

TALLINNA
FARMAATSIATEHASE AS

*Annual Report for
The Financial Year
Ended 31 December 2003*

TALLINNA FARMAATSIATEHASE AS

ANNUAL REPORT

Beginning of the financial year	1 January 2003
End of the financial year	31 December 2003
Name of the company	TALLINNA FARMAATSIATEHASE AS
Registration number	10093221
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Field of activity	Production of pharmaceuticals
Auditors	AS Deloitte & Touche Audit

TALLINNA FARMAATSIATEHASE AS

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TALLINNA FARMAATSIATEHASE AS

DIRECTOR'S DECLARATION

The Director has prepared the management report and the annual accounts of Tallinna Farmaatsiatehase AS for the financial year ended 31 December 2003.

The annual accounts have been prepared according to International Financial Reporting Standards (IFRS), and present a true and fair view of the financial position, economic performance and cash flows of Tallinna Farmaatsiatehase AS.

Preparation of the annual accounts according to IFRS involves estimates made by the Director on Tallinna Farmaatsiatehase AS assets and liabilities as at the balance sheet date, and on income and expenses during the financial year. These estimates are based on up-to-date information about the state of Tallinna Farmaatsiatehase AS and consider the plans and risks as at the date of the annual accounts' preparation. The actual outcome of the business transactions recorded may differ from those estimates.

Significant circumstances that have an effect on the valuation of assets and liabilities until preparation of the annual accounts on 1 March 2004 are taken into consideration.

The Director considers Tallinna Farmaatsiatehase AS to carry its activities as a going concern.

Name	Position	Signature	Date
Ibrahim Muhtši	Director	_____	_____

TALLINNA FARMAATSIATEHASE AS

MANAGEMENT REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

GENERAL DATA

As at 31 December 2003, the share capital of Tallinna Farmaatsiatehase AS was 12 500 000 EEK.

The number of employees as at 31 December 2003 was 92. Salaries and wages paid to the employees in 2003 amounted to 9 688 947 EEK.

SHAREHOLDERS

The list of Tallinna Farmaatsiatehase AS shareholders holding more than 1% of shares as at 31 December 2003 is as follows:

<u>Shareholder</u>	<u>Number of shares</u>	<u>% of shares</u>
PJSC Grindeks	801 681	64.14
Hansabanka Clients	281 767	22.54
<i>incl. PJSC Grindeks</i>	<i>131 767</i>	<i>10.54</i>
Nordberg Capital Group Inc	13 262	1.06

COUNCIL

Based on the decision of shareholders of Tallinna Farmaatsiatehase AS the following Council members were elected from 14 April 2003:

- Jelena Borcova - Chairman of the Council;
- Karina Springe - Member of the Council;
- Valdis Jakobsons - Member of the Council.

Based on the decision of shareholders of Tallinna Farmaatsiatehase AS the following Council members were elected from 25 July 2003:

- Kirovs Lipmans - Chairman of the Council;
- Vitalijs Gavrilovs - Member of the Council;
- Valdis Jakobsons - Member of the Council.

Salaries paid to the members of the Council in 2003 amounted to 200 869 EEK.

BOARD

Since 19 March 2003 the only member of the Board is Ibraim Muhtši. Salaries paid to the members of the Board in 2003 amounted to 456 905 EEK.

MANAGEMENT (as at 31.12.2003)

Raivo Unt	-	Finance Director
Priit Allikajaka	-	Technical Director
Irene Pehk	-	Head of production department
Allan Ahtloo	-	Head of logistic's department
Heidi Pedosk	-	Deputy Manager of development and registration department
Ibraim Muhtši	-	Head of sales planning department
Raivo Kurs	-	Head of sales and marketing department
Kadri Randveer	-	Head of personnel department
Galina Kutepova	-	Head of quality control department
Helle Mäe	-	Chief Accountant
Katrin Näär	-	Quality Control Manager (ISO)

TALLINNA FARMAATSIATEHASE AS

MANAGEMENT REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

FINANCIAL RESULTS IN 2003

Comments to the Income Statement

During 2003 the net sales amounted to 75,494 thousand EEK (4,825 thousand EUR). Compared to 2002 net sales decreased by 18,381 thousand EEK (1,175 thousand EUR) or 19,6% (2002 net sales were 93,875 thousand EEK or 5,999 thousand EUR). Total revenue decreased by 3,805 thousand EEK (243 thousand EUR) or 4.0%.

Operating expenses have decreased compared to 2002 by 8,435 thousand EEK (539 thousand EUR) or 9,49%, (in 2002 operating expenses were 88,899 thousand EEK or 5,682 thousand EUR and in 2003 operating expenses were 80,465 thousand EEK or 5,143 thousand EUR), of which decrease of expenses for raw materials made up 11,587 thousand EEK (741 thousand EUR), miscellaneous operating expenses decrease was 225 thousand EEK (14 thousand EUR) and other expenses decrease was 1,194 thousand EEK (76 thousand EUR).

Operating profit increased in 2003 compared to 2002 by 4,630 thousand EEK (296 thousand EUR) or 76,4% (in 2002 operating profit was 6,064 thousand EEK or 388 thousand EUR and in 2003 operating profit was 10,694 thousand EEK or 683 thousand EUR) and net profit for the financial year increased by 5,233 thousand EEK (334 thousand EUR) or 104,8% compared to 2002 (in 2002 net profit was 4,995 thousand EEK or 319 thousand EUR and in 2003 net profit was 10,228 thousand EEK or 654 thousand EUR).

Comments to the Balance Sheet

As at 31 December 2003 the Company's total assets amounted to 56,840 thousand EEK (3,633 thousand EUR). The largest decrease in assets has occurred in receivables from parent of 15,029 thousand EEK (961 thousand EUR) or 59,6% and in finished goods of 7,095 thousand EEK (453 thousand EUR) or 47,2%. Current assets in total decreased by 24,888 thousand EEK (1,591 thousand EUR) or 50,1%.

In liabilities, current liabilities decreased by 12,559 thousand EEK (803 thousand EUR) or 62,4%, including decrease in supplier payables of 2,662 thousand EEK (170 thousand EUR) or 35,5%. Non-current liabilities decreased by 28,661 thousand EEK (1,832 thousand EUR) or 96,1%. Shareholders' equity increased by 10,228 thousand EEK (654 thousand EUR) or 27,0%, as a result of 2003 net profit.

Financial data

Comparison of financial data of 2003 and 2002:

	2003	2002
Gross margin	14,4	6,4
Net margin	13,8	5,3
Return on equity (ROE)	21,3	13,0
Return on assets (ROA)	18,0	5,6
Equity/assets ratio	84,7%	43,1%
Receivable collection (in days)	96	115
Earnings per share (EEK)	8,18	3,99
Earnings per share (EUR)	0,52	0,25

TALLINNA FARMAATSIATEHASE AS

MANAGEMENT REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

INVESTMENTS

Main investments in 2003 were directed for renewing equipment in the ointment department and quality control and development department laboratories.

In the ointment department additional ointment transportation containers were bought and some rooms were reconstructed.

During the year the planned investments were carried out to renew development and quality control department laboratories. Supplementary equipment for the gas chromatography system was bought and the microbiological laboratory was transferred to a new location, which complies with current regulations.

In 2003, investments were made in the total amount of 1,286 thousand EEK, including investments in intangible assets in the amount of 519 thousand EEK and in fixed assets in the amount of 767 thousand EEK.

PRODUCTION AND PRODUCT DEVELOPMENT

In 2003 Tallinna Farmaatsiatehase AS produced over 20 different pharmaceuticals, i.e. injections and ointments. The output of the Company was 9,0 million packages. Compared to 2002, production of injections decreased by 34% owing to the closing of injection department on 1 July 2003, because of the production's non-conformity to Good Manufacturing Practice (GMP).

In 2002 a new mixer (Koruma) was installed in the ointment department. In 2003 the validation of production procedures of ointments made by the new mixer was continued.

The production of tablets under TFT trademark took place until November 2003 according to the agreement, concluded between Tallinna Farmaatsiatehase AS and PJSC Grindeks on 8 February 2002 and approved at the extraordinary shareholders' meeting on 5 March 2002.

At the extraordinary shareholders' meeting on 10 November 2003 an intellectual property and technological information sale agreement between Tallinna Farmaatsiatehase AS and PJSC Grindeks was presented to the small investors for approval. The proceeds from the sale offset the loan payable to PJSC Grindeks.

At the extraordinary shareholders' meetings on 25 July 2003 and 10 November 2003 the long-term strategy of the Company was approved, meaning that the Company concentrates on the production of ointments in the group.

Training was a priority in 2003. The employees participated in the following courses: principles of management, financial reporting, production management and implementation according to GMP.

Lot of work has been done to ensure that documentation complies with European Union requirements. In 2003, 7 pharmaceuticals were submitted for registration or re-registration in 5 countries. In 2003, 18 pharmaceuticals (in 7 countries) were registered.

TALLINNA FARMAATSIATEHASE AS

MANAGEMENT REPORT FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

On 1 July 2003 the Ministry of Social Affairs issued an operating license N.3667 to the Company until 1 July 2008 for the following production lines: ointments production and tablets packaging and releasing.

SALES

Year 2003 sales results may be considered satisfactory. Estonian sales achieved 92% of the plan. One of the main reasons why the Company could not meet the sales plan was nomenclature of tablets, which was out of date and resulted in a decrease in the consumption. Sales of tablets were 69% of total Estonian sales.

Exports were 86% of the plan. Exports were strongly affected by the weakening of US dollar. In 2003 67% of the total sales and 88% of exports were denominated in USD. Sales of ointments were 63% of the total sales. The total sale of the ointments was 8,1 million tubes in 2003, 4,5% more than in 2002. The most successful ointments were Capsicam and Viprosal, which are original pharmaceuticals and trademarks developed by Tallinna Farmaatsiatehase AS.

FUTURE OUTLOOK

The main goal for 2004 will be ensuring the ointment production meets the international requirements and standards. The main task is to develop new ointments capable of production. 2004 budget is prepared in line with these priorities.

The marketing and sales priorities for 2004 will be to strengthen its position in the export markets and expand the sales of the products in cooperation with partners.

Ibrahim Muhtši
Director

TALLINNA FARMAATSIATEHASE AS

**BALANCE SHEETS
AS AT 31 DECEMBER 2003 AND 2002**

ASSETS	Note	31.12.2003 EEK	31.12.2002 EEK
Current assets			
Cash and bank accounts	2	1 268 124	77 664
Customer receivables			
Accounts receivable		2 250 283	2 405 714
Other receivables			
Receivables from parent	19	10 188 177	25 217 139
Other short-term receivables		76 574	388 851
Total		<u>10 264 751</u>	<u>25 605 990</u>
Accrued income			
Interest receivable		1 786	3 321
Prepaid expenses			
Prepaid taxes		433 108	1 434 496
Other prepaid expenses		55 060	64 573
Total		<u>488 168</u>	<u>1 499 069</u>
Inventories	3		
Raw material		2 428 072	3 409 309
Work-in-progress		-	315 850
Finished goods		7 946 957	15 041 542
Prepayments to suppliers		120 864	1 298 751
Total		<u>10 495 893</u>	<u>20 065 452</u>
Total current assets		<u>24 769 005</u>	<u>49 657 210</u>
Non-current assets			
Long-term financial investments			
Other long-term receivables	4	344 110	380 679
Fixed assets	5		
Land and buildings		31 554 379	34 162 157
Machinery and equipment		14 921 278	28 899 553
Other fixed assets		2 980 626	3 594 294
Accumulated depreciation		(20 439 557)	(31 269 720)
Prepayments for fixed assets		2 155 100	205 751
Total		<u>31 171 826</u>	<u>35 592 035</u>
Intangible assets	6		
Patents and licenses		538 634	1 307 931
Prepayments for intangible assets		16 442	894 194
Total		<u>555 076</u>	<u>2 202 125</u>
Total non-current assets		<u>32 071 012</u>	<u>38 174 839</u>
TOTAL ASSETS		<u>56 840 017</u>	<u>87 832 049</u>

TALLINNA FARMAATSIATEHASE AS

BALANCE SHEETS
AS AT 31 DECEMBER 2003 AND 2002

LIABILITIES AND SHAREHOLDERS' EQUITY	Note	31.12.2003 EEK	31.12.2002 EEK
Current liabilities			
Debt obligations			
Finance lease obligations	7	740 846	1 098 046
Current portion of long-term bank loans	9	-	9 414 873
Total		740 846	10 512 919
Supplier payables		4 839 076	7 500 876
Accrued expenses			
Due to employees		1 156 703	1 334 146
Dividends payable	8	446 814	446 814
Interest payable		-	58 813
Other		367 976	257 154
Total		1 971 493	2 096 927
Total current liabilities		7 551 415	20 110 722
Non-current liabilities			
Long-term debt obligations			
Finance lease obligations	7	1 171 335	1 912 182
Bank loans	9	-	9 414 875
Total		1 171 335	11 327 057
Other long-term payables			
Payables to parent	19	-	18 505 029
Total non-current liabilities		1 171 335	29 832 086
Total liabilities		8 722 750	49 942 808
Shareholders' equity			
Share capital	11	12 500 000	12 500 000
Reserves	12		
Statutory legal reserve		1 250 000	1 250 000
Other reserves		1 066 210	1 066 210
Retained earnings		23 073 031	18 077 916
Net profit for the financial year		10 228 026	4 995 115
Total shareholders' equity		48 117 267	37 889 241
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		56 840 017	87 832 049

TALLINNA FARMAATSIATEHASE AS

INCOME STATEMENTS
FOR THE YEARS 2003 AND 2002

	Note	2003 EEK	2002 EEK
Revenue			
Net sales	13	75 493 863	93 875 016
Other revenue	14	<u>15 664 587</u>	<u>1 088 103</u>
Total revenue		91 158 450	94 963 119
Operating expenses			
Materials, consumables and supplies	15	(38 193 980)	(49 781 308)
Change in inventories of finished goods and work-in-progress		(7 410 435)	1 651 352
Miscellaneous operating expenses	16	(9 387 641)	(9 612 578)
Personnel expenses	17	(14 247 938)	(17 246 911)
Depreciation, amortisation and value adjustments	5, 6	(7 649 055)	(9 140 061)
Other expenses		<u>(3 575 863)</u>	<u>(4 769 912)</u>
Total operating expenses		<u>(80 464 912)</u>	<u>(88 899 418)</u>
Operating profit		10 693 538	6 063 701
Financial income and expenses			
Interest expense		(1 907 282)	(4 555 708)
Foreign exchange gain		1 472 684	3 558 520
Other financial expenses		<u>(30 914)</u>	<u>(71 398)</u>
Total financial income and expenses		<u>(465 512)</u>	<u>(1 068 586)</u>
Net profit for financial year		<u>10 228 026</u>	<u>4 995 115</u>
Earnings per share	18	8.18	4.00

TALLINNA FARMAATSIATEHASE AS**STATEMENT OF SHAREHOLDERS' EQUITY
FOR THE YEARS 2003 AND 2002**

	Share capital EEK	Reserves EEK	Retained earnings EEK	Net profit for financial year EEK	Total EEK
31 December 2001	12 500 000	2 316 210	7 808 463	10 269 453	32 894 126
Allocation of net profit for financial year to retained earnings	-	-	10 269 453	(10 269 453)	-
Net profit for financial year	-	-	-	4 995 115	4 995 115
31 December 2002	12 500 000	2 316 210	18 077 916	4 995 115	37 889 241
Allocation of net profit for financial year to retained earnings	-	-	4 995 115	(4 995 115)	-
Net profit for financial year	-	-	-	10 228 026	10 228 026
31 December 2003	12 500 000	2 316 210	23 073 031	10 228 026	48 117 267

Additional information for share capital is provided in note 11 and for reserves in note 12 to the annual accounts.

TALLINNA FARMAATSIATEHASE AS

**CASH FLOW STATEMENTS
FOR THE YEARS 2003 AND 2002**

	Note	2003 EEK	2002 EEK
OPERATING ACTIVITIES			
Net profit for the financial year		10 228 026	4 995 115
Transformation of net profit from operating activities into net cash flows:			
Deprecation and amortisation	5, 6	7 649 055	9 140 061
Gain from disposal of fixed assets	14	(249 562)	(10 424)
Gain from disposal of intangible assets	6, 14	(11 850 594)	-
Loss from write-off of prepayments for intangible assets	6	576 103	-
Interest income		(24 202)	(40 509)
Interest expense		1 907 282	4 555 708
Changes in current assets and current liabilities:			
Accounts receivable		155 431	925 621
Other receivables		9 470 486	(2 125 367)
Prepaid expenses		1 010 901	(812 076)
Inventories		9 569 559	371 453
Supplier payables		(2 661 800)	1 302 546
Taxes payable		-	(39 159)
Accrued expenses (excl. interest payable)		(66 621)	(255 929)
Cash flows from operating activities		25 714 064	18 007 040
INVESTING ACTIVITIES			
Acquisition of fixed and intangible assets	5, 6	(2 933 808)	(3 224 923)
Proceeds from disposal of fixed assets		249 562	10 424
Repayments of loans granted	4	28 795	45 939
Interest received		25 737	37 188
Cash flows used in investing activities		(2 629 714)	(3 131 372)
FINANCING ACTIVITIES			
Repayments of loans raised	9	(18 829 748)	(9 414 875)
Repayments of finance lease	7	(1 098 047)	(1 184 416)
Interest paid		(1 966 095)	(4 589 050)
Cash flows used in financing activities		(21 893 890)	(15 188 341)
Change in cash		1 190 460	(312 673)
CASH AT THE BEGINNING OF THE YEAR		77 664	390 337
CASH AT THE END OF THE YEAR		1 268 124	77 664

TALLINNA FARMAATSIATEHASE AS

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

NOTE 1. ACCOUNTING POLICIES

The annual accounts of Tallinna Farmaatsiatehase AS (hereinafter also “the Company”) have been prepared in accordance with Estonian Accounting Law, enacted on 1 January 2003 and International Financial Reporting Standards (IFRS).

The annual accounts have been prepared in Estonian kroons (EEK).

The Company produces and markets pharmaceuticals in Estonia and Latvia. The parent of the Company is PJSC Grindeks. The shares of the Company are listed in the secondary list of Tallinn Stock Exchange.

Foreign currency transactions

Foreign currency transactions are recorded at the foreign currency exchange rates quoted by the Bank of Estonia at the transaction date. Monetary and non-monetary assets and liabilities, denominated in foreign currencies, which are recorded at fair value, are translated into EEK using the official foreign currency exchange rate valid on the balance sheet date. Gains and losses from foreign currency transactions are recorded as net in the income statement. The following are the applicable rates of the principal currencies in EEK:

Currency	31.12.2003	31.12.2002
USD	12,4096	14,9364
EUR	15,6466	15,6466
RUR	0,4243	0,4676

Financial assets and financial liabilities

Cash, trade receivables, accrued income, other short and long-term receivables are considered to be financial assets. Supplier payables, accrued expenses, other short and long-term payables are considered to be financial liabilities.

Financial assets and liabilities are initially measured at cost, which is the fair value of consideration given or received to acquire the financial asset or liability. Transaction costs are included in the initial measurement of all financial assets and liabilities.

Financial assets and liabilities are recognised on the balance sheet, when the ownership title is transferred to the Company in accordance with the contract terms.

Cash and bank accounts

Cash and bank accounts comprise cash on hand and demand bank deposits. The cash flow statement is prepared using the indirect method.

Valuation of receivables

Receivables recorded on the balance sheet are valued on the basis of the estimated receivable amount. Accounts receivable considered to be doubtful are expensed during the financial year. Receivables, which were expensed, but then collected during the financial year, are recorded on the same expense account as a reverse entry.

**NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003**

Inventories

Purchased goods, raw materials and supplies are recorded at cost, which comprises direct and indirect acquisition expenditures incurred without which the inventories would not be in their present condition and quantity. Finished goods and work-in-progress are recorded at production cost, which consists of direct and indirect manufacturing costs.

Inventories are expensed applying the weighted average method. Inventories are stated on the balance sheet at the lower of cost and net realisable value. Inventories in the consignment stocks are recorded at production cost.

A warranty reserve has been made for the write-off of the pharmaceuticals, which have passed the expiry date and do not meet quality standards.

Fixed assets

Fixed assets with a useful life of over one year and with a minimum value of 5 000 EEK are considered to be fixed assets. Fixed assets are recorded at cost, which comprises purchase price, non-refundable taxes and other directly attributable expenditures.

Depreciation is charged using the straight-line method. Depreciation rates are set separately to each fixed asset depending on its estimated useful life as follows:

- buildings - 4% per annum;
- machinery and equipment - 10-25% per annum;
- other equipment - 25% per annum.

The improvements to fixed assets are capitalized if the asset is improved to a qualitatively new level, or if it is possible to prove that the revenue resulting from the expenditure made will be generated during the future periods. Maintenance and repairs are expensed.

If the recoverable value of the asset is permanently below its carrying value, the asset is presented at its estimated net realisable value. Write-down of fixed assets is recognised as an increase of accumulated depreciation on the balance sheet and expensed in the income statement as "Depreciation, amortisation and value adjustments".

Intangible assets

The sales and production licenses of pharmaceuticals are recorded as intangible assets. Licenses are recorded at cost and amortised on a straight-line basis over their validity period. All recorded licenses are valid up to five years. Amortisation is recognised as a decrease of net book value on the balance sheet and expensed in the income statement as "Depreciation, amortisation and value adjustments".

Revenue recognition

Net sales are recorded on the accrual basis of accounting. Net sales comprise the revenue earned from goods and services sold from which sales discounts and returned goods have been subtracted. Net sales from services are recorded in the period when the service has been provided.

Interest income is recorded on the accrual basis of accounting.

**NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003**

Research and development expenditure

Expenditure on research and development activities is recognised as an expense in the period in which it is incurred.

Liabilities

Liabilities with payment terms over one year from the balance sheet date are considered to be long-term liabilities. Other liabilities are reported as short-term.

Vacation payment expenses are recorded in the period when the vacation was earned, i.e. when the right to claim vacation by an employee occurs. Vacation payment earned or its change is recorded in the income statement as an expense and the balance accrued on the balance sheet as a short-term liability.

Potential liabilities, guarantees and warranties are disclosed in the notes to the annual accounts as contingent liabilities.

Leases

Leases are classified as finance leases whenever the term of the lease transfer substantially all the risks and rewards of ownership to the lessee. Other leases are classified as operating leases.

Finance leases are recognised on the balance sheet by recording an asset and a liability equal to the present value of minimum lease payments at the inception of the lease. Finance lease assets are depreciated in accordance with the depreciation policy described above, with the depreciation period being the estimated useful life of the asset. Repayments of the principal reduce lease liabilities, whilst the finance charge component of the lease payment is charged directly to expense. Payments made under operating leases are charged to expense in equal instalments over the period covered by the lease term.

The asset leased out under an operating lease is recorded on the balance sheet on a regular basis, similar to other assets recorded on the balance sheet. Payments received under operating leases are credited to income in equal instalments over the period covered by the lease term.

Taxation

The Income Tax Law that became effective in Estonia on 1 January 2000 replaces the taxation of earnings with the taxation of dividend distributions and other payments that have the characteristics of profit distribution. Due to the principles of taxation, the term *tax base of assets and liabilities* does not have substance and deferred income tax assets and liabilities as defined in IAS 12 cannot arise.

Earnings per share

Calculation of earnings per share is based on the net profit for the financial year, adjusted with dividends on preferred shares.

Diluted earnings per share are calculated according to the amount of net profit for the period per share, adjusted as follows: net profit for the year will be increased by the dividend and interest expenses adjusted by the income tax resulting from the potential common shares.

TALLINNA FARMAATSIATEHASE AS

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

Subsequent events

Significant circumstances, occurring during the preparation period of the annual accounts and that are related to the transactions which took place during the financial year or previous periods and confirm the conditions that existed at the balance sheet date, are considered in the valuation of assets and liabilities.

Significant events, occurring during the preparation period of the annual accounts which are not considered in the valuation of assets and liabilities but which significantly influence the results of the next financial year, are disclosed in the notes to the annual accounts.

Reclassification

In 2003, the following opening balances have been reclassified in relation to the classification of residual value of written-off fixed assets from the income statement line "Other expenses" to the line "Depreciation, amortisation and value adjustments" and offsetting gains and losses from changes in foreign currencies:

	Initial opening balance EEK	Adjustment EEK	Adjusted opening balance EEK
Other income	4 962 883	-3 874 780	1 088 103
Depreciation, amortisation and value adjustments	5 700 566	3 439 495	9 140 061
Other expenses	12 084 187	-7 314 275	4 769 912

NOTE 2. CASH AND BANK ACCOUNTS

	31.12.2003 EEK	31.12.2002 EEK
Cash on hand	4 172	27 251
Bank accounts in EEK	786 445	44 835
Bank accounts in foreign currency	472 111	207
Other cash equivalents	5 396	5 371
Total	1 268 124	77 664

TALLINNA FARMAATSIATEHASE AS**NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003****NOTE 3. INVENTORIES**

	31.12.2003 EEK	31.12.2002 EEK
Raw materials	2 428 072	3 409 309
Work-in-progress	-	315 850
Finished goods at Estonian plant	2 532 952	6 418 812
Finished goods at consignment warehouses	4 978 068	8 100 256
Finished goods in the quality control	435 937	522 474
Total finished goods	7 946 957	15 041 542
Prepayments to suppliers	120 864	1 298 751
Total	10 495 893	20 065 452

In 2003 the Company had three consignment warehouses, two of them were located in Estonia and one abroad. Since 2004 finished goods are sold directly to the parent in Latvia without using the consignment warehouses.

In 2003 and 2002 the materials unsuitable for production and realisation have been written off in the amount of 420 678 EEK and 1 908 338 EEK, respectively.

An allowance has been made for estimated out of date and low-quality finished goods or raw materials, which reduces the balances of finished goods or raw materials. In 2003 the allowance amounted to 250 000 EEK for finished goods and to 250 000 EEK for raw materials. In 2002 the respective expenses were 359 369 EEK and 167 482 EEK.

NOTE 4. LONG-TERM LOANS GRANTED

The Company has granted the following loans:

	31.12.2003 EEK	31.12.2002 EEK
Long-term unsecured loans to private persons with annual interest rate of 5,7%	395 324	424 119
Including short-term portion	51 214	43 440
Long-term portion	344 110	380 679

As at 31 December 2003, for two persons a long-term loan has been granted, including the Director, Ibraim Muhtši, in the amount of 339 194 EEK. The short-term portion in the amount of 51 214 EEK is recorded as "Other short-term receivables".

The repayments of granted loans presented above are as follows:

	EEK
Within 1 year	51 214
1-5 years	105 931
After 5 years	238 179
Total	395 324

TALLINNA FARMAATSIATEHASE AS

NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

NOTE 5. FIXED ASSETS

The statement of fixed assets is as follows:

	Land and buildings EEK	Machinery and equipment EEK	Other fixed assets EEK	Construction- in-progress EEK	Prepay- ments for fixed assets EEK	Total EEK
Acquisition cost						
31 December 2001	33 679 350	32 115 398	4 129 469	3 821 374	316 747	74 062 338
Additions	281 127	849 656	138 829	113 173	999 425	2 382 210
Disposals and write-offs	-	(8 902 389)	(680 404)	-	-	(9 582 793)
Reclassification	201 680	4 836 888	6 400	(3 934 547)	(1 110 421)	-
31 December 2002	34 162 157	28 899 553	3 594 294	-	205 751	66 861 755
Additions	-	201 112	38 846	22 636	2 454 260	2 716 854
Disposals and write-offs	(2 646 934)	(14 667 778)	(652 514)	-	-	(17 967 226)
Reclassification	39 156	488 391	-	(22 636)	(504 911)	-
31 December 2003	31 554 379	14 921 278	2 980 626	-	2 155 100	51 611 383
Accumulated depreciation						
31 December 2001	6 736 310	22 820 253	3 421 686	-	-	32 978 249
Depreciation	1 552 612	6 094 430	227 222	-	-	7 874 264
Disposals and write-offs	-	(8 902 389)	(680 404)	-	-	(9 582 793)
31 December 2002	8 288 922	20 012 294	2 968 504	-	-	31 269 720
Depreciation	3 760 868	3 174 219	201 976	-	-	7 137 063
Disposals and write-offs	(2 646 934)	(14 667 778)	(652 514)	-	-	(17 967 226)
31 December 2003	9 402 856	8 518 735	2 517 966	-	-	20 439 557
Carrying amount						
31 December 2002	25 873 235	8 887 259	625 790	-	205 751	35 592 035
31 December 2003	22 151 523	6 402 543	462 660	-	2 155 100	31 171 826

Due to the transfer of the tablet production to PJSC Grindeks from 1 July 2002 fixed assets were written off in the residual value of 3 397 730 EEK in 2002.

During the financial year fixed assets were written off in the residual value of 3 252 612 EEK, including 1 056 013 EEK in relation to the termination of the injection production from 1 July 2003, obsolete production building in Kirna in the residual value of 1 962 124 EEK and other fixed assets in the residual value of 234 475 EEK.

Write-offs of fixed assets are recorded on the balance sheet as an increase of accumulated depreciation and as an impairment on the income statement line "Depreciation, amortisation and value adjustments".

On the line "Prepayments for fixed assets" is recorded prepayment for a land, which was entered to the real estate register on 23 January 2004.

TALLINNA FARMAATSIATEHASE AS**NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003****NOTE 6. INTANGIBLE ASSETS**

The statement of intangible assets is as follows:

	Patents and licenses EEK	Prepay- ments for intangible assets EEK	Total EEK
Acquisition cost			
31 December 2001	6 853 007	375 950	7 228 957
Additions	78 978	763 735	842 713
Reclassification	245 491	(245 491)	-
31 December 2002	7 177 476	894 194	8 071 670
Additions	-	216 954	216 954
Reclassification	518 603	(518 603)	-
Disposals and write-offs	(6 346 349)	(576 103)	(6 922 452)
31 December 2003	1 349 730	16 442	1 366 172
Accumulated amortisation			
31 December 2001	4 603 748	-	4 603 748
Amortisation	1 265 797	-	1 265 797
31 December 2002	5 869 545	-	5 869 545
Amortisation	511 992	-	511 992
Disposals	(5 570 441)	-	(5 570 441)
31 December 2003	811 096	-	811 096
Carrying amount			
31 December 2002	1 307 931	894 194	2 202 125
31 December 2003	538 634	16 442	555 076

The licenses for sale of pharmaceuticals are recorded as intangible assets. The pharmaceuticals are registered for five years and are amortised respectively. Expenses on registration of pharmaceuticals amounted to 893 555 EEK and 127 258 EEK, in 2003 and 2002, respectively.

According to the sales agreement, concluded on 27 October 2003 between the Company and PJSC Grindeks, the Company sold registration documents, know-how and intellectual property, which were related to tablet pharmaceuticals initially developed, produced and registered in several countries by the Company for 12 626 502 EEK. The profit on the agreement is recorded as "Other revenue" reduced by residual value of sold licenses in the amount of 775 908 EEK (see also note 14).

The Company continues to register the tablet pharmaceuticals until their re-registration to the name of purchaser (latest within 24 months).

TALLINNA FARMAATSIATEHASE AS

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

In 2003, the following pharmaceuticals were registered in different countries:

Estonia	Digoxin TFT tbl
Latvia	Apilak ointment
Lithuania	Capsicam ointment, Benzylbenzoat ointment, Apilak tbl
Russia	Apilak ointment, Viprosal B ointment, Apilak tbl, Cyclodol tbl, Digoxin TFT tbl, Piroxicam TFT tbl, Humisol inj, Emoxipin inj
Moldova	Apilak ointment, Viprosal B ointment, Apilak tbl, Piroxicam TFT tbl
Ukraine	Benzylbenzoat ointment
Hungary	Viprosal B ointment

As at 31 December 2003 and 2002, the following number of pharmaceuticals have been registered in different countries:

	31.12.2003	31.12.2002
Belarus	28	30
Estonia	27	37
Georgia	16	15
Russia	13	36
Kazakhstan	13	13
Ukraine	9	9
Moldova	9	8
Latvia	9	18
Armenia	5	5
Lithuania	3	6
Poland	1	1
Hungary	1	-

TALLINNA FARMAATSIATEHASE AS**NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003****NOTE 7. FIXED ASSETS ACQUIRED THROUGH FINANCE LEASE**

The fixed assets acquired through finance leases and respective liabilities are the following:

	Land and buildings EEK	Machinery and equipment EEK	Other fixed assets EEK	Total EEK
Acquisition cost				
31 December 2001	3 102 900	3 761 880	413 570	7 278 350
31 December 2003	3 102 900	3 761 880	413 570	7 278 350
Accumulated depreciation				
31 December 2002	672 295	517 259	90 683	1 280 237
Depreciation	310 290	564 281	68 012	942 583
31 December 2003	<u>982 585</u>	<u>1 081 540</u>	<u>158 695</u>	<u>2 222 820</u>
Carrying amount				
31 December 2002	2 430 605	3 244 621	322 887	5 998 113
31 December 2003	<u>2 120 315</u>	<u>2 680 340</u>	<u>254 875</u>	<u>5 055 530</u>
Financial lease liability				
31 December 2003	-	1 821 427	90 754	1 912 181
Short-term portion	-	650 092	90 754	740 846
Long-term portion	-	1 171 335	-	1 171 335
Principal payments for the period	397 198	588 471	112 378	1 098 047
Interest expense for the period	15 039	176 233	12 955	204 227
Annual interest rate	10%	6%	8%	

Finance lease payments are divided as follows:

	EEK
Less than 1 year	740 846
1-5 years	<u>1 171 335</u>
Total	<u>1 912 181</u>

NOTE 8. DIVIDENDS PAYABLE

Dividends payable as at 31 December 2003 and 2002 in the amount of 446 814 EEK consists of unpaid dividends to the state from 1994.

TALLINNA FARMAATSIATEHASE AS

NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

NOTE 9. LONG-TERM BANK LOANS

The Company has the following long-term bank loans:

	31.12.2003	31.12.2002
	EEK	EEK
Long-term loan from AS Sampo Pank with annual interest rate of 6 months EURIBOR+7,25%, from 19 February 2003 6 months EURIBOR+4,5%, monthly payments in the amount of 784 573 EEK plus interest, maturity date December 2004. The liability was secured by mortgage on the buildings and facilities of the Company located at Tondi 33, Tallinn and Kirna, Järva county, and commercial pledge (in the amount of 65 million EEK). The loan was returned before the maturity date on 15 August 2003.	-	18 829 748
Total long-term bank loans	-	18 829 748
Including short-term portion	-	(9 414 873)
Long-term portion	-	9 414 875

NOTE 10. LEASES AS LESSOR

The carrying amount of assets leased out under operating lease is as follows:

	31.12.2003		31.12.2002	
	EEK		EEK	
	Acquisition cost	Accumulated depreciation	Acquisition cost	Accumulated depreciation
Production building in Kirna village, Järva county	-	-	2 345 168	297 055

In the income statement of 2002 depreciation of the leased out fixed assets was 93 807 EEK and rental income was 111 519 EEK. The rental agreement was terminated on 21 June 2002. As at 31 December 2003 the obsolete building was written off with a residual value of 1 962 124 EEK (see also note 5).

TALLINNA FARMAATSIATEHASE AS

NOTES TO THE ANNUAL ACCOUNTS FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

NOTE 11. SHARE CAPITAL

As at 31 December 2003 and 2002 the share capital of the Company is 12 500 000 EEK consisting of 1 250 000 shares with a nominal value of 10 EEK. The shares of the Company are listed in the secondary list of Tallinn Stock Exchange.

As at 31 December 2003 and 2002 the shareholders of the Company are the following:

	31.12.2003	31.12.2002
PJSC Grindeks	64,1%	64,1%
Hansabanka Clients	22,5%	-
<i>incl. PJSC Grindeks</i>	10,5%	-
Norberg Capital Group Inc	1,1%	-
Banque Carnegie Luxembourg SA Clients	-	14,8%
Nordea Bank Finland Plc Clients Account Trading	0,5%	2,7%
Pyramid Software AS	-	2,4%
Skandinaviska Enskilda Banken AB Clients	0,2%	0,2%
Other small investors	11,6%	15,8%
Total	100,0%	100,0%

NOTE 12. RESERVES

According to the Commercial Code, the statutory legal reserve is created in the 10% range of the share capital allocated from net profit based on the decision of general meeting of shareholders. Statutory legal reserve cannot be used for payment of dividends to the shareholders.

In 1999, the share capital was reduced by 25 200 340 EEK and the statutory legal reserve was reduced by 2 520 034 EEK. In 1995, 6,5% of the net profit in the amount of 1 066 210 EEK was allocated to the going concern reserve.

NOTE 13. NET SALES

Net sales are divided by markets as follows:

	2003 EEK	%	2002 EEK	%
Latvia	57 567 038	76	73 917 514	79
Estonia	17 926 825	24	19 957 502	21
Total	75 493 863	100	93 875 016	100

TALLINNA FARMAATSIATEHASE AS**NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003**

and by product groups as follows:

	2003		2002	
	EEK	%	EEK	%
Ointments	47 527 934	63	49 056 759	52
Injections	12 302 709	16	14 655 452	16
Tablets	5 777 444	8	28 244 883	30
Other	9 885 776	13	1 917 922	2
Total	75 493 863	100	93 875 016	100

From 1999, all export sales of the Company is conducted through parent PJSC Grindeks.

NOTE 14. OTHER REVENUE

	2003	2002
	EEK	EEK
Gain on disposal of intangible assets (see also note 6)	11 850 594	-
Royalty	3 440 223	877 594
Gain on disposal of fixed assets	249 562	10 424
Other revenue	124 208	200 085
Total	15 664 587	1 088 103

According to the license agreement from 8 February 2002 PJSC Grindeks paid to the Company a royalty that was 23% of the net sales of products manufactured by PJSC Grindeks under the TFT trademark. According to the sale agreement dated 27 October 2003, the Company's tablet pharmaceuticals registration documents, know-how and intellectual property were sold, and therefore the calculation of royalty was terminated.

NOTE 15. GOODS, RAW MATERIALS AND SERVICES

	2003	2002
	EEK	EEK
Raw materials	29 479 139	43 979 154
Goods	5 279 383	1 855 308
Energy	1 557 159	1 975 545
Registration of pharmaceuticals, trademarks	1 066 292	932 258
Transportation of finished goods	532 858	664 243
Fuel, spare parts	47 842	54 321
Other cost of materials	231 307	320 479
Total	38 193 980	49 781 308

TALLINNA FARMAATSIATEHASE AS

NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

NOTE 16. MISCELLANEOUS OPERATING EXPENSES

	2003 EEK	2002 EEK
Outsourced services	2 634 332	2 649 831
Training and consultations	2 273 217	737 071
Marketing	905 493	1 925 059
Repairs	692 038	1 205 682
Operating lease expense, rent	466 292	260 434
Commission fees	554 713	523 637
Miscellaneous fees	465 613	332 350
Transportation	395 722	456 387
Representation costs	266 482	280 718
Office expenses	134 362	187 507
Business trips	109 211	161 069
Other expenses	490 166	892 833
Total	9 387 641	9 612 578

NOTE 17. PERSONNEL EXPENSES

	Salary		Average number of employees	
	2003 EEK	2002 EEK	2003	2002
Salaries and wages	10 562 226	12 792 084	113	156
incl. workers	2 849 882	4 781 010	60	95
administration	6 839 065	6 959 996	52	59
board	456 905	414 557	1	2
other personnel expenses	416 374	636 521	-	-
Social taxes	3 685 712	4 454 827	-	-
Total	14 247 938	17 246 911	113	156

In 2003, the average number of employees in the Company was 113, of whom 52 were specialists or managers. The average salary in 2003 was 6 979 EEK per month. In 2002, the average number of employees was 156, of whom 59 were specialists or managers. The average salary in 2002 was 6 148 EEK per month.

In conjunction with the termination of injection production from 1 July 2003, the Company laid-off 31 employees, to whom redundancy fees were paid in the amount of 399 752 EEK.

TALLINNA FARMAATSIATEHASE AS

NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003

NOTE 18. EARNINGS PER SHARE

	2003 EEK	2002 EEK
Net profit for the financial year	10 228 026	4 995 115
Weighted average number of shares	1 250 000	1 250 000
Earnings per share (EPS)	8.18	4.00

During both periods, the Company had no potential common shares to be issued and therefore diluted and basic earnings per share are equal.

NOTE 19. RELATED PARTY TRANSACTIONS

The transactions with related parties are transactions with the parent PJSC Grindeks. The transactions with related parties in 2003 and the respective balances as at 31 December 2002 and 2003 are the following:

19.1. Purchases

Related party	Payable 31.12.2002	Goods and services purchased	Paid	Payable 31.12.2003
PJSC Grindeks	-	5 631 428	5 631 428	-

Prices used in purchases are agreed prices that do not differ materially from market prices.

19.2. Sales

Related party	Receivable 31.12.2002	Goods and services sold	Received	Receivable 31.12.2003
PJSC Grindeks	25 217 139	57 567 038	72 596 000	10 188 177

19.3. Loan transactions

As at 31 December 2002 the Company's loan liability to PJSC Grindeks was 18 505 029 EEK, with the interest rate of 8%, and of 7% starting from May 2003. Maturity date of the loan was December 2006. The principle payments of the loan were stopped until 1 January 2004, therefore the total loan balance was recorded as long-term.

According to the schedule of payments of the loan, signed by the Company and PJSC Grindeks on 21 April 2003, the loan liability in the amount of 300 000 USD was agreed to be netted with accounts receivable from PJSC Grindeks. The rest of the loan balance was settled with proceeds from the sale of intellectual property according to the amendment to the loan agreement on 27 October 2003.

Interest expense was 923 205 EEK in 2003 and 1 715 988 EEK in 2002.

The Company has also granted loan to the Director (see note 4).

**NOTES TO THE ANNUAL ACCOUNTS
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003**

NOTE 20. RISK RELATED TO THE OPERATING ACTIVITIES OF THE COMPANY**Currency risk**

Exports are 76% of sales. Export invoices are issued in USD. The Company is exposed to fluctuations of USD exchange rate. The Company does not use currency options and forward contracts. From 2004 the Company has changed over to EUR to manage the risk.

Foreign currency positions as at 31 December 2003 were as follows:

	Assets EEK	Liabilities EEK	Net position EEK
USD	9 008 700	(514 950)	8 493 750
EUR	1 320 369	(1 759 759)	(439 390)
GBP	-	(2 201)	(2 201)
Total	10 329 069	(2 276 910)	8 052 159

NOTE 21. LITIGATIONS

As at 31 December 2003 Woodbridge Enterprises Ltd. had filed a monetary claim against the Company in the amount of 2 457 955 EEK. On 18 February 2004 the State Court decided not to proceed the appeal of Woodbridge Enterprises Ltd. as the base for the proceedings was not justified. Consequently, the sentence pronounced by the County Court which gave the right to the Company, remains in force.

NOTE 22. POTENTIAL INCOME TAX ON DIVIDENDS

According to the Estonian Income Tax Act the accrued profit of a resident legal entity is not subject to corporate income tax, instead the tax is due on the dividend distribution. Resident legal entities are, since 1 January 2003, liable to income tax on all dividends paid and other profit distributions irrespective of the recipient. The tax rate applicable is 26/74 on the actual dividends paid.

The contingent tax liability that may occur if all distributable retained earnings should be paid out as dividends is not reported on the balance sheet. The income tax due on dividend distribution is expensed in the income statement when dividends are declared.

The Company's retained earnings that may be distributed as of 31 December 2003 amounted to 33 301 057 EEK. Consequently, the maximum possible tax liability which would become payable if retained earnings were fully distributed is 11 700 371 EEK.

* * *

TALLINNA FARMAATSIATEHASE AS

PROPOSAL FOR PROFIT ALLOCATION

The Director of Tallinna Farmaatsiatehase AS proposes to allocate the net profit for 2003 in the amount of 10 228 026 EEK to retained earnings.

1 March 2004

Ibrahim Muhtši
Director

[Translation from Estonian]

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Tallinna Farmaatsiatehase AS:

We have audited the annual accounts of Tallinna Farmaatsiatehase AS ("the Company") for the year ended 31 December 2003. These annual accounts are the responsibility of the Company's Director. Our responsibility is to express an opinion on these annual accounts based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the annual accounts. An audit also includes assessing the accounting principles used and significant estimates made by the Director, as well as evaluating the overall presentation of the annual accounts. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the annual accounts present fairly, in all material respects, the financial position of the Company as of 31 December 2003, the results of its operations and its cash flows for the year then ended, in accordance with Estonian Accounting Law and International Financial Reporting Standards.

Villu Vaino
Certified Auditor
5 March 2004

AS Deloitte & Touche Audit

TALLINNA FARMAATSIATEHASE AS

**DIRECTOR'S AND COUNCIL'S SIGNATURES TO THE ANNUAL REPORT
FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2003**

The Director has prepared the management report and the annual accounts of Tallinna Farmaatsiatehase AS on 1 March 2004.

The Council of Tallinna Farmaatsiatehase AS has reviewed the annual report, prepared by the Director, consisting of the management report and the annual accounts, Director's proposal for profit allocation and the independent auditors' report, and approved the annual report for presentation on the Shareholders' General Meeting.

The annual report has been signed by the Director and all the members of the Council.

Name	Position	Signature	Date
Ibrahim Muhtši	Director	_____	_____
Kirovs Lipmans	Chairman of the Council	_____	_____
Vitalijs Gavrilovs	Member of the Council	_____	_____
Valdis Jakobsons	Member of the Council	_____	_____