MEDIKA d.d.

AUDITOR'S REPORT AND UNCONSOLIDATED FINANCIAL STATEMENTS 31 DECEMBER 2013

This version of the financial statements is a translation from the original, which was prepared in the Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of the financial statements takes precedence over this translation.

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Operating result in 2013

Medika d.d. ("the Company") in 2013 realized unconsolidated revenue in the amount of HRK 2,192,142 thousand, an increase of 2.0%. Unconsolidated operating profit amounts to HRK 57,408 thousand which is a 12.9% increase in comparison to prior year.

Unconsolidated profit before tax amounts to HRK 43,850 thousand and unconsolidated net profit HRK 41,409 thousand, which is an increase of 20.3% in comparison to prior year.

The Management of the Company adopted a decision to reinvest profits for the purpose of long-term goals of encouraging investment in the amount of HRK 40,762 thousand, which will be registered during 2014 as an increase of the Company's share capital. Increase of share capital will be carried out by increasing the nominal value of the shares, which means that existing shareholder rights will not change, and will belong to the shareholders in proportion to their previous participation in the share capital.

When analysing operating segments (note 6 in financial statements), 60.8% of total unconsolidated income was generated through the "pharmacies" segment, and 24.7% through the "hospitals" segment. In comparison to prior year, the "pharmacies" and "hospitals" segment remained at the same level.

Total unconsolidated assets amount to HRK 1,865,347 thousand, a decrease of 0.7% in comparison to prior year. Unconsolidated current assets comprise 87.2% of total assets. Trade and other receivables are the largest and most significant amount of total unconsolidated assets and have decreased by 4.3% in comparison to prior year. In June 2013 the rehabilitation of clinical hospitals was performed and trade receivables recorded significant decline in the first half of the year. In the second half of the year, the cash inflow was significantly reduced, which along with an increase in sales led to a renewed increase in receivables. At the same time, inventory increased by 12.9% in comparison to prior year because of increased purchases due to sales growth.

Equity to assets ratio is 21% which means that 21% of total unconsolidated assets are financed through own resources.

Total unconsolidated indebtedness exposure is HRK 316,771 thousand, of which HRK 311,133 thousand relates to short-term loans and finance leases, while the remainder of HRK 5,638 thousand relates to long-term loans and finance leases (note 25).

Unconsolidated operating results are presented in the statement of comprehensive income, page 6 of the financial statements.

The vision of company development

The business plan of Medika d.d. for 2014 anticipates annual decline of sales of 3%. Considering that sales decline of Medika is expected to be lower than decline of market, increase of market share is expected. The Company will continue with its core business: distribution of pharmaceuticals and medical products and will strongly develop operations with products that represent the core business of the firm.

In 2013 construction work on a new business center in Osijek started. Completion of construction and relocation to a new business center is expected in early 2015. This investment will provide appropriate and quality warehouse facilities with all necessary accompanying premises in accordance with regulations and standards. Increase in storage capacity will create the preconditions for further development of business in Slavonia, and thus the development of the whole Medika.

Treasury shares

During 2013, the Company granted 715 of its treasury shares to key management.

During 2013, the Company has acquired 230 of its treasury shares.

Medika d.d. currently owns 1,155 treasury shares, which represents 3.83% of shares issued.

Subsidiaries and associates

Medika d.d. has a subsidiary Zdravstvena ustanova Ljekarne Prima Pharme, registered in Split which is 100% owned by Medika d.d. and an associate Litmus d.o.o., registered in Zagreb, which is 41.53% owned by Medika d.d.

Zdravstvena ustanova Ljekarne Prima Pharme itself has subsidiaries: Zdravstvena ustanova Ljekarne Delonga (Okrug Gornji), Zdravstvena ustanova Ljekarne Ines Škoko (Zagreb), Zdravstvena ustanova Ljekarne Atalić (Osijek) and Ljekarna Elvira Štimac (Opatija). These subsidiaries are wholly owned by ZU Ljekarne Prima Pharme.

During 2013, Ljekarna Alagić (Split), Zdravstvena ustanova Ljekarne Čaić (Bošnjaci) and Ljekarna Ksenija Gabrić (Zagreb) have been merged into ZU Ljekarne Prima Pharme. In 2013 ZU Ljekarne Prima Pharme established the associate Zdravstvena ustanovu Sv. Kuzma i Damjan and sold it in the same year.

Zdravstvena ustanova Ljekarne Jagatić (Zagreb) is 49% owned by ZU Ljekarne Prima Pharme.

Risks

The most significant market risk for Medika d.d. is the long collection period for receivables, especially HZZO (Croatian State Health Insurance) and HZZO related receivables. Therefore, a significant amount of working capital is not available with strong influence on cash flows and timely settlement of Medika d.d. liabilities.

As these receivables are either dependent from or owned by State institutions, risk of bad debt is not considered high. However, this increases the need for additional financing, which increases operating expenses.

Significant risk for Medika d.d. operations is a continuous decrease in the price of prescription medication on the HZZO list and the HZZO administrative approach in determining prices and margins of medication. To lower this risk, Medika d.d. has focused on increasing products which are not limited by law in respect of the price of the product.

Currency risk is a significant financial risk. Majority of inventories are purchased from foreign suppliers in foreign currencies, hence exposure to currency risk.

Interest risk for the Company arises from short-term and long-term borrowings, with variable interest rate.

Credit risk most significantly arises from trade receivables. Credit risk is higher when dealing with pharmacies, which have more potential going concern issues. Hospitals which have longer collection periods do not have a collection issue and going concern issue.

Corporate governance code

As a listed entity of the Zagreb Stock Exchange, Medika d.d. adopts the corporate governance code of the CFSSA (Croatian Financial Services Supervisory Agency) and the Zagreb Stock Exchange. The corporate governance is published on the web site of the Zagreb Stock Exchange.

The Company has not entered into joint venture, and it does not have securities with special rights nor securities with restriction to vote. There are no cases in which financial rights from securities are separated from ownership of those securities.

Management and Supervisory Board

Management has one member: Mr. Jasminko Herceg, member of the Management Board.

Supervisory Board of the company during the year were as follows: Mr. Mate Perković, president, Mr. Damjan Možina, vice-president, and members: Mr. Tihomir Orešković, Mr. Oleg Uskoković, Mr. Hrvoje Volarić, Mr. Nikica Gabrić and Mrs. Ružica Vađić.

Zagreb, 7 March 2014

Jasminko Herceg
Director

Medika d.d.
ZAGREB, Capraška 1

STATEMENT OF MANAGEMENT AND SUPERVISORY BOARD RESPONSIBILITIES

Management is required to prepare financial statements for each financial year which give a true and fair view of the financial position of the Company and of the results of its operations and cash flows, in accordance with applicable accounting standards, and is responsible for maintaining proper accounting records to enable the preparation of such financial statements at any time. It has a general responsibility for taking such steps which are reasonably available to it to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Management is responsible for selecting suitable accounting policies to conform with applicable accounting standards and then apply them consistently; make judgements and estimates that are reasonable and prudent; and prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business.

Management is responsible for the submission to the Supervisory Board of its annual report on the Company together with the annual financial statements, following which the Supervisory Board is required to approve the annual financial statements for submission to the General Assembly of Shareholders for adoption.

The financial statements set out on pages 6 to 45 were authorised by Management on 7 March 2014 for issue to the Supervisory Board and are signed below to signify this.

By order of the Management Board

Jasminko Herceg
Director

Independent auditor's report to the shareholders of Medika d.d.

We have audited the accompanying separate financial statements of Medika d.d. ("the Company"), which comprise the unconsolidated statement of financial position as at 31 December 2013, the unconsolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards adopted by the Europen Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the unconsolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the separate financial statements give a true and fair view of the unconsolidated financial position of the Company as at 31 December 2013, and of its unconsolidated financial performance and its unconsolidated cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

KPMG Croatia d.o.o.

KPMG Croatia d.o.o. za reviziju
Croatian Certified Auditors
Eurotower, 17th floor
Ivana Lučića 2a
10000 Zagreb, Croatia

KPMG Croatia
d.o.o. za reviziju
Eurotower, 17. kat
Ivana Lučića 2a, 10000 Zagreb

7 March 2014

This version of our audit report is a translation from the original, which was prepared in the Croatian language. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

MEDIKA d.d.

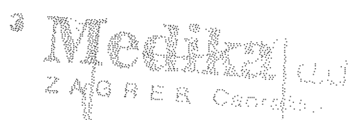
UNCONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR ENDED 31 DECEMBER 2013

(all amounts are expressed in thousands of HRK)	Note	2013	2012
Revenues	5, 6	2,192,142	2,149,310
Cost of trade goods sold	6	(2,006,052)	(1,976,151)
Staff costs	7	(57,033)	(57,626)
Marketing and promotion expenses	8	(9,030)	(7,059)
Depreciation and amortisation	13, 14	(13,306)	(13,182)
Other operating expenses	9	(45,342)	(45,261)
Other (losses) / gains – net	10	(3,971)	806
Operating profit		**57,408**	**50,837**
Finance costs – net	11	(13,558)	(14,368)
Profit before tax		**43,850**	**36,469**
Income tax	12	(2,441)	(2,040)
Profit for the year		**41,409**	**34,429**
Other comprehensive income		-	-
Total comprehensive income		**41,409**	**34,429**

The financial statements set out on pages 6 to 45 were approved by the Management Board of the Company in Zagreb on 7 March 2014.

Jasminko Herceg
Director



The accompanying notes on pages from 11 to 45 form an integral part of these financial statements.

MEDIKA d.d.

UNCONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS AT 31 DECEMBER 2013

(all amounts are expressed in thousands of HRK)	Note	As at 31 December 2013	2012
ASSETS			
Non-current assets			
Property and equipment	13	146,572	151,251
Intangible assets	14	19,640	23,749
Investments in subsidiaries and associates	15	59,148	59,148
Deferred tax assets	26	441	557
Trade and other receivables	17	12,089	15,829
		237,890	250,534
Current assets			
Inventories	18	211,090	186,905
Trade and other receivables	17	1,360,473	1,421,434
Income tax receivable		4,236	3,578
Cash and cash equivalents	19	51,658	15,343
		1,627,457	1,627,260
Total assets		**1,865,347**	**1,877,794**
EQUITY AND LIABILITIES			
Capital and reserves			
Share capital	20	74,476	37,439
Reserve for reinvested profit	21	40,762	33,817
Reserves	22	67,278	67,278
Retained earnings	23	205,535	204,888
		388,051	343,422
Non-current liabilities			
Borrowings	25	5,638	121,935
Provisions	27	516	441
		6,154	122,376
Current liabilities			
Trade and other payables	24	1,158,568	1,263,821
Borrowings	25	311,133	146,794
Provisions	27	1,441	1,381
		1,471,142	1,411,996
Total equity and liabilities		**1,865,347**	**1,877,794**

The accompanying notes on pages from 11 to 45 form an integral part of these financial statements.

UNCONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR ENDED 31 DECEMBER 2013

(all amounts are expressed in thousands of HRK)	Note	Share capital	Reserve for reinvested profit	Reserves	Retained earnings	Total
At 1 January 2012		**37,848**	**-**	**67,278**	**204,276**	**309,402**
Total comprehensive income						
Profit for the year		-	-	-	34,429	34,429
Other comprehensive income		-	-	-	-	-
Total comprehensive income		**-**	**-**	**-**	**34,429**	**34,429**
Transactions with owners recognized directly in equity						
Transfer	21	-	33,817	-	(33,817)	-
Release of treasury shares	20	1,815	-	-	-	1,815
Acquisition of treasury shares	20	(2,224)	-	-	-	(2,224)
Transactions with owners recognized directly in equity		**(409)**	**33,817**	**-**	**(33,817)**	**(409)**
At 31 December 2012		**37,439**	**33,817**	**67,278**	**204,888**	**343,422**
At 1 January 2013		**37,439**	**33,817**	**67,278**	**204,888**	**343,422**
Total comprehensive income						
Profit for the year		-	-	-	41,409	41,409
Other comprehensive income		-	-	-	-	-
Total comprehensive income		**-**	**-**	**-**	**41,409**	**41,409**
Transactions with owners recognized directly in equity						
Increase of share capital	20	33,817	(33,817)	-	-	-
Transfer	21	-	40,762	-	(40,762)	-
Release of treasury shares	20	4,901	-	-	-	4,901
Acquisition of treasury shares	20	(1,681)	-	-	-	(1,681)
Transactions with owners recognized directly in equity		**37,037**	**6,945**	**-**	**(40,762)**	**3,220**
At 31 December 2013		**74,476**	**40,762**	**67,278**	**205,535**	**388,051**

UNCONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED 31 DECEMBER 2013

(all amounts expressed in thousands of HRK)	Note	2013	2012
Cash flows from operating activities:			
Profit for the year		**41,409**	**34,429**
Adjustments for:			
Income tax	12	2,441	2,040
Depreciation and amortisation	13, 14	13,306	13,182
Impairment of receivables	9	3,977	5,634
Inventory impairment	18	4,777	4,826
Unrealised foreign exchange differences		(1,149)	(1,676)
Change in provisions		135	(6)
Gain on disposal of property and equipment	10	(199)	(607)
Impairment of property and equipment	9, 13	-	240
Building write off	13	5,522	-
Intangible assets disposal	14	1	-
Impairment loss on remeasurement of investment	9, 15	-	1,302
Interest expense	11	13,491	15,861
Interest income	5	(1,560)	(533)
Changes in:			
Inventories		(28,962)	(5,859)
Trade and other receivables		100,652	(160,731)
Trade and other payables		(83,580)	155,973
Cash flows generated from operating activities		**70,261**	**64,075**
Interest paid		(13,882)	(17,206)
Income tax paid		(4,698)	(4,152)
Cash flows from operating activities		**51,681**	**42,717**
Cash flows from investing activities:			
Purchase of property, plant and equipment and intangible assets	13, 14	(10,603)	(10,815)
Proceeds from sale of property, plant and equipment		761	1,051
Proceeds from repayment of loans given		12,483	4,284
Investment in subsidiary	15	-	(450)
Loans given		(52,420)	(9,803)
Interest received		1,679	533
Cash flows from investing activities		**(48,100)**	**(15,200)**

The accompanying notes on pages from 11 to 45 form an integral part of these financial statements.

UNCONSOLIDATED STATEMENT OF CASH FLOWS (continued)

FOR THE YEAR ENDED 31 DECEMBER 2013

(all amounts expressed in thousands of HRK)	Note	2013	2012
Cash flows from financing activities:			
Repayment of borrowings		(223,800)	(286,622)
Proceeds from borrowings		261,000	243,198
Repayment of finance lease		(2,785)	(2,103)
Acquisition of treasury shares	20	(1,681)	(2,224)
Cash flows from financing activities		**32,734**	**(47,751)**
Net increase / (decrease) in cash and cash equivalents		**36,315**	**(20,234)**
Cash and cash equivalents at beginning of year		15,343	35,577
Cash and cash equivalents at end of year	19	**51,658**	**15,343**

The accompanying notes on pages from 11 to 45 form an integral part of these financial statements.

NOTE 1 – GENERAL INFORMATION

Medika d.d. (hereinafter: "the Company") is a joint stock company incorporated in Croatia. The principal activity of the Company is the wholesale distribution of pharmaceutical products. The Company is domiciled in Zagreb, Capraška 1.

As at 31 December 2013, the Company's shares were listed on official market on the Zagreb Stock Exchange. Shareholder structure is shown in note 20.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted by the European Union. The financial statements have been prepared under the historical cost convention, unless otherwise stated.

The preparation of financial statements in conformity with IFRS adopted by the European Union requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in note 4.

The Company has issued these unconsolidated financial statements in accordance with International Financial Reporting Standards (IFRS) adopted by the European Union. The Company has also prepared consolidated financial statements in accordance with IFRS for the Company and its subsidiaries (the Group), which were approved by the Management Board on 7 March 2014. In the consolidated financial statements, subsidiary undertakings – which are those companies in which the Group, directly or indirectly, has an interest of more than half of the voting rights or otherwise has power to exercise control over the operations – have been fully consolidated. Users of these non-consolidated financial statements should read them together with the Group's consolidated financial statements as at and for the year ended 31 December 2013 in order to obtain full information on the financial position, results of operations and changes in financial position of the Group as a whole.

New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations have been released and are not yet effective for the year ended 31 December 2013, and have not been applied in preparing these financial statements. None of these are expected to have a significant effect on the financial statements of the Company.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Segment reporting

A business segment is an integral part of the business entity that engages in business activities from which revenues can be realized, by which costs are incurred and for which there are separate financial information. Its operating results are regularly reviewed and evaluated by chief operating decision maker of the business entity in order to decide on resources to be allocated to the segment.

2.3 Foreign currencies

(a) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in Croatian kuna (HRK), which is the Company's functional and presentation currency, rounded to the nearest thousand.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Non-monetary assets and positions, which are stated at historical cost, are not translated into functional currency using new foreign exchange rates.

Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated into functional currency at foreign exchange rates ruling at the dates at which the values were determined.

2.4 Investments in subsidiaries and associates

(a) Subsidiaries

Subsidiaries are all entities over which the Company has the power to govern the financial and operating policies, generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. In Company's financial statements, these investments are stated using historical cost less impairment losses, if any.

(b) Associates

Associates are those entities in which the Company has significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when the Company holds between 20 and 50 percent of the voting power of another entity. In Company's financial statements, these investments are stated using historical cost less impairment losses, if any.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Property and equipment

Property and equipment are included in the statement of financial position at historical cost less accumulated depreciation and impairment. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land and assets under construction are not depreciated. Depreciation of other assets is calculated using the straight-line method to allocate their cost over their estimated useful lives. Depreciation is calculated for each asset until the asset is fully depreciated or to its residual values if significant.

The estimated useful lives are as follows:

Buildings	10 - 40 years
Equipment	2 - 20 years

The residual value of an asset is the estimated amount that the Company would currently obtain from disposal of the asset less the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life. The residual value of an asset is nil if the Company expects to use the asset until the end of its physical life. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (note 2.7).

Gains and losses on disposals are determined by comparing the proceeds with carrying amount, and are recognised within 'other gains – net' in the income statement.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.6 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill on acquisition of subsidiaries is included in intangible assets.

Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Goodwill is allocated to cash-generating units for the purpose of impairment testing. The allocation is made to those cash-generating units that are expected to benefit from the business combination in which the goodwill arose. The Company allocates goodwill to each business segment in which it operates.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

(b) Licences

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their estimated useful lives (5 to 10 years).

2.7 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation and depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.8 Financial assets

The Company classifies its financial assets as trade and other receivables. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

Trade and other receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the reporting date. These are classified as non-current assets.

Trade and other receivables are carried at amortised cost using effective interest method.

The Company assesses at each reporting date whether there is indication for financial assets to be impaired. Impairment testing of trade and other receivables is described in note 2.11.

2.9 Leases

The Company leases certain property and equipment. Leases of property and equipment, where the Company has substantially all the risks and rewards of ownership, are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of fair value of the leased property or the present value of minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the balance outstanding. The interest element of the finance costs is charged to the income statement over the lease period. The property and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset and the lease term.

Leases where the significant portion of risks and rewards of ownership are not retained by the Company are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

2.10 Inventories

Inventories are stated at the lower of cost or net realisable value. Cost includes all costs attributable to the purchase of goods and is calculated based on the average purchase price. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. At each reporting date, the Company examines if there are damaged and/or obsolete inventories. With respect to differences identified, a provision is made for such inventories against cost of trade goods sold.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.11 Trade and loan receivables

Trade and loan receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables.

Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy, and default or delinquency in payments are considered indicators that the trade receivable is impaired. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement within 'other operating expenses'.

Loans and receivables with maturities greater than 12 months after the reporting date are classified as non-current assets.

2.12 Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held at call with banks and other short-term highly liquid instruments with original maturities of three months or less.

2.13 Share capital

Ordinary shares are classified as equity.

Where the Company purchases its equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes) is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

2.14 Trade payables

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

2.15 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost. Any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.16 Income tax

The current income tax charge is calculated on the basis of the tax law enacted at the reporting date in Croatia. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulations are subject to interpretation and consider establishing provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

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

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets and liabilities are determined using tax rates (and laws) that have been enacted or substantially enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

2.17 Employee benefits

(a) Pension obligations and post-employment benefits

In the normal course of business through salary deductions, the Company makes payments to mandatory pension funds on behalf of its employees as required by law. All contributions made to the mandatory pension funds are recorded as salary expense when incurred. The Company does not have any other pension scheme and consequently, has no other obligations in respect of employee pensions. In addition, the Company is not obliged to provide any other post-employment benefits.

(b) Long-term employee benefits

The Company recognises a liability for long-term employee benefits (jubilee awards and termination benefits) evenly over the period the jubilee award/termination benefit is earned based on actual years of service. The long-term employee benefit liability includes assumptions regarding the likely number of staff to whom the benefit will be payable, estimated benefit cost and the discount rate. Termination benefits and jubilee awards falling due more than 12 months after the reporting date are discounted to their present value.

(c) Short-term employee benefits

The Company recognises a provision for bonuses, unused annual leave and other considerations where contractually obliged or where there is a past practice that has created a constructive obligation.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.17 Employee benefits (continued)

(c) Short-term employee benefits (continued)

Short-term liabilities for termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy.

Short-term employee benefits include termination benefits and jubilee awards (stated in paragraph (b) above), which will be paid within a period of 12 months after the reporting date.

2.18 Provisions

Provisions for costs are recognised when: the Company has a present legal or constructive obligation as a result of past events; it is more likely than an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures that is expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The amount of provision increases in each period to reflect the passage of time. This increase is shown as interest expense.

2.19 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Company's activities. Revenue is shown, net of value-added tax, estimated returns, rebates and discounts.

The Company recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and specific criteria have been met for each of the Company's activities as described below.

(a) Sales of goods

Income from the wholesale of goods is recognised when the Company has delivered products to the customer, the customer has accepted the products and collectability of the related receivables is reasonably assured. Products are sold with volume discounts and customers have a right to return faulty products in the wholesale market. Sales are recorded based on the price specified in the sales contracts, net of estimated volume discounts and returns at the time of sale.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.19 Revenue recognition (continued)

(b) Sales of services

Service revenue mainly relates to revenue from consignment commissions and is recognised when the goods are taken from the consignment warehouse and when a calculation of the consignment service provided is prepared for the owner of the goods.

(c) Interest income

Interest income arising from fixed-term bank deposits and given loans is recognised on a time-proportion basis using the effective interest method.

2.20 Finance expenses

Finance expenses comprise interest expense on borrowings, impairment losses recognised on financial assets, and foreign exchange losses. All borrowing costs are recognised in profit or loss using the effective interest method.

2.21 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

2.22 Value added tax

The Tax Authorities require the settlement of VAT on a net basis. VAT related to sales and purchases is recognised and disclosed in the statement of financial position on a net basis. Where a provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the receivable, including VAT.

NOTE 3 – FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk and cash flow interest rate risk), credit risk and liquidity risk. The Company does not have a written risk management programme, however, overall risk management in respect of these risks is carried out by the Company's Finance department.

(a) Market risk

(i) Foreign exchange risk

The Company's sales are predominantly realised on the domestic market in Croatian kuna (HRK). The Company's purchase of goods is predominantly realised on the foreign market. The Company is therefore exposed to foreign exchange risk arising from various changes in foreign exchange rates mainly linked to the EUR, which may have an impact on future operating results and cash flows.

At 31 December 2013 (notes 17, 19, 24, 25), if the EURO had weakened/strengthened by 0.93% (2012: 1.56%) against the HRK, with all other variables held constant, the profit after tax for the reporting period would have been HRK 2,488 thousand higher/lower (2012: HRK 5,004 thousand), mainly as a result of foreign exchange gains/losses on translation of EURO-denominated trade payables.

(ii) Cash flow and fair value interest rate risk

As the Company has no significant interest-bearing assets, the Company's income and operating cash flows are substantially independent of changes in market interest rates.

The Company's interest rate risk arises from the borrowings. Borrowings issued at variable rates expose the Company to cash flow interest rate risk. Borrowings issued at fixed rates expose the Company to fair value interest rate risk.

The Company does not use derivative instruments to actively hedge cash flow and fair value interest rate risk exposure. However, the Company continuously monitors changes in interest rates. Various scenarios are simulated taking into account refinancing, renewal of existing positions and alternative financing.

At 31 December 2013, if the effective interest rate on borrowings (issued at variable rate) had been 0.28% higher/lower on an annual level (2012: 0.20%), the profit after tax for the reporting period would have been HRK 2,183 thousand lower/higher (2012: HRK 2,255 thousand).

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

(b) Credit risk

Current assets, which potentially subject the Company to concentrations of credit risk primarily include cash, trade receivables and other receivables. The Company has no significant concentrations of credit risk. The Company has policies in place to ensure that sales of products are made to customers with an appropriate credit history. With respect to credit risk exposure, customers are grouped into three categories: pharmacies, hospitals and other customers. Pharmacies present higher credit risk since they have potential going concern issue. On the other hand, collection period for hospitals is longer, but there are no impairment indications, namely, there is no going concern issue. Other customers are not significant because of dispersion on large number of customers, individually small balances and Company's strict measures of collection of outstanding debts and delivery of goods. The Company insures part of the trade receivables by bills of exchange and promissory notes. Detailed credit risk analysis is shown under notes 16 and 17.

(c) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash, the availability of funding through an adequate amount of committed credit facilities and the ability to meet all obligations. The Company aims to maintain flexibility in funding by keeping committed credit lines available. The Finance department regularly, monthly, monitors available cash resources. The Commission Board in charge of monitoring the Company's liquidity prepares a payment plan on a monthly basis, and carries out payments on a daily basis, in accordance with the priority list received from managers who are in charge of the purchase of specific groups of products. Most of the customers are either state-owned or state-dependant hence the Company's liquidity risk is dependent upon the state.

The table below analyses financial liabilities of the Company according to contracted maturities. The amounts stated below represent undiscounted cash flows.

(in thousands of HRK)	Less than 1 year	Between 1-3 years	Over 3 years	Total
31 December 2013				
Trade and other payables	1,158,568	-	-	1,158,568
Borrowings	315,360	5,780	-	321,140

(in thousands of HRK)	Less than 1 year	Between 1-3 years	Over 3 years	Total
31 December 2012				
Trade and other payables	1,263,821	-	-	1,263,821
Borrowings	164,122	29,809	102,356	296,287

During 2014, the Company will settle trade and other liabilities according to the collection of receivables which depends on liquidity of the whole healthcare system. The Company is currently involved in negotiations with local banks regarding the refinancing of a part of current debt to non-current.

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.2 Capital risk management

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

The Company monitors capital on the basis of the self-financing ratio in financial statements. This ratio is calculated as the proportion of total equity and total assets.

The equity to assets ratio is as follows:

	2013	2012
	(in thousands of HRK)	
Total equity (capital and reserves)	388,051	343,422
Total assets	1,865,347	1,877,794
Equity to assets ratio	**21%**	**18%**

In 2013, the ratio has increased in comparison to 2012 showing that 21% of the Company's total assets are financed from own resources. In accordance with the stated, 79% of assets is financed from other resources.

3.3 Fair value estimation

The fair value of financial instruments traded in active markets is based on quoted market prices at the reporting date. The quoted market price used for financial assets held by the Company is the current bid price. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date.

The carrying value less impairment provision of trade receivables and payables are assumed to approximate their fair values.

The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Company for similar financial instruments.

NOTE 4 – CRITICAL ACCOUNTING ESTIMATES

Estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Assumptions to determine amount of provisions of trade receivables

Due to the significance of the amount of trade receivables recorded in the statement of financial position, Management estimates the likelihood of the collection of trade receivables based on an analysis of individual categories of such assets. Factors taken into consideration by Management include: ageing analysis of trade receivables and the financial position of customers compared to the collection history with the customer. The estimated recoverable amount of trade receivables represents the present value of estimated future cash flows, discounted at the effective interest rate of 4.60% per year (2012: 4.99%). Should actual collections be less than management estimates, the Company would be required to record additional impairment expense.

At 31 December 2013, if the assessment of the amount of uncollectible receivables and overdue in total receivables had been 1% lower/higher, with all other variables held constant, profit after tax for the reporting period would have been HRK 3,068 thousand higher/lower than the one recorded (2012: HRK 1,327 thousand). The effect in the hospital segment would be HRK 2,777 thousand (2012: HRK 879 thousand), in the pharmacy segment HRK 134 thousand (2012: HRK 169 thousand) and in the segment 'other' HRK 157 thousand (2012: HRK 279 thousand).

NOTE 5 – REVENUES

	2013	2012
	(in thousands of HRK)	
Revenue from sales	2,181,513	2,139,032
Other income	10,629	10,278
	2,192,142	**2,149,310**

Other income include interest income in the amount of HRK 1,560 thousand (2012: HRK 533 thousand)

NOTE 6 – SEGMENT INFORMATION

Segment information follows the structure used by the Company for internal reporting purposes, which has remained unchanged in comparison with the previous year.

The Company monitors revenues and gross profit through distribution channels:

1. Pharmacies, which are for the purpose of reporting, divided into the following categories:
   - county pharmacies
   - private pharmacies
   - self-owned pharmacies (subsidiary ZU Ljekarne Prima Pharme with its subsidiaries).

The company operates with approximately 440 pharmacies and medical institutions.

2. Hospitals, which are by the Regulation on conditions for the classification of hospitals passed as a part of health system reform started in 2011, divided into the following categories:
   - national hospitals
   - county hospitals with regional significance
   - county hospitals
   - local hospitals

3. Other customers divided into:
   - dental practices
   - veterinary clinics
   - medical centres
   - pharmacy wholesalers
   - other customers (herbal pharmacies, companies, optics, etc.)

The Company uses margin calculated as sales revenue minus cost of goods sold as a measure of success of a particular segment.

Transactions between segments do not exist. The Company applies the same accounting policies in all segments.

NOTE 6 – SEGMENT INFORMATION (continued)

The results of the stated segments for the year ended 31 December 2013 are as follows:

(in thousands of HRK)	Pharmacies	Hospitals	Other	Total
Revenue from sales	1,062,224	541,142	308,429	1,911,795
Other income	447	1	9,774	10,222
Revenue from sales and other income from related parties (note 32)	269,451	-	674	270,125
Total revenues	**1,332,122**	**541,143**	**318,877**	**2,192,142**
Cost of trade goods sold	(1,238,444)	(494,648)	(272,960)	(2,006,052)
Segment results	**93,678**	**46,495**	**45,917**	**186,090**
Operating expenses				(128,682)
Operating profit				**57,408**
Finance costs - net				(13,558)
Profit before tax				**43,850**
Income tax				(2,441)
Profit for the year				**41,409**

The results of the stated segments for the year ended 31 December 2012 are as follows:

(in thousands of HRK)	Pharmacies	Hospitals	Other	Total
Revenue from sales	1,061,858	526,586	297,104	1,885,548
Other income	-	-	9,710	9,710
Revenue from sales and other income from related parties (note 32)	253,595	-	457	254,052
Total revenues	**1,315,453**	**526,586**	**307,271**	**2,149,310**
Cost of trade goods sold	(1,223,755)	(479,451)	(272,945)	(1,976,151)
Segment results	**91,698**	**47,135**	**34,326**	**173,159**
Operating expenses				(122,322)
Operating profit				**50,837**
Finance costs - net				(14,368)
Profit before tax				**36,469**
Income tax				(2,040)
Profit for the year				**34,429**