market, we trim our 2007 target for Krka's sales in Russia/CIS to USD 260.7mn, down from USD 286.9mn, but still corresponding to a 15% y/y rise. For 2008, we remain optimistic and project another 22.5% y/y growth to USD 319.3mn.

...trimming our target sales there to USD 260.7mn, corresponding to 15% y/y rise (down from earlier envisaged 25% y/y growth)

Changes to 2007 forecasts

EUR mn	2006 results		2007 original forecast		2007 new forecast	
Net sales	668.1	100.0%	774.2	100.0%	777.0	100.0%
Costs of good sold	249.0	37.3%	277.3	35.8%	284.8	36.7%
Gross profit	419.0	62.7%	496.9	64.2%	492.1	63.3%
Sales & marketing expenses	165.9	24.8%	202.5	26.1%	192.4	24.8%
Research & development expenses	52.7	7.9%	61.2	7.9%	61.4	7.9%
General & administrative expenses	53.6	8.0%	65.0	8.4%	61.8	8.0%
Other operating income	3.6	0.5%	22.1	2.9%	15.5	2.0%
Operating profit	150.5	22.5%	190.3	24.6%	192.1	24.7%
Financial result	-1.7	-0.3%	0.1	0.0%	-0.6	-0.1%
Income taxes	37.1	5.6%	45.7	5.9%	45.9	5.9%
Minorities	0.4	0.1%	0.2	0.0%	0.4	0.1%
Net income	111.3	16.7%	144.5	18.7%	145.1	18.7%

Source: Erste Bank

Better than expected sales performance in Western markets in 2006 warrants lift of our 2007 forecast

Krka's Western European sales strategy concentrates on patent expiration opportunities. In 2005, Krka's sales - in the absence of new introductions - dropped by 7.9% y/y. In 2006, the company saw a revival, boosted by the launch of lansoprazole (a generic version of *Ogastro*). Going forward, we assume that the volatility will persist, with the sales tempo dictated by the actual number of product launches and the speed with which competitive pressures in the opening generic markets mount over time. Given Krka's still very rich generics pipeline, we believe that sales growth should hover at least around 10% in the long run. As the 2006 sales tempo was clearly ahead of our original forecasts, we opt for a minor upward correction (reflecting the company's recent guidance, pointing to a return to single-digit growth terms in 2007). We are raising our sales target for Western markets from EUR 106.5mn to EUR 110.8mn. Incorporating all of the above-mentioned adjustments, our sales target for 2007 arrives at around EUR 777.0mn, up from EUR 774.2mn, corresponding to 16.3% y/y growth. We envisage Krka's consolidated sales advancing by another 16.2% y/y to EUR 902.9mn in 2008.

All told, we raise our 2007 sales target to EUR 777mn, up from EUR 774.2mn

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Free cash flow forecasts (EUR mn)	2007e	2008e	2009e	2010e	2011e
EBIT	192.1	227.2	265.9	311.3	364.5
Depreciation	52.0	56.7	61.8	67.3	73.4
EBITDA	244.1	283.9	327.7	378.6	437.9
Investments	-100.3	-99.0	-100.6	-117.9	-119.8
Change in working capital	-7.2	-10.0	-12.2	-19.3	-21.2
Corporate income taxes	-45.9	-54.6	-64.1	-75.3	-88.3
Free cash flow	90.7	120.3	150.7	166.2	208.5

	2007-2011	perpetuity	PV of the FCF (EUR mn)	608.6
beta	0.84	1.00	PV of the TV (EUR mn)	2,503.6
risk free rate (%)	4.5%	5.0%	Total (EUR mn)	3,112.2
market premium (%)	5.0%	5.0%	- net debt (EUR mn)	-55.9
WACC (%)	8.6%	9.9%	Equity value of the company (EUR mn) as of 31.12. 2006	3,056.3
perpetuity cash flow growth rate (%)	4.5%		Equity value per share (EUR) as of 31.12. 2006	862.7
			Equity value per share (EUR) as of 31.3. 2008	960.0

Equity value/share (EUR) as of 31.3. 2008	discount rate					
	3.50%	8.75%	9.25%	9.75%	10.25%	10.75%
		993.2	903.0	827.3	763.0	707.7
	4.00%	1,079.5	972.7	884.6	810.7	747.9
perpetuity cash flow growth rate	4.50%	1,186.2	1,057.0	952.7	866.6	794.5
	5.00%	1,321.2	1,161.3	1,035.2	933.2	849.2
	5.50%	1,497.9	1,293.3	1,137.0	1,013.8	914.3

Source: Erste Bank

2006 gross profitability below our forecast; we reduce our 2007 gross margin target to 63.3%

However, on operating level, this should be largely compensated for by lower than expected provisioning

We slightly raise our 2007 operating profit target to EUR 192.1mn

Witnessing the negative impact of the less favorable 4Q sales structure (with a decreasing share of Russia/CIS sales), which depressed the 4Q gross margin to 58.7% (down from the 64.1% recorded in 1-3Q2006), Krka's 2006 gross profitability margin lagged somewhat behind our expectations. Nevertheless, the company's progress was undeniable here, with the gross margin rising from 60.9% in 2005 to 62.7% in 2006. While we continue to see the sales mix improving, with an increasing share of new innovative generics and improving economies of scale (in modern, up-to-date facilities) as the main forces behind further gross profitability progress, we opt for a downward fine-tuning of our gross margin target, from 64.2% to 63.3% for 2007. Krka's numerous patent litigations make the company's forecasts a bit more challenging for the time being. While we had forecast provisioning reaching SIT 8bn for 2006, the actual figure stood at just SIT 5bn. Reflecting the y/y decreasing provisioning, sales and marketing costs were below our forecast. On the other hand, given the significantly y/y lower reversal of provisions, other income of SIT 0.85bn was well below our target of SIT 3.2bn in 2006. Here, we want to stress that the creation of provisions for litigation and their release (to be recorded under other operating income) remain the biggest question mark going forward. With respect to Krka's engagement in the litigation-rich generics field, we continue to project a similar level of provisions in the following years, with their release positively affecting the other income. All told, we opt for a downward correction to our sales and marketing cost forecast to EUR 192.4mn (down from the EUR 202.5mn envisaged earlier), or 24.8% of total sales in 2007. With R&D costs in 2006 broadly in line with our full-year projections, we stick to our assumptions and project their share staying at around 7.9% of sales in 2007.

Contrary to most of its CEE-based peers, Krka's business portfolio remains broad, ranging from the core pharmaceutical business to health resort activities. While we believe that further streamlining would definitely shore up the company's profitability, Krka is not actively planning such activity. All told, incorporating the above-mentioned changes into our forecasts, our new 2007 operating profit target is only marginally changed at EUR 192.1mn (up from the EUR 190.3mn projected earlier). Our EBIT target

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Changes to corporate tax law from January 2007 to work in company's favor

Our net profit target for 2007 arrives at EUR 145.1mn

for 2008 arrives at EUR 227.2mn, up from the earlier projected EUR 223.2mn. With the 2006 financial result only marginally worse than we anticipated, we opt for a minor downward correction of our projections for 2007, from a profit of EUR 0.1mn to a loss of EUR 0.6mn. The changes in the corporate tax law in Slovenia valid from January 2007 are set to work in Krka's favor, reducing the statutory tax rate to 23% and recognizing provisions as tax-deductible items (among other factors). As this change was already incorporated into our earlier forecasts, we stick to our effective tax rate assumption (at 24% in 2007). As a result, our new 2007 consolidated net profit target arrives at EUR 145.1mn, up from the EUR 144.5mn projected earlier. This translates into a bold 30.4% y/y rise. For 2008, we set a new net profit target of EUR 172.5mn, corresponding to another 18.9% y/y increase.

CEE pharmaceutical valuations at a glance

	P/E				P/CE				EV/EBITDA			
	2005	2006e	2007e	2008e	2005	2006e	2007e	2008e	2005	2006e	2007e	2008e
Egis	16.1	10.7	13.9	10.4	11.0	7.9	9.0	7.2	11.0	7.5	7.7	6.3
Richter Gedeon	15.0	13.0	16.1	13.3	11.3	9.9	11.2	9.5	11.9	9.5	10.9	8.9
Pliva	neg.	30.7	26.9	20.3	30.0	15.7	14.1	11.7	14.3	15.0	11.6	9.2
Krka	30.3	26.4	20.3	17.0	15.4	16.1	16.2	13.8	18.4	15.1	12.2	10.4
Zentiva	29.3	25.0	20.4	16.9	21.7	17.9	12.4	10.8	17.6	13.8	11.8	9.7
Median CEE	22.7	25.0	20.3	16.9	15.4	15.7	12.4	10.8	14.3	13.8	11.6	9.2
Actavis Group hf	30.8	28.5	21.0	15.4	27.1	14.2	10.6	8.5	20.4	11.9	11.3	9.5
Barr Pharmaceuticals Inc	12.7	14.3	15.1	12.6	11.5	10.6	n.a.	n.a.	10.9	14.6	9.4	7.3
Mylan Laboratories	18.6	13.8	14.2	14.1	18.1	11.9	11.9	n.a.	12.3	8.2	9.2	7.6
Bayer Schering Pharma AG	32.1	31.9	27.0	24.4	20.4	25.4	18.8	18.8	8.0	14.1	13.0	11.9
Schwarz Pharma AG	high	416.5	203.3	70.1	high	126.2	94.0	47.2	70.4	55.7	92.2	34.2
Stada Arzneimittel AG	46.8	26.7	19.7	16.5	19.5	17.6	13.5	12.0	9.6	13.7	12.1	9.8
Teva Pharmaceutical	20.5	15.8	17.3	14.4	15.4	18.1	14.3	12.3	18.7	11.4	12.0	9.7
Watson Pharmaceuticals	17.1	25.5	21.8	14.2	8.5	7.8	6.7	n.a.	7.5	9.5	6.8	6.6
Median	20.5	26.1	20.4	14.9	18.1	15.9	13.5	12.3	11.6	12.8	11.6	9.6
Euro Stoxx Healthcare	30.6	26.7	22.1	18.9	19.1	16.4	15.3	15.2	11.3	13.7	12.1	9.8
CEE to Peer, Prem/Disc	11%	-4%	-1%	13%	-15%	-1%	-8%	-12%	24%	8%	0%	-5%
Krka to Western peers	47.8%	1.2%	-0.6%	14.2%	-15.0%	1.1%	19.8%	11.9%	58.3%	18.1%	4.8%	8.1%
Krka to CEE peers	33.2%	5.8%	0.0%	0.6%	0.0%	2.3%	30.0%	27.2%	28.2%	9.6%	5.2%	13.4%

Source: Erste Bank, JCF estimates. Based on closing prices as of March 29, 2007

With LJSE liquidity significantly improving since January 2007, London listing currently on hold

Our revised 12-month target price of EUR 960 per share indicates Krka's competitive edge not reflected in current share price; we upgrade to Accumulate

Although Krka delivered a superb growth tempo in 2006, its recent share price performance has been rather lacklustre. Not only was solid progress expected from the company, but also the slump in the share prices of its regional peers further magnified Krka's premium to the regional average. Nevertheless, we believe that the extent of Krka's recent share price depreciation was not fundamentally justified. Although the earlier plans for a London listing were put on hold for the time being, we see the increasing liquidity on Krka's home bourse as a very encouraging sign (in 2006, Krka's trading volume totaled EUR 305.3mn; in the first two months of 2007, it had already climbed to EUR 94.4mn). The prepared stock split (to be voted on at the next AGM in July 2007) will facilitate further liquidity improvements. More importantly, as we were informed, the company is intensifying its acquisition efforts, with tangible results to be seen soon. Should Krka find the right target, the size of the deal could even reach up to EUR 1bn. In this case, the financing could be accomplished not only by expanding loans (with new debt reaching up to EUR 700mn), but also via equity (using existing treasury shares). Our revised 12-month DCF-derived target price of EUR 960 per share (up from EUR 788 per share) indicates that Krka's combination of sound profitability and healthy organic growth, with a potential boost from acquisitions, remains attractive, and is not fully priced in at the current levels. Consequently, we upgrade our recommendation from Hold to Accumulate.

Company Report

Income Statement (IFRS, EUR mn, 31/12)	2005	2006p	2007e	2008e
Net sales	554.0	668.1	777.0	902.9
Costs of good sold	216.4	249.0	284.8	330.2
Gross profit	337.6	419.0	492.1	572.7
Sales & marketing expenses	173.6	165.9	192.4	223.6
Research & development expenses	40.1	52.7	61.4	71.3
General & administrative expenses	55.9	53.6	61.8	70.9
Other operating income	51.0	3.6	15.5	20.3
EBIT	119.0	150.5	192.1	227.2
Financial result	4.2	-1.7	-0.6	0.4
Pre-tax profit	123.2	148.8	191.4	227.6
Income taxes	25.9	37.1	45.9	54.6
Minority interest	0.1	0.4	0.4	0.4
Net income after deduction of min. interest	97.2	111.3	145.1	172.5

Balance Sheet

(IFRS, EUR mn, 31/12)				
Fixed assets	502.8	574.4	642.0	724.4
Tangible fixed assets	451.5	506.8	557.5	618.8
Intangible fixed assets	21.1	23.6	29.5	36.9
Current assets	285.5	304.3	333.1	372.1
Inventory	120.9	115.9	121.3	130.4
Receivables	137.8	153.9	165.6	178.0
Short term financial investment	14.2	24.1	30.1	38.4
TOTAL ASSETS	788.3	878.7	975.1	1,096.6
Equity	479.6	570.5	691.2	829.8
Share capital	59.1	59.1	59.1	59.1
Reserves	148.0	151.3	153.6	153.6
Treasury shares	-19.5	-19.5	-19.5	-19.5
Retained earnings	284.4	371.7	490.2	628.7
Capital of minority shareholders	7.6	7.9	7.9	7.9
Long-term provisions	98.7	122.6	107.2	91.1
Long-term liabilities	51.8	41.4	39.3	37.4
Total short-term liabilities	124.6	116.7	122.1	127.7
Accruals	33.6	27.6	15.2	10.6
TOTAL LIABILITIES & EQUITY	788.3	878.7	975.1	1,096.6

Cash Flow Statement

(IFRS, EUR mn, 31/12)				
Cash flow from operating activities	109.6	135.9	165.0	176.0
Cash flow from investing activities	-89.1	-106.8	-100.3	-99.0
Cash flow from financing activities	-19.7	-31.3	-59.0	-67.8
CHANGE IN CASH & CASH EQUIVALENTS	0.8	-2.2	5.7	9.3

Margins & Ratios

Sales growth	16.8%	20.6%	16.3%	16.2%
EBIT growth	58.4%	26.5%	27.6%	18.3%
Net income growth	48.5%	14.5%	30.4%	18.9%
EBITDA margin	29.7%	29.7%	31.4%	31.4%
EBIT margin	21.5%	22.5%	24.7%	25.2%
Net profit margin	17.5%	16.7%	18.7%	19.1%
Sales/employee (EUR 000)	106.0	119.3	136.3	155.7
Current ratio	2.3	2.6	2.7	2.9
Quick ratio	1.3	1.6	1.7	1.9
Average collection period (days)	77.2	78.6	74.0	68.5
ROA (%)	13.5%	13.4%	15.7%	16.7%
ROE (%)	22.0%	21.2%	23.0%	22.7%

Source: Krka, Erste Bank. Consolidated results according to IFRS accounting standards.

Company Report

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Company Report

Rating History

Date	Product	Rating	Price	Price target
30. Jun 06	SR	downgrade to Hold	SIT 144500	SIT 158710
1. Sep 06	CR	Hold maintained	SIT 157249	SIT 171200
1. Dec 06	CR	Hold maintained	SIT 186999	SIT 188770

Erste Bank rating definitions

Buy	> +20% to target price
Accumulate	+10% < target price < +20%
Hold	0% < target price < +10%
Reduce	-10% < target price < 0%
Sell	< -10% to target price

Our target prices are established by determining the fair value of stocks, taking into account additional fundamental factors and news of relevance for the stock price (such as M&A activities, major forthcoming share deals, positive/negative share/sector sentiment, news) and refer to 12 months from now. All recommendations are to be understood relative to our current fundamental valuation of the stock. The recommendation does not indicate any relative performance of the stock vs. a regional or sector benchmark.

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Krka	--	--



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