MEDIKA d.d.

AUDITOR'S REPORT AND CONSOLIDATED 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

In the year 2013, Medika Group realized consolidated revenue in the amount of HRK 2,283,831 thousand, an increase of 1,9% . Consolidated operating profit amounts to HRK 60,250 thousand which is a HRK 7,317 thousand decrease in comparison to prior year.

Consolidated profit before tax amounts to HRK 45,346 thousand and consolidated net profit HRK 42,697 thousand, which is a decrease of HRK 5,573 thousand 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.

If analysing operating business segments (note 6 in financial statements), 62.3% of total consolidated income was generated through "pharmacies" segment, of which 14.5% from own pharmacies, and 23.7% through "hospitals" segment. In comparison to prior year, the "pharmacies" and "hospitals" segment remained at the same level.

Total consolidated assets amount to HRK 1,959,027 thousand, a decrease of 2.9% in comparison to prior year. Consolidated current assets comprise 79.6% of total assets. Trade and other receivables are the largest and most significant amount of total assets and have decreased by 9.0% in comparison to prior year. In June 2013 was performed the rehabilitation of clinical hospitals and trade receivables recorded significant decline in the first half of the year. In the second half of the year, the 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 10.4% in comparison to prior year because of increased purchases due to sales growth.

Based on Partnership Agreement, during 2013 the Group founded associate Zdravstvena ustanova Sv. Kuzma i Damjan registred in Zagreb. The Group made an equity contribution by transferring a licence for performing pharmaceutical services and as a result of contribution acquired 49% stake in the newly incorporated institution. The Group sold its share in ZU Sv. Kuzma i Damjan in 2013.

Group's equity to assets ratio shows that 22% of total consolidated assets are financed through own resources.

Total consolidated credit indebtedness of the Medika Group is HRK 348,566 thousand, of which HRK 335,750 thousand relates to short-term loans (loans and finance lease), while the remainder in the amount of HRK 12,816 thousand relates to long-term loans and finance lease (note 26).

Consolidated financial results are presented in the statement of comprehensive income on page 6 of the financial statements.

Subsequent events

There are no events after the reporting date that require adjustment of the financial statements or additional disclosures in 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 Medika's sales decline is expected to be lower than decline of the market, increase in 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.

Construction work on a new business center in Osijek started in 2013. 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 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 has the following 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) were merged into ZU Ljekarne Prima Pharme. In 2013 ZU Ljekarne Prima Pharme established the associate Zdravstvena ustanovu Sv. Kuzma i Damjan which is 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's 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 medications. To lower this risk, Medika has focused on increasing the lines of 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. A portion of loans from commercial banks are settled with foreign currency clause.

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, Director.

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

MEDIKA d.d.

STATEMENT OF MANAGEMENT AND SUPERVISORY BOARD'S RESPONSIBILITIES

The Management Board is required to prepare the consolidated financial statements for each financial year which give a true and fair view of the financial position of the Group 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. The Management Board has the responsibility of taking steps which are reasonably available to it in order to safeguard the assets of the Group and to prevent and detect fraud and other irregularities. The Management Board 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 consolidated financial statements on a going concern basis unless it is inappropriate to presume that the Group will continue in business.

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

The financial statements set out on pages 6 to 51 were authorised by the Management Board 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 consolidated financial statements of Medika d.d. ("the Company"), which comprise the consolidated statement of financial position as at 31 December 2013, the consolidated 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 Consolidates Financial Statements

Management is responsible for the preparation and fair presentation of these consolidates financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements give a true and fair view of the consolidated financial position of the Company as at 31 December 2013, and of its consolidated financial performance and its consolidated 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
Eurotower, 17. kat
Ivana Lučića 2a, 10000 Zagreb

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

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.

CONSOLIDATED 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	2,283,831	2,242,224
Cost of trade goods sold	6	(2,023,040)	(1,993,901)
Staff costs	7	(104,811)	(102,718)
Marketing and promotion expenses	8	(9,245)	(7,339)
Depreciation and amortisation	14, 15	(15,679)	(16,206)
Other operating expenses	9	(66,858)	(62,762)
Other (losses) / gains – net	10	(3,948)	8,269
Operating profit		**60,250**	**67,567**
Finance costs – net	11	(15,549)	(16,579)
Share of profits in associates	16	645	623
Profit before tax		**45,346**	**51,611**
Income tax	12	(2,649)	(3,341)
Profit for the year		**42,697**	**48,270**
Other comprehensive income		-	-
Total comprehensive income		**42,697**	**48,270**
Earnings per share:			
- basic/diluted (*in HRK*)	13	**1,487.08**	**1,687.47**

The consolidated financial statements set out on pages 6 to 51 were approved by the Management Board of the Company in Zagreb on 7 March 2014.

Jasminko Herceg
Director

The accompanying notes on pages 11 to 51 form an integral part of these consolidated financial statements.

CONSOLIDATED 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	14	155,426	159,679
Intangible assets	15	188,718	190,019
Investment in associates	16	39,368	39,182
Deferred tax asset	27	988	1,031
Trade and other receivables	18	14,631	16,479
		399,131	406,390
Current assets			
Inventories	19	239,143	216,553
Trade and other receivables	18	1,248,975	1,371,586
Income tax receivable		5,184	3,784
Cash and cash equivalents	20	66,594	19,566
		1,559,896	1,611,489
Total assets		**1,959,027**	**2,017,879**
EQUITY AND LIABILITIES			
Capital and reserves			
Share capital	21	74,476	37,439
Reserve for reinvested profit	22	40,762	33,817
Reserves	23	67,278	67,278
Retained earnings	24	238,707	236,772
		421,223	375,306
Non-current liabilities			
Borrowings	26	12,816	136,977
Deferred tax liability	27	15,790	15,342
Provisions	28	800	679
		29,406	152,998
Current liabilities			
Trade and other payables	25	1,170,564	1,293,518
Income tax liabilities		-	485
Borrowings	26	335,750	194,097
Provisions	28	2,084	1,475
		1,508,398	1,489,575
Total equity and liabilities		**1,959,027**	**2,017,879**

The accompanying notes on pages 11 to 51 form an integral part of these consolidated financial statements.

CONSOLIDATED 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
As at 1 January 2012		**37,848**	**-**	**67,278**	**222,319**	**327,445**
Total comprehensive income						
Profit for the year		-	-	-	48,270	48,270
Other comprehensive income		-	-	-	-	-
Total comprehensive income		**-**	**-**	**-**	**48,270**	**48,270**
Transactions with owners recognized directly in equity						
Transfer	22	-	33,817	-	(33,817)	-
Release of treasury shares	21	1,815	-	-	-	1,815
Acquisition of own shares	21	(2,224)	-	-	-	(2,224)
Transactions with owners recognized directly in equity		**(409)**	**33,817**	**-**	**(33,817)**	**(409)**
As at 31 December 2012		**37,439**	**33,817**	**67,278**	**236,772**	**375,306**
As at 1 January 2013		**37,439**	**33,817**	**67,278**	**236,772**	**375,306**
Total comprehensive income						
Profit for the year		-	-	-	42,697	42,697
Other comprehensive income		-	-	-	-	-
Total comprehensive income		**-**	**-**	**-**	**42,697**	**42,697**
Transactions with owners recognized directly in equity						
Increase of share capital	21	33,817	(33,817)	-	-	-
Transfer	22	-	40,762	-	(40,762)	-
Release of treasury shares	21	4,901	-	-	-	4,901
Acquisition of own shares	21	(1,681)	-	-	-	(1,681)
Transactions with owners recognized directly in equity		**37,037**	**6,945**	**-**	**(40,762)**	**3,220**
As at 31 December 2013		**74,476**	**40,762**	**67,278**	**238,707**	**421,223**

The accompanying notes on pages 11 to 51 form an integral part of these consolidated financial statements.

MEDIKA d.d.

CONSOLIDATED STATEMENT OF CASH FLOW

FOR THE YEAR ENDED 31 DECEMBER 2013

(all amounts expressed in thousands of HRK)	Note	2013	2012
Profit for the year		**42,697**	**48,270**
Adjustments for:			
Income tax	12	2,649	3,341
Depreciation and amortisation	14, 15	15,679	16,206
Impairment of receivables	9	5,242	5,771
Inventory impairment	19	5,080	5,155
Unrealised foreign exchange differences		(933)	(1,809)
Change in provisions	28	730	82
Gains on sale of tangible assets	10	(222)	(600)
Impairment of property and equipment	9, 14	162	240
Property write-off		5,522	
Impairment of intangible assets	15	304	-
Interest income		(1,560)	(569)
Interest expense	11	15,368	18,069
Share of (profit) / loss from associates	16	(645)	(623)
Gain on disposal of subsidiary	10	-	(7,470)
Changes in:			
Inventories		(26,079)	(6,497)
Trade and other receivables		165,139	(170,406)
Trade and other payables		(111,021)	166,356
Cash generated from operating activities		**118,112**	**75,516**
Interest paid		(15,788)	(19,344)
Income tax paid		(6,435)	(5,005)
Cash flows from operating activities		**95,889**	**51,167**
Cash flows from investing activities			
Purchase of property and equipment		(10,969)	(9,738)
Proceeds from sale of property and equipment		800	1,264
Purchase of intangible assets	15	(934)	(14,599)
Acquisition of subsidiary, net of cash acquired	31	(1,955)	(5,888)
The effect of disposal of subsidiary	32	-	(172)
Proceeds from the repayment of loans given		12,483	4,284
Loans given		(52,420)	(9,803)
Interest received		1,679	569
Cash paid for shares in subsidiaries	16	-	(450)
Dividend received	16	459	748
Cash flows from investing activities		**(50,857)**	**(33,785)**

The accompanying notes on pages 11 to 51 form an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOW (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		(274,452)	(313,138)
Proceeds from borrowings		281,000	279,198
Repayment of finance lease		(2,871)	(2,231)
Acquisition of own shares	21	(1,681)	(2,224)
Cash flows from financing activities		**1,996**	**(38,395)**
Net increase / (decrease) in cash and cash equivalents		**47,028**	**(21,013)**
Cash and cash equivalents at beginning of year		19,566	40,579
Cash and cash equivalents at end of year	20	**66,594**	**19,566**

The accompanying notes on pages 11 to 51 form an integral part of these consolidated 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 and its subsidiaries (together "the Group") is the wholesale and retail distribution of pharmaceutical products. The Company headquarters is in Zagreb, Capraška 1.

The Group is comprised of the Company and the following subsidiaries and associates:

	2013	2012
- Zdravstvena ustanova Ljekarne Prima Pharme, Split	100%	100%
- Zdravstvena ustanova Ljekarne Delonga, Okrug Gornji (from May 2007)	100%	100%
- Zdravstvena ustanova Ljekarne Ines Škoko, Zagreb (from March 2011)	100%	100%
- Zdravstvena ustanova Ljekarne Atalić, Osijek (from June 2011)	100%	100%
- Ljekarna Alagić, Split (from August 2012)	-	100%
- Zdravstvena ustanova Ljekarne Čaić, Bošnjaci (from October 2012)	-	100%
- Ljekarna Elvira Štimac, Opatija (from July 2013)	100%	-
- Ljekarna Ksenija Gabrić (acquired and merged in 2013)	-	-
- Zdravstvena ustanova Ljekarne Jagatić, Zagreb (from November 2008)	49%	49%
- Zdravstvena ustanova Sv. Kuzma i Damjan (established and sold in 2013)	-	-
- Primus nekretnine d.o.o., Zagreb (disposed in 2012)	-	-
- Litmus d.o.o., Zagreb (established in August 2012)	41,53%	41,53%

As at 31 December 2013, the Company's shares were listed on the official market on the Zagreb Stock Exchange. The shareholder structure is shown in note 21.

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

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

These financial statements are a translation of the official statutory financial statements prepared in Croatian.

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

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 Group.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Consolidation

(a) Subsidiaries

Subsidiaries are all entities over which the Group 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 Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill (note 2.6). If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-group transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated, but considered if an impairment indicator of the asset transferred exists. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Associates

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

The Group's share of its associates' post-acquisition profits or losses is recognized in the income statement, and its share of post-acquisition movements in reserves is recognized in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivable which form an integral part of net investments, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized losses are also eliminated, unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

2.3 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Foreign currencies

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated 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 in foreign currencies

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 items that are measured at foreign currency historical cost are not retranslated at new 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.

2.5 Property and equipment

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

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 Group 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 Group 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 Group 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Property and equipment (continued)

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.

2.6 Intangible assets

(a) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group'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 Group 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 pharmaceutical service licences are capitalised by the amount for which future economic benefits are expected. These licences are amortized over their estimated useful life of 5 to an infinite lifetime. Recoverable amount is estimated on an annual basis.

(c) Software

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).

(d) Other rights

Other rights are shown at historical cost, they have a finite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of other rights over their estimated useful lives (5 years).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 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 other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.8 Financial assets

The Group 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 measured at amortised cost using effective interest rate method.

The Group assesses at each reporting date whether there is indication for financial asset or a group of financial assets to be impaired. Impairment testing of given loans and receivables is described in note 2.11.

2.9 Leases

The Group leases certain property and equipment. Leases of property, plant and equipment, where the Group 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, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life or the lease term.

Leases where the significant portion of risks and rewards of ownership are not transferred to the Group 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 Group examines if there are damaged and/or expired inventories. With respect to differences identified, a provision is made for such inventories against cost of trade goods sold.

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 receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of 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 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.

When 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

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 asset and liability 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 Group 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 Group does not have any other pension scheme and consequently, has no other obligations in respect of employee pensions. In addition, the Group is not obliged to provide any other post-employment benefits.

(b) Long-term employee benefits

The Group recognises a liability for long-term employee benefits (jubilee awards and termination benefits as defined by the collective bargaining agreement) 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.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.17 Employee benefits (continued)

(c) Short-term employee benefits

The Group 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.

Short-term liabilities for termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group 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) previously mentioned), which will be paid within a period of 12 months after the reporting date.

2.18 Provisions

Provisions for costs are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

When 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 item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures 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 Group's activities. Revenue is shown, net of value-added tax, estimated returns, rebates and discounts.

The Group 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 Group's activities as described below.

(a) Sale of goods

Income from the wholesale of goods is recognised when the Group 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)

(a) Sale of goods (continued)

Income from the retail sales of goods is recognised when the Group sells a product to the customer. Retail sales are usually in cash or by credit card. The recorded revenue includes credit card fees payable for the transaction. Such fees are included in other operating expenses.

(b) Sale 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, changes in the fair value of financial assets at fair value through profit or loss, impairment losses recognised on financial assets and foreign currency 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 debtor, including VAT.

2.23 Earnings per share

The Group presents basic earnings per share (EPS) data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period.

NOTE 3 – FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and equity securities risk) credit risk and liquidity risk. The Group does not have a written risk management programme, and did not use derivative financial instruments to actively hedge financial risks. However, overall risk management in respect of these risks is carried out by the Group's Finance department.

(a) Market risk

(i) Foreign exchange risk

The Group's sales are predominantly realised on the domestic market in Croatian kuna (HRK). However, the Group's purchase of goods is predominantly realised on the foreign market. Furthermore, a part of the borrowings is linked to foreign currencies. The Group 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.

As at 31 December 2013, if the EURO had weakened/strengthened against the HRK by 0.93% (2012: 1.56%), with all other variables held constant, the profit after tax for the reporting period would have been HRK 2,574 thousand higher/lower (2012: HRK 5,311 thousand), mainly as a result of foreign exchange gains/losses on translation of EURO-denominated trade payables and liabilities and loans and borrowings.

(ii) Cash flow and fair value interest rate risk

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

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

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

As 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: 1.56%), the profit after tax for the reporting period would have been HRK 2,139 thousand lower/higher by HRK 2,139 thousand (2012: HRK 3,032 thousand).

NOTE 3 – FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

(b) Credit risk

Group's exposure to credit risk is influenced mainly by current assets which comprise cash, trade and other receivables. The Group does not have a significant concentration of credit risk. Group's sales policies ensure that sale is done towards customers with adequate credit history. As for the credit exposure, customers are divided 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. The majority of receivables are either financially dependent or owned by the State causing the Group, from perspective of credit risk exposure, also to be dependent on the State. Other customers are not significant because of dispersion on large number of customers, individually small balances and Group's strict measures of collection of outstanding debts and delivery of goods. The Group insures part of the trade receivables by bills of exchange and promissory notes. Detailed credit risk analysis is shown under notes 17 and 18.

(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 Group aims to maintain flexibility in funding by keeping committed credit lines available. The Finance department regularly – monthly monitors available cash resources. The Commission in charge of monitoring the Group'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. The majority of debtors are either financially dependent or owned by the State so the Group is also dependent on the State on the liquidity risk side.

The table below analyses financial liabilities of the Group 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	1,170,564	-	-	1,170,564
Borrowings	341,022	8,713	-	349,735

(in thousands of HRK)	Less than 1 year	Between 1-3 years	Over 3 years	Total
31 December 2012				
Trade and other payables	1,293,518	-	-	1,293,518
Borrowings	212,594	36,168	111,956	360,718

During 2014, the Group will settle trade and other liabilities according to the collection of receivables which depends on liquidity of the whole healthcare system. The Group 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 Group's objectives when managing capital are to safeguard the Group'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 Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

The Group 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 self-financing ratio is as follows:

	2013	2012
	(in thousands of HRK)	
Total equity (capital and reserves)	421,223	375,306
Total assets	1,959,027	2,017,879
Self-financing ratio	**22%**	**19%**

In 2013, the ratio has increased in comparison to 2012 showing that 22% of the Group's total assets are financed from own resources. In accordance with the stated, 78% 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 Group 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 Group 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 Group for similar financial instruments.