

Public Joint Stock Company *Grindeks*

Annual Report for the year 2005 prepared in
accordance with Latvian statutory requirements and
Independent Auditor's Report

PJSC GRINDEKS

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PJSC GRINDEKS

ANCILLARY INFORMATION

Name	GRINDEKS
Legal status	Public Joint Stock Company
Number, place and date of registration	40003034935, Riga, Republic of Latvia; 11 October 1991
Business activities	Production of pharmaceutical, medical and fitochemical substances
Legal address	53 Krustpils Str. Riga, LV – 1057, Latvia
Reporting year	1 January 2005 - 31 December 2005
Previous reporting year	1 January 2004 - 31 December 2004
Subsidiaries	JSC Tallinn Pharmaceutical Plant Tondi 33 11316 Tallinn Estonia JSC Kalceks 53 Krustpils Str. Riga, LV - 1057, Latvia
Auditors' names and addresses	Deloitte Audits Latvia Ltd. Licence No. 43 Doma laukums 1 (legal address) Biskapa gate 2 (postal address) Riga, LV-1050, Latvia Maris Bergmanis Sworn Auditor Certificate No. 67

PJSC GRINDEKS

THE BOARD AND THE SUPERVISORY COUNCIL

Board of the Company

(in accordance with the dates of election / suspension)

From 23 December 2003 to the date of issuing the financial statements:

<u>Name</u>	<u>Position</u>
Valdis Jakobsons	Chairman of the Board
Vitalijs Skrivelis	Board member
Janis Romanovskis	Board member

Council of the Company

(in accordance with the dates of election / suspension)

From 23 December 2003 till 6 December 2005:

<u>Name</u>	<u>Position</u>
Kirovs Lipmans	Chairman of the Supervisory Council
Vitalijs Gavrilovs	Vice-Chairman of the Supervisory Council
Uldis Osis	Member of the Supervisory Council
Janis Naglis	Member of the Supervisory Council
Juris Cilinskis	Member of the Supervisory Council

From 20 January 2006 to the date of issuing the financial statements:

<u>Name</u>	<u>Position</u>
Kirovs Lipmans	Chairman of the Supervisory Council
Vitalijs Gavrilovs	Vice-Chairman of the Supervisory Council
Uldis Osis	Member of the Supervisory Council
Janis Naglis	Member of the Supervisory Council
Ivars Kalvins	Member of the Supervisory Council

Chairman of the Board
Valdis Jakobsons

Chairman of the Supervisory Council
Kirovs Lipmans

PJSC GRINDEKS

MANAGEMENT REPORT

In 2005, the leading pharmaceutical manufacturer in the Baltic States, JSC *Grindeks* has been successfully continuing the Company's long-term development strategy, which resulted in achieving the highest performance in terms of revenues and profit in the history of *Grindeks*.

In 2005, the net turnover of *Grindeks* amounted to 32.22 million LVL, which is 30.3% more than in 2004. The net profit was 4.62 million LVL, showing an increase of 89% compared to the previous year.

The gross profit of the Company grew substantially, and the gross profit margin in 2005 was 48.2%. The net profit margin was 14.3% compared to 9.9% in 2004.

In 2005, *Grindeks* exported its production to a total of 37 countries worldwide and the total amount of exports in 2005 made up 29.87 million LVL, being 29% more than in 2004.

The increase in turnover has been achieved, mainly, due to the constantly growing volume of the final dosage form medicine, particularly highlighting the sales results in Russia and Commonwealth of Independent States (CIS countries) of the *Grindeks* originator product *Mildronate*.

The sales volume of the final dosage form medicine produced by the Company in 2005 achieved 28.85 million LVL, thus making 52.5% growth compared to the previous year.

During 2005 *Grindeks* has expanded its network of representation offices in Russia – now *Grindeks* is represented in Moscow, St.Petersburg, Novosibirsk, Volgograd, Yekaterinburg, Rostov-on-Don and Krasnoyarsk.

For its part, in CIS, alongside with Ukraine and Byelorussia, Kazakhstan pushed forward as a progressively developing market in 2005. *Grindeks* has commenced to carry out and expand its commercial activities in Uzbekistan, Kyrgyzstan and Azerbaijan. *Grindeks* originator product *Mildronate* has been granted an award for highest sales volume among prescription medicine in Ukraine in 2005.

Grindeks actively continued its expansion of activities in the member states of EU, especially focusing on the markets of Poland, the Czech Republic and Hungary. As an important step in the year 2005 can be considered the Company's products registration process commencement in Finland and Bulgaria.

In 2005 the export of active pharmaceutical substances made up 3.37 million LVL, continuing to strengthen the presence of substances produced at *Grindeks* in the most developed markets of Western countries. In 2005 *Grindeks* received its second CEP certificate (Certificate of Suitability of the Monograph of the European Pharmacopoeia) for the active pharmaceutical substance Zopiclone (*Oxytocine* substance has been previously assigned this certificate). These certificates open extensive marketing possibilities in the market of EU.

Grindeks continues to invest heavily in the development of its product portfolio. In 2005 a new *Business development structure* was created in company's organization and an extensive large scale international originator products clinical trials program has been undertaken, offering possibilities in future to register *Grindeks* originator products in many countries worldwide.

In 2005 *Grindeks* and its originator product *Mildronate* obtained a range of awards – the award for Innovations presented by Latvian Employers Confederation (together with Latvian Institute of Organic Synthesis), the award of the Ministry of Economics for the fastest export growth, and the award for the most exportable product in its category assigned by Latvian Chamber of Commerce and Trade.

In June 2005 the Company increased the share capital by issuing 1,850,000 new shares at a nominal value of 1 LVL each. The shares were issued with a premium of 5.9 LVL each, resulting in a total share premium of LVL 10,915,000 less emission costs of LVL 403,650.

The funds raised during the additional share emission are invested in the modernization process of technological capacities and in increase of production capacities. A project for a new final dosage forms plant has been started in 2005. This project would allow to double the production capacities and to manufacture at least 2 billions of tablets and capsules per year. It is planned to finalize the construction in the year 2007.

PJSC GRINDEKS

MANAGEMENT REPORT

With the co-finance of EU Structural funds (1.5 million LVL) the development of the new active pharmaceutical ingredients analytic scaling laboratory has been started. The total costs of the project are planned to be 3.26 million LVL. The new laboratory would allow precipitating the implementation of new active substances in the manufacturing process, including for the needs of clinical trials. The project is planned to be finished in 2006, thus allowing to increase the Company's competitiveness in the markets of the European Union and the United States of America.

In 2005 the compliance of the plants and the production with international standards has been approved by seven clients audits with a positive assessment and the repeatedly received *Good Manufacturing practice* certificate. A lot of effort has been put in the fields of environmental protection, human health protection and safety of labor conditions, thus strengthening the Company's contribution to the achievement of Goals in the UN *Global Compact* movement and the *Responsible Care* program of the world's chemical industry.

Starting from January 2, 2006, the JSC *Grindeks*' shares are quoted in the Official List of *Riga Stock Exchange*.

In 2005 the profit per share (EPS coefficient) of JSC *Grindeks* was 0.48 LVL.

In 2006 the turnover of JSC *Grindeks* is planned to reach approximately 40 million LVL, and the net profit forecast is approx. 5.8 million LVL. According to the Company's long-term strategy it is predicted that the turnover of the Company will achieve 70 million LVL in 2009.

In order to ensure substantial manufacturing and marketing growth, *Grindeks* continues to expand its group structure. Already at present some of *Grindeks*' products are sold in Estonia, Lithuania and Poland and in the future it plans to organize the production also in the region of Russia and other countries. The strategy of the competitiveness strengthening is mainly concerned with new originator products development and increase of their specific weight in turnover, increase of the effectiveness of production and development of new marketing structures in new regions as well.

There have been no events subsequent to 31 December 2005 which would have a significant effect on the financial position of the Company as at 31 December 2005.

Chairman of the Board
Valdis Jākobsons

Chairman of the Supervisory Council
Kirovs Lipmans

22 May 2006

INDEPENDENT AUDITOR'S REPORT

To the shareholders of PJSC Grindeks:

We have audited the accompanying financial statements (page 8 to 26) of PJSC Grindeks ("the Company"), which comprise the balance sheet as of 31 December 2005 and the related statements of profit and loss, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of 31 December 2005, and the results of its operations, changes in equity and its cash flows for the year then ended in accordance with the Latvian law "On the Annual Reports of Enterprises".

We have read the management report for the year ended 31 December 2005 as shown on pages 5 and 6 of the annual report and we have not identified any material discrepancies between the historical financial information presented in the management report and the financial statements for the year ended 31 December 2005.

Deloitte Audits Latvia SIA
Licence No. 43

Kenneth Taylor Hansen
Authorised Representative

Maris Bergmanis
Sworn Auditor
Certificate No. 67

Rīga, Latvia
22 May 2006

PJSC GRINDEKS

**BALANCE SHEET
AS OF 31 DECEMBER 2005**

	Notes	31.12.2005. LVL	31.12.2004. LVL
ASSETS			
Non-current assets			
Intangible assets			
Patents, licenses, trademarks and other rights		441,947	519,686
Software		165,032	76,112
Advances for intangible assets		118,894	-
Total intangible assets	3	725,873	595,798
Tangible fixed assets			
Land, buildings and constructions		3,251,190	2,936,556
Equipment and machinery		1,841,708	1,577,984
Other fixed assets		456,884	337,166
Construction in progress		-	36,524
Advance payments for fixed assets		1,159,643	203,024
Total tangible fixed assets	4	6,709,425	5,091,254
Non-current financial investments			
Investments in subsidiaries	5	5,612,891	5,576,631
Total no-current financial investments		5,612,891	5,576,631
Total non-current assets		13,048,189	11,263,683
Current assets			
Inventory			
Raw materials		1,095,500	1,108,890
Unfinished goods		837,839	604,320
Finished goods and goods for resale	6	2,212,523	1,953,477
Total inventory		4,145,862	3,666,687
Receivables			
Trade receivables		7,311,370	4,978,089
Other receivables	7	863,125	500,484
Deferred expenses		78,996	129,337
Total receivables		8,253,491	5,607,910
Current financial investments			
Other investments	8	5,050,284	-
Total current financial investments		5,050,284	-
Cash	9	5,967,184	299,850
Total current assets		23,416,821	9,574,447
TOTAL ASSETS		36,465,010	20,838,130

The accompanying notes on pages 13 to 26 are an integral part of these financial statements.

The financial statements were signed on 22 May 2006 on behalf of the Company by:

Chairman of the Board
Valdis Jakobsons

Chairman of the Supervisory Council
Kirovs Lipmans

PJSC GRINDEKS**BALANCE SHEET
AS OF 31 DECEMBER 2005**

	Notes	31.12.2005. LVL	31.12.2004. LVL
EQUITY AND LIABILITIES			
Equity			
Share capital	10	9,585,000	7,735,000
Share premium		15,687,750	5,176,400
Other reserves		464,905	464,905
Accumulated loss / retained earnings:			
a) accumulated loss		(4,694,681)	(7,140,379)
b) current year profit		4,623,691	2,445,698
Total equity		25,666,665	8,681,624
Liabilities			
Non-current liabilities			
Loans from credit institutions	11	2,745,307	2,695,072
Long-term portion of finance lease liabilities		-	63,174
Other non - current liabilities	5	-	502,000
Deferred tax liabilities	19	369,006	317,199
Total non-current liabilities		3,114,313	3,577,445
Current liabilities			
Loans from credit institutions	11	1,795,551	2,285,049
Short-term portion of finance lease liabilities		63,157	74,660
Advances from customers		17,343	14,270
Trade accounts payable	12	3,941,489	4,149,248
Taxes and social security payments	13	452,816	228,890
Other current liabilities	5	1,347,507	1,730,997
Other payables		50,629	73,130
Accrued liabilities	14	15,540	22,817
Total current liabilities		7,684,032	8,579,061
Total liabilities		10,798,345	12,156,506
TOTAL LIABILITIES AND EQUITY		36,465,010	20,838,130

The accompanying notes on pages 13 to 26 are an integral part of these financial statements.

The financial statements were signed on 22 May 2006 on behalf of the Company by:

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PJSC GRINDEKS

**STATEMENT OF PROFIT AND LOSS
FOR THE YEAR ENDED 31 DECEMBER 2005**

	Notes	2005 LVL	2004 LVL
Net sales	15	32,221,202	24,724,742
Cost of goods sold	16	(16,695,732)	(15,675,785)
Gross profit		15,525,470	9,048,957
Selling expenses	17	(5,634,601)	(3,446,369)
Administrative expenses	18	(3,880,415)	(2,677,264)
Other operating income		109,660	385,217
Other operating expenses		(454,958)	(364,581)
Gain from investments in subsidiaries and associated companies		-	201,515
Interest income and similar income		112,226	35
Interest expense and similar expense		(204,787)	(180,860)
Profit before taxation		5,572,595	2,966,650
Corporate income tax	19 (a)	(910,000)	(485,904)
Other taxes	21	(38,904)	(35,048)
NET PROFIT		4,623,691	2,445,698

The accompanying notes on pages 13 to 26 are an integral part of these financial statements.

The financial statements were signed on 22 May 2006 on behalf of the Company by:

Chairman of the Board
Valdis Jakobsons

Chairman of the Supervisory Council
Kirovs Lipmans

PJSC GRINDEKS

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2005**

	Share capital	Share premium	Other reserves	Accumu- lated loss	Total
	LVL	LVL	LVL	LVL	LVL
At 31 December 2003	7,735,000	5,176,400	464,905	(7,140,379)	6,235,926
Profit for the year	-	-	-	2,445,698	2,445,698
At 31 December 2004	7,735,000	5,176,400	464,905	(4,694,681)	8,681,624
Issue of shares	1,850,000	10,511,350	-	-	12,361,350
Profit for the year	-	-	-	4,623,691	4,623,691
At 31 December 2005	9,585,000	15,687,750	464,905	(70,990)	25,666,665

The accompanying notes on pages 13 to 26 are an integral part of these financial statements.

In June 2005 the Company increased the share capital by issuing 1,850,000 new shares at a nominal value of LVL 1 each. The shares were issued with a premium of 5.9 LVL each, resulting in a total share premium of LVL 10,915,000 less costs of LVL 403,650.

The financial statements were signed on 22 May 2006 on behalf of the Company by:

Chairman of the Board
Valdis Jakobsons

Chairman of the Supervisory Council
Kirovs Lipmans

PJSC GRINDEKS

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2005**

	Notes	2005 LVL	2004 LVL
OPERATING ACTIVITIES			
Net profit before taxation		5,572,595	2,966,650
Adjustments to reconcile net profit to net cash provided by operating activities:			
Depreciation and amortization		911,104	746,654
Loss / (profit) on disposal of fixed assets		3,303	(26,130)
Vacation accrual		7,277	(17,183)
Loss / (profit) on fluctuations in currency exchange rates		(57,908)	182,290
Gain from acquisition of long term investments		-	(83,103)
Interest income		(112,226)	(35)
Interest expense		204,787	180,860
Gain from long term investments		-	(118,412)
Changes in operating assets and liabilities:		6,528,932	3,831,591
Increase in inventory		(479,175)	(644,294)
Increase in receivables		(2,630,965)	(2,166,190)
(Decrease) / increase in liabilities		(338,139)	1,494,842
Gross cash provided by operating activities		3,080,653	2,515,949
Real estate and corporate income tax paid		(572,113)	(435,959)
Net cash provided by operating activities		2,508,540	2,079,990
INVESTING ACTIVITIES			
Purchase of tangible and intangible fixed assets		(2,662,653)	(1,171,559)
Sale of fixed assets		-	26,130
Acquisition of long term financial investments		(921,750)	(1,500,422)
Purchase of short term financial investments		(5,000,000)	-
Interest received		47,326	-
Net cash used in investing activities		(8,537,077)	(2,645,851)
FINANCING ACTIVITIES			
Share issue		12,361,350	-
Interest paid		(207,384)	(145,358)
Loans received from credit institutions		1,842,383	1,817,902
Loans repaid to credit institutions		(2,300,478)	(908,386)
Net cash provided by financing activities		11,695,871	764,158
Net increase in cash		5,667,334	198,297
CASH AT THE BEGINNING OF THE YEAR	9	299,850	101,553
CASH AT THE END OF THE YEAR	9	5,967,184	299,850

The accompanying notes on pages 13 to 26 are an integral part of these financial statements.

The financial statements were signed on 22 May 2006 on behalf of the Company by:

Chairman of the Board
Valdis Jakobsons

Chairman of the Supervisory Council
Kirovs Lipmans

PJSC GRINDEKS

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

1. GENERAL INFORMATION

Grindeks ("the Company") is a public joint stock company registered in the Republic of Latvia on 11 October 1991, and as a public joint stock company - on 25 August 1997. The Company's main activities are the production, distribution and sale of pharmaceuticals, diagnostic kits and various other products.

The accompanying financial statements are presented in the national currency of Latvia, the lat ("LVL").

The principal accounting policies adopted by the Company are set out below.

2. ACCOUNTING POLICIES

Basis of Preparation

The financial statements have been prepared in accordance with Latvian statutory requirements on the historical cost basis of accounting, except for revaluation of certain assets.

Changes in accounting policies

In comparison with prior year the Company has changed the method of valuation of investments in subsidiaries. In prior years investments in subsidiaries were valued applying the equity method. These changes were made to meet the requirement of paragraph 26 of the law "On the Annual Reports of Enterprises" replacing paragraph 39 that is not effective any more. The application of the new accounting policy did not result in a restatement of the comparative financial information.

Reclassification

Certain balances of 2004 have been restated in order to be consistent with the presentation for 2005. The reclassifications do not affect the financial results.

2004	As previously reported LVL	Reclassification LVL	Reported in these financial statements LVL
Balance sheet			
Deferred income tax liability (Provisions)	317,199	(317,199)	-
Deferred income tax liability (Non – current liabilities)	-	317,199	317,199
Provisions for unused vacations (Provisions)	22,817	(22,817)	-
Accrued liabilities (Short term liabilities)	-	22,817	22,817
Statement of profit and loss			
Cost of goods sold	15,921,407	(245,622)	15,675,785
Selling expenses	3,069,275	377,094	3,446,369
Administrative expenses	2,434,337	242,927	2,677,264
Other operating expenses	738,980	(374,399)	364,581

PJSC GRINDEKS

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

Foreign currencies

Transactions denominated in foreign currencies are translated into LVL at the official exchange rate of the Bank of Latvia at the date of the transaction. Monetary assets and liabilities are translated at the Bank of Latvia rate of exchange at the balance sheet date.

The applicable rates used for the principal currencies as of 31 December were as follows:

	2005	2004
USD	0.593000	0.5160
EUR	0.702804	0.7030
EEK	0.044900	0.0449

Gains and losses on translation are credited or charged to the profit and loss account at the Bank of Latvia official exchange rate as of the balance sheet date.

Intangible assets

Intangible assets are initially recognized at cost and are amortized using the straight-line method over a five-year period.

Tangible fixed assets

Tangible fixed assets are stated at historical cost less accumulated depreciation.

The cost of an item comprises its purchase price, including import duties and any directly attributable costs of bringing the asset to working condition for its intended use. The cost of self-constructed assets is determined using the same principles as for an acquired asset. If the recoverable value of a fixed asset is lower than its carrying amount, due to circumstances not considered to be temporary, the fixed asset is written down to its recoverable value.

Depreciation is provided for all fixed assets based on historical cost. Depreciation of tangible assets is computed using the straight-line method over the assets estimated average useful lives:

Buildings and constructions	5 – 50 years
Machinery and equipment	3 – 8 years
Other fixed assets	3 – 10 years

Repair and maintenance costs are expensed when incurred. Capital expenditures such as refurbishment of buildings and improvements to structural elements are recognized as an asset if the expenditures improve the condition of the asset beyond its original estimated life.

Investments in subsidiaries

Investments in subsidiaries are investments in enterprises controlled by the Company. Control is achieved where the Company has the power to govern the financial and operating policies of an investor enterprise so as to obtain the benefits from its activities.

Investments in subsidiaries are recognized at cost less impairment losses. If the recoverable amount of an investment is lower than its carrying amount, due to circumstances not considered to be temporary, the investment value is written down to its recoverable amount.

PJSC GRINDEKS

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

Financial investments

Short-term financial investments represent investment in the mutual fund “Lat Reserve Fund” and it is recorded at the market value.

Inventories

Inventories are stated at the lower of cost and net realizable value. Net realizable value represents the estimated selling price less all estimated costs of completion and costs to be incurred in marketing, selling and distribution.

The cost of materials is allocated using the weighted average method. Work in progress is valued at the direct cost of materials used. The cost of finished goods is valued at manufacturing costs and includes direct manufacturing costs - cost of materials and direct labor costs, other manufacturing costs - energy, ancillary materials, equipment and maintenance costs, depreciation and general manufacturing costs – service costs related to manufacturing.

Trade receivables

Trade receivables represent the gross balance due from customers less provision for bad debts, which is estimated by an individual review of each debtor. The provision for bad debts represents the estimated amounts of losses at the balance sheet date.

Cash

Cash includes cash on hand and demand deposits with credit institutions.

Finance leases

Finance leases are recorded at the fair value of the asset on the day of acquisition. Finance lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Impairment

At each balance sheet date the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indications that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of cash-generating unit to which the asset belongs.

Recoverable amount is the higher of fair value less costs of sale and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005**

Revenue and expense recognition

Revenues and expenses are recognised on an accrual basis.

Sales of goods are recognized when goods are delivered and ownership is passed to customers. Sales of goods are shown net of discounts allowed.

Expenses are recognised when incurred.

Finance expenses

Finance expenses related to borrowings are expensed in the period to which they are attributable. Amounts are disclosed in the profit and loss statement as interest and similar expense.

Corporate income tax

Corporate income tax is assessed based on the taxable income for the period in accordance with Latvian tax legislation. The tax rate stated by Latvian tax legislation is 15 %.

Deferred tax

Deferred tax is provided for by the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some proportion or all deferred tax assets will not be realized.

Use of estimates

The preparation of financial statements requires the management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets, liabilities and off balance sheet items, as well as the reported revenues and expenses. Actual results could differ from those estimates.

Related party transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties are defined as shareholders, employees, members of the management board, their close relatives and companies that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting entity.

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005

3. INTANGIBLE ASSETS

	Patents, licenses, trademarks and other rights LVL	Software LVL	Advances for intangible assets LVL	Total LVL
Historical cost				
31 December 2003	912,267	180,204	-	1,092,471
Additions	-	27,050	-	27,050
31 December 2004	912,267	207,254	-	1,119,521
Additions	62,500	126,606	118,894	308,000
31 December 2005	974,767	333,860	118,894	1,427,521
Accumulated amortisation				
31 December 2003	248,674	100,329	-	349,003
Amortisation for the year	143,907	30,813	-	174,720
31 December 2004	392,581	131,142	-	523,723
Amortisation for the year	140,239	37,686	-	177,925
31 December 2005	532,820	168,828	-	701,648
Carrying amount				
31 December 2004	519,686	76,112	-	595,798
31 December 2005	441,947	165,032	118,894	725,873

4. TANGIBLE FIXED ASSETS

	Land, buildings and constructions LVL	Equipment and machinery LVL	Other fixed assets LVL	Construc- tion in progress LVL	Advances for fixed assets LVL	Total LVL
Historical cost						
31 December 2003	3,230,260	5,207,622	887,360	142,955	382,230	9,850,427
Additions	327,514	604,039	226,680	-	-	1,158,233
Transfers	285,637	-	-	(106,431)	(179,206)	-
Disposals	-	(88,819)	(1,389)	-	-	(90,208)
31 December 2004	3,843,411	5,722,842	1,112,651	36,524	203,024	10,918,452
Additions	216,263	771,215	207,532	-	1,159,643	2,354,653
Transfers	239,548	-	-	(36,524)	(203,024)	-
Disposals	-	(4,889)	(15,290)	-	-	(20,179)
31 December 2005	4,299,222	6,489,168	1,304,893	-	1,159,643	13,252,926
Accumulated depreciation						
31 December 2003	792,322	3,822,351	729,781	-	-	5,344,454
Depreciation for the year	114,533	410,398	47,003	-	-	571,934
Disposals	-	(87,891)	(1,299)	-	-	(89,190)
31 December 2004	906,855	4,144,858	775,485	-	-	5,827,198
Depreciation for the year	141,177	506,094	85,908	-	-	733,179
Disposals	-	(3,492)	(13,384)	-	-	(16,876)
31 December 2005	1,048,032	4,647,460	848,009	-	-	6,543,501
Carrying amount						
31 December 2004	2,936,556	1,577,984	337,166	36,524	203,024	5,091,254
31 December 2005	3,251,190	1,841,708	456,884	-	1,159,643	6,709,425

PJSC GRINDEKS

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

The cadastral value of the land owned by the Company as at 31 December 2005 was LVL 108,333.

The Company has pledged its real estate with the book value of LVL 3,005,567 as security for the loans (Note 11).

5. INVESTMENTS IN SUBSIDIARIES

	31.12.2005.		31.12.2004.	
	LVL	%	LVL	%
JSC Kalceks	3,425,490	97.40%	3,425,490	97.40%
JSC Tallinn Pharmaceutical Plant (TPP)	<u>2,187,401</u>	95.01%	<u>2,151,141</u>	93.53%
	<u>5,612,891</u>		<u>5,576,631</u>	

The net loss of JSC Tallinn Pharmaceutical Plant in 2005 was EEK 984,351 (LVL 44,197). As at 31 December 2005 the equity of JSC Tallinn Pharmaceutical Plant was EEK 50,239,437 (LVL 2,255,751). In 2005 the Company bought an additional 18,581 shares of JSC Tallinn Pharmaceutical Plant.

During 2004, Grindeks has entered into a pre-sales / purchase agreement for the acquisition of JSC Kalceks. At the end of 2004, Grindeks has taken over the full control of JSC Kalceks' activities and has made an initial settlement of LVL 1,192,493 in respect of the purchase. As of the date of issuing these financial statements, Grindeks is finalizing the acquisition of 97.4% of JSC Kalceks for a total consideration price of LVL 3,425,490. As of 31 December 2004 the remaining balance due of LVL 2,232,997 is shown in liabilities (short term: LVL 1,730,997; long term: LVL 502,000). The outstanding short term liabilities balance as at 31 December 2005 was LVL 1,347,507.

The net loss of JSC Kalceks in 2005 was LVL 12,815. As of 31 December 2005 the equity of Kalceks was LVL 3,081,995

6. FINISHED GOODS AND GOODS FOR RESALE

	31.12.2005.	31.12.2004.
	LVL	LVL
Goods for resale	1,423,866	1,266,142
Self-manufactured and co-manufactured production	<u>788,657</u>	<u>687,335</u>
Total	<u>2,212,523</u>	<u>1,953,477</u>

7. OTHER RECEIVABLES

	31.12.2005.	31.12.2004.
	LVL	LVL
Value added tax (Note 13)	242,482	58,326
Overpaid personal income tax (Note 13)	4,589	-
Real estate and natural resources tax (Note 13)	187	5,170
Overpaid social tax (Note 13)	-	18,256
Other	<u>615,867</u>	<u>418,732</u>
Total	<u>863,125</u>	<u>500,484</u>

PJSC GRINDEKS

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005**

8. OTHER INVESTMENTS

Other investments represent an investment in the Mutual fund "Lat Reserve Fund". The Company owns 4,509,826 shares of the fund with a market price as at 31 December 2005 of LVL 1.11984 each.

9. CASH

	31.12.2005.	31.12.2004.
	LVL	LVL
Cash in bank	5,956,440	293,413
Cash on hand	10,744	6,437
Total	5,967,184	299,850

10. CAPITAL

As of 31 December 2004 the issued share capital of the Company consisted of 7,735,000 ordinary shares with a nominal value of LVL 1 each.

In 2005 the Company issued additional shares with the nominal value of LVL 1,850,000. Shares were sold with LVL 10,511,350 share premium (refer to page 11).

The shareholders as of 31 December 2005 and 2004 were as follows:

	Percentage holding	
	(%)	
	31.12.2005.	31.12.2004.
Kirovs Lipmans	28.73	27.38
Anna Lipmane	16.69	20.70
Vitalijs Gavrilovs	11.30	14.00
SJSC State Social Insurance Fund	2.29	2.84
Janis Naglis	-	3.70
Other shareholders	40.99	31.38
Total	100.00	100.00

PJSC GRINDEKS

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005**

11. LOANS FROM CREDIT INSTITUTIONS

	31.12.2005.	31.12.2004.
	LVL	LVL
Credit line from HVB Bank, Latvia	849,999	-
Ministry of Finance (World Bank loan)	380,000	380,000
HVB Bank, Latvia	191,163	191,216
Parex Bank, Latvia	177,550	177,600
Hansabank, Latvia	167,189	167,235
Hansabank, Latvia	29,650	197,806
Credit line from Hansabank, Latvia	-	1,171,192
Current loans from credit institutions	1,795,551	2,285,049
Hansabank, Latvia	992,384	-
Ministry of Finance (World Bank loan)	684,769	1,064,769
HVB Bank, Latvia	477,907	669,256
Parex Bank, Latvia	325,509	503,200
Hansabank, Latvia	264,738	432,047
Hansabank, Latvia	-	25,800
Non-current loans from credit institutions	2,745,307	2,695,072
Total	4,540,858	4,980,121

The borrowings are repayable as follows:

	31.12.2005.	31.12.2004.
	LVL	LVL
Within one year	1,795,551	2,285,049
Second year	1,338,741	941,851
Third to fifth year inclusive	1,406,566	1,753,221
Total	4,540,858	4,980,121
Less: Amount due for settlement within 12 months (shown under current liabilities)	(1,795,551)	(2,285,049)
Non current loans from credit institutions	2,745,307	2,695,072

	31.12.2005.	31.12.2004.
	LVL	LVL
In 1994 the Company received a rehabilitation loan from the Ministry of Finance in the total amount of USD 6,322,957 (later linked to a currency basket consisting of USD 1, JPY 125, and DEM 2) with an annual interest rate of 7.6 %.		
On 22 November 2004 the loan agreement has been rescheduled and outstanding balance was LVL 1,444,769. Interest rate equals annual interest rate for Latvian Treasury bills plus 0.5 %. The loan matures on 5 September 2007.		
The loan is secured by the property of the Company.	1,064,769	1,444,769

PJSC GRINDEKS**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005**

On 29 August 2005 the Company signed loan agreement with Hansabank in total amount of 4,642,830 EUR for purchase of new equipment and creation of a laboratory. The maturity date is 29 August 2012. Interest rate is calculated as sum of 6 months EURIBOR and 1.75% fixed rate. The credit line is secured by a commercial pledge.	992,384	-
On 5 May 2005 the Company signed a credit line agreement with HVB Bank Latvia in amount of 850,000 LVL. The maturity date is 28 April 2006. Total interest amount is calculated as sum of 3 months RIGIBOR and fixed rate 1.55 %. The credit line is secured by commercial pledge.	849,999	-
On 29 June 2004 the Company has received a long term loan from HVB Bank Latvia in the amount of EUR 1,200,000 for refinancing acquisition of fixed assets. The maturity of the loan is 30 June 2009. Annual interest rate is 3 months EURIBOR plus 1.6 %. The loan is secured by a commercial pledge.	669,070	860,472
On 10 March 2004 the Company has received a long term loan from Parex Bank in the amount of EUR 1,360,000 for financing working capital. The maturity of the loan is 10 October 2008. Annual interest rate is 3 months EURIBOR plus 1.65 %. The loan is secured by a commercial pledge.	503,059	680,800
On 30 July 2003, the Company received a long term loan from Hansabank in the amount of EUR 1,130,000 with the maturity in 2008. The loan was taken for the purpose of settling the liabilities of TPP to Sampopank in Estonia. The annual interest rate is 6 month EUR LIBOR plus 2 %. The loan is secured by a commercial pledge.	431,927	599,282
On 9 September 1999 the Company received a loan from Hansabank in the amount of USD 1,000,000. On 20 March 2000 the amount of the loan was increased to USD 1,800,000 with the maturity on 20 March 2003. On 24 February 2003 the maturity date was extended till 20 February 2006. The annual interest rate is 3 months USD LIBOR plus 2 %. The loan is secured by a commercial pledge.	29,650	223,606
On 20 March 1998, the Company received a credit line from Hansabank. According to the amendments dated 20 January 2003 the limit of the credit line was increased to USD 2,200,000, the credit line was repayable on 20 January 2004. The annual interest rate is 3 month USD LIBOR plus 2% starting from May 2003. On 20 January 2004 the agreement term was extended to 20 January 2005. On 20 January 2005 the limit of credit line was increased to EUR 2,400,000 and interest rate is 6 months EURIBOR plus 1.8%, maturity is extended to 27 January 2006. The loan is secured by a commercial pledge.	-	1,171,192
Total	4,540,858	4,980,121

PJSC GRINDEKS

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005**

12. TRADE ACCOUNTS PAYABLE

	31.12.2005.	31.12.2004.
	LVL	LVL
JSC Tallinn Pharmaceutical Plant (TPP)	919,283	1,185,824
JSC Sanitas	646,334	1,831,982
JELFA S.A.	320,885	67,020
Johnson and Johnson Consumer Pharmaceuticals	-	20,929
Others	2,054,987	1,043,493
Total	3,941,489	4,149,248

13. TAXES AND SOCIAL SECURITY PAYMENTS

	Tax liabilities as of 31 December 2004	Overpaid tax as of 31 December 2004	Calculated in 2005	Transfers	Paid in 2005	Tax liabilities as of 31 December 2005	Overpaid tax as of 31 December 2005
	LVL	LVL	LVL	LVL	LVL	LVL	LVL
Corporate income tax	201,611	-	858,193	(77,351)	(539,492)	442,961	-
Real estate tax	-	(4,683)	38,904	-	(32,621)	1,600	-
Value added tax	-	(58,326)	(1,114,569)	930,413	-	-	(242,482)
Social security payments	-	(18,256)	962,964	(801,341)	(135,312)	8,055	-
Natural resources tax	-	(487)	1,546	(5)	(1,241)	-	(187)
Personal income tax	27,096	-	820,071	(51,713)	(800,043)	-	(4,589)
Risk duty	183	-	2,338	(3)	(2,318)	200	-
Total	228,890	(81,752)	1,569,447	-	(1,511,027)	452,816	(247,258)

14. ACCRUED LIABILITIES

Accrued liabilities represent vacations accruals, which are calculated for all employees, taking into account each employee's average daily salary and number of accrued vacations days as of the date of the reporting period.

PJSC GRINDEKS

NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005

15. NET SALES

	2005 LVL	2004 LVL
Russia	16,250,417	9,003,150
Commonwealth of Independent States	10,109,169	6,929,953
Latvia	2,504,310	2,429,904
Lithuania	2,289,922	4,166,541
Estonia	1,051,233	1,124,042
Other countries	2,939,322	3,522,810
Services	28,492	155,449
Gross sales	35,172,865	27,331,849
Discounts	(2,951,663)	(2,607,107)
Net sales	32,221,202	24,724,742

16. COST OF GOODS SOLD

	2005 LVL	2004 LVL
Goods purchased for resale	7,990,262	8,897,572
Raw materials and packaging	2,749,666	2,645,108
Direct labor and social security payments	2,350,302	1,814,601
Research services costs	1,342,551	461,933
Depreciation of fixed assets and amortization of intangible assets	574,104	476,026
Machinery, buildings and equipment repairs	445,875	302,423
Electricity resource expenses	344,034	311,457
Household expenses	125,676	106,868
Waste disposal	89,390	81,389
Transport	56,925	52,878
Rent of work clothing	55,158	52,204
Other	571,789	473,326
Total	16,695,732	15,675,785

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005**

17. SELLING EXPENSES

	2005	2004
	LVL	LVL
Advertising	2,651,673	1,449,318
Expenses for representative offices	928,982	574,669
Salaries and social security payments	533,054	442,004
Protection of patents	403,761	212,636
Distribution expenses for goods	278,449	231,960
Registration costs for medicine	138,550	115,140
Commissions	132,481	69,261
Freight insurance	55,336	54,135
Depreciation of fixed assets and amortization of intangible assets	50,657	40,881
Other	461,658	256,365
Total	5,634,601	3,446,369

18. ADMINISTRATIVE EXPENSES

	2005	2004
	LVL	LVL
Administrative salaries and social security payments	1,224,355	916,659
Depreciation of fixed assets and amortization of intangible assets	286,343	229,747
Professional services	228,254	92,558
Personnel training and hiring expenses	168,847	66,890
Employee life insurance	132,391	109,413
Transport	117,938	127,603
Security costs	115,613	108,907
Electricity	78,413	70,634
Development and implementation of documents management system	72,994	4,500
Business trips	68,681	62,623
Bank charges	63,074	43,872
Communication expense	46,993	39,118
Computers maintenance	32,262	26,471
Property and responsibility insurance	19,132	13,518
Other	1,225,125	764,751
Total	3,880,415	2,677,264

The average number of employees during 2005 and 2004 was 527 and 502, respectively.

PJSC GRINDEKS

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005**

The salaries and social security for the Council and the Board members were as follows:

	2005	2004
	LVL	LVL
Salary of the Council members	445,610	300,240
Social security payments	17,712	14,761
Total Council expenses	463,322	315,001
Salary of the Board members	271,672	198,105
Social security payments	13,556	13,514
Total Board expenses	285,228	211,619
Total	748,550	526,620

19. CORPORATE INCOME TAX

19 (a) Components of corporate income tax

	2005	2004
	LVL	LVL
Current corporate income tax	858,193	442,464
Deferred tax charge for the year	51,807	43,440
Total	910,000	485,904

19 (b) Deferred income tax liabilities

Temporary differences and deferred tax liabilities are as follows:

	2005	2004
	LVL	LVL
Temporary difference related to net book value of fixed assets due to accelerated tax depreciation for tax purposes	2,475,580	2,137,479
Provisions for unused vacations	(15,540)	(22,817)
Total temporary differences	2,460,040	2,114,662
Deferred income tax liabilities, net	369,006	317,199

PJSC GRINDEKS

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005**

20. BALANCES AND TRANSACTIONS WITH RELATED PARTIES

There were miscellaneous transactions with group companies including trade.

Balances and transactions with group companies and settlement amounts were as follows:

Amounts in balance sheet are as follows:

	2005	2004
	LVL	LVL
Trade accounts payable JSC Tallinn Pharmaceutical Plant	919,283	1,185,824
Trade accounts payable JSC "Kalceks"	106,367	30,634
Total liabilities	1,025,650	1,216,458

Income and expense are as follows:

	2005	2004
	LVL	LVL
<u>Income</u>		
Other operating income	-	18,922
Total income	-	18,922
<u>Expense</u>		
Purchase of goods JSC Tallinn Pharmaceutical Plant	2,090,690	2,727,439
Purchase of goods JSC "Kalceks"	325,209	-
Research expenses JSC Tallinn Pharmaceutical Plant	124,816	-
Rent of equipment JSC "Kalceks"	27,646	-
Other operating expenses	-	7,539
Total expense	2,568,361	2,734,978

21. OTHER TAXES

	2005	2004
	LVL	LVL
Property tax	37,048	33,738
Real estate tax (land)	1,856	1,310
Total	38,904	35,048

22. COMMITMENTS AND CONTINGENCIES

22. (1) The Company has pledged its real estate with the book value of LVL 3,005,567 as a security for loans (refer to Note 11).

22. (2) The Company has entered in to fixed assets rent agreement with a payment of LVL 213,744 in 2006. The agreement could be terminated based on mutual agreement by both parties.

22. (3) With the co-finance of EU Structural funds (1.5 million LVL) the development of the new active pharmaceutical ingredients analytic scaling laboratory has been started. The total costs of the project are planned to be 3.26 million LVL. The project is planned to be finished in 2006
