

Pharmaco hf.

**Interim consolidated financial statements
Nine months ended 30 September 2003
Euro**

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Endorsement by the Board of Directors and CEO

The interim financial statements include the consolidated financial statements of Pharmaco hf. and its subsidiaries. In the beginning of the year the Company acquired a 68,6% share in the Serbian pharmaceutical company Zdravlje. The impact of this company's results are included in the statement for the whole period. At the end of June the Company invested 800.000 euro in the Danish pharmaceutical development company Colotech A/S, bringing the total ownership up to 77,2%. Due to last years mergers the functional currency of the Company has changed to euro and the consolidated financial statements are now prepared in euro.

The accounting principles applied in preparing the Group's interim financial statements are consistent with those used in the previous year except for the amortization of goodwill resulting from the purchases of other companies. The management has decided to change from linear amortization to impairment tests. Impairment tests will be performed annually and all reduction in goodwill resulting from such tests will be amortized fully when incurred. Due to these changes net profit for the period is increased by 7,0 million euro. This new method is consistent with that of many other companies in the same line of business.

In the third quarter an impairment loss on fixed assets amounting to 18,9 million euro is charged to expenses. This impairment loss is mainly due to revaluation of the Group's raw material factory in Razgrad that produces raw material for veterinary pharmaceuticals. This operation is not in line with the Group's main line of business and therefore the book value of the assets is reduced to expected sales price. During the year the Group has been setting new goals for all business units. The aforementioned impairment loss is the result of this work.

Also in this quarter a special reserve amounting to 3,7 million euro is made to the book value of investments in unlisted companies that are not in line with the Group's main line of business. Today's investment policy is focused on investments in line with the Group's main line of business.

In the management's opinion there will be no further impairment losses due to the aforementioned assets.

Net profit for the period amounted to 42,0 million euro before impairment losses and special reserves. Taking into consideration the impairment losses and special reserves net profit amounted to 23,3 million euro according to the income statement. Stockholders' equity, according to the balance sheet, amounted to 241,2 million euro at the end of the period.

The Board of Directors and the CEO of Pharmaco hf. hereby confirm the Company's consolidated interim financial statement for the nine months ended 30 September 2003 by means of their signatures.

Hafnarfjordur, 10 November 2003.

Board of Directors:

Bjorgolfur Gudmundsson
Karl Wernersson
Bjorgolfur Thor Bjorgolfsson
Magnus Thorsteinsson

CEO:

Robert Wessman

Auditors' review report

Board of directors of Pharmaco hf.

We have reviewed the accompanying interim consolidated balance sheet of Pharmaco hf. and its subsidiaries as of 30 September, 2003, and the related consolidated income statement and consolidated statement of cash flows for the nine months then ended, in accordance with standards. The interim financial statements are based on Company data and information from its management.

A review consists principally of a review of the documents on which the interim consolidated financial statements are based, inquiries of company personnel and analytical procedures applied to financial data and ratios. It is substantially less in scope than an audit performed in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the consolidated financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the interim consolidated financial statements in order for them to conform with generally accepted accounting principles in Iceland.

Without qualifying our report we draw attention to the changes in accounting principles concerning the amortisation of goodwill. The change from straight line amortisation to applying impairment tests is further explained in note one. The impairment test is a new method and the change has the effect that net earnings for the period are increased by 7,0 million euro.

Hafnarfjordur, 10 November 2003.

Alexander G. Edvardsson

Sigríður Armannsdóttir

KPMG Endurskoðun hf.

Consolidated income statement

for nine months ended 30 September 2003

	Notes	Current quarter		Nine months	
		1 July to 30 September 2003	2002	1 January to 30 September 2003	2002
Operating revenue:					
Sales		72.434	54.487	229.308	134.784
Other revenue		4.361	4.461	8.568	5.736
		<u>76.795</u>	<u>58.948</u>	<u>237.876</u>	<u>140.520</u>
Operating expenses:					
Direct production expenses / cost of sales		39.987	35.268	130.636	86.389
Sales and marketing expenses		6.601	4.306	15.717	10.134
General and administrative expenses		5.213	5.098	18.301	9.866
Other operating expenses		4.418	859	9.124	2.681
Depreciation and amortization	18	4.242	5.952	12.567	9.255
Impairment losses on fixed assets	18	18.887	0	18.887	0
		<u>79.348</u>	<u>51.483</u>	<u>205.232</u>	<u>118.325</u>
Profit (loss) from operations		(2.553)	7.465	32.644	22.195
Net financial income (expenses)	14	(2.912)	6.625	(1.723)	9.587
Special reserve on investment		(3.689)	0	(3.689)	0
Profit (loss) before income tax		(9.154)	14.090	27.232	31.782
Income tax		1.698	(312)	(2.165)	(4.477)
Profit (loss) before minority interest		(7.456)	13.778	25.067	27.305
Minority interest		(412)	(9)	(1.738)	(441)
Net profit (loss)		<u>(7.868)</u>	<u>13.769</u>	<u>23.329</u>	<u>26.864</u>

Consolidated balance sheet

Assets

	Notes	30.9.2003	31.12.2002
Fixed assets:			
Intangible assets:			
Development expenditure and pharmaceutical know-how	15	21.395	15.575
Goodwill	16	190.811	191.739
	5,6	212.206	207.314
Property and equipment:			
Property and plant		47.474	50.263
Machinery and equipment		47.410	51.695
	7,17	94.884	101.958
Investments:			
Investments in associated companies	8	4.204	8.512
Investments in other companies	8	3.186	2.415
Securities		1.803	1.836
Deferred tax assets	12,23	8.595	3.217
		17.788	15.980
Total fixed assets		324.878	325.252
Current assets:			
Inventories	9,20	61.535	55.932
Receivables:			
Accounts receivable	10	64.904	56.203
Other receivables	10	15.080	12.355
Cash		27.447	8.863
Total current assets		168.966	133.353
Total assets		493.844	458.605

30 September 2003

Stockholders' equity and liabilities

	Notes	30.9.2003	31.12.2002
Stockholders' equity:			
Capital stock	11,21	36.793	7.419
Share premium		128.281	162.240
Translation reserve		(20.872)	(8.223)
Statutory reserve		950	950
Retained earnings		96.045	73.389
Total stockholders' equity	22	241.197	235.775
Provisions:			
Minority interest		7.510	3.218
Deferred tax liabilities	12,23	3.042	3.722
		10.552	6.940
Long-term liabilities:			
Bonds	24	173.062	74.946
Current liabilities:			
Bank loans		2.894	61.389
Accounts payable		30.470	26.701
Current maturities of long-term liabilities	24	12.186	31.732
Accrued liabilities and expenses		23.483	21.122
		69.033	140.944
Total liabilities and provisions		252.647	222.830
Total stockholders' equity and liabilities		493.844	458.605

Consolidated statement of cash flows

for nine months ended 30 September 2003

	Notes	2003 1.1-30.9	2002 1.1-30.9
Cash flows from operating activities:			
Net profit		23.329	26.864
Adjustments to reconcile net profit to net cash provided by operating activities:			
Depreciation and amortization	18	31.454	13.091
Currency fluctuations and indexation		(3.559)	(7.273)
Changes in deferred taxes		(2.654)	(275)
Other changes		5.522	(5.211)
Working capital provided by operating activities		54.092	27.196
Changes in operating assets and liabilities:			
Inventories, (increase) decrease		(3.897)	235
Receivables, (increase) decrease		(10.654)	24
Short-term liabilities, (decrease) increase		(1.405)	1.061
Changes in operating assets and liabilities		(15.956)	1.320
Net cash provided by operating activities		38.136	28.516
Cash flows to investing activities:			
Increase in intangible assets		(10.020)	(3.871)
Investment in property and equipment		(18.575)	(21.176)
Proceeds from sale of property and equipment		1.381	9.382
Investments in other companies net of cash acquired		(6.481)	(26.062)
Securities, change		(56)	(1.795)
		(33.751)	(43.522)
Cash flows from financing activities:			
Changes in capital stock		(3.173)	(51.508)
Dividend paid		(673)	(483)
Changes in minority interest		(17)	(2.499)
Proceeds from long-term borrowings		58.585	76.745
Payments of long-term debt		(34.299)	(43.283)
Bank loans, (decrease) increase		(5.530)	36.230
		14.893	15.202
Increase in cash		19.278	196
Cash at beginning of year		8.863	9.617
Effects of exchange rate changes on beginning balances		(694)	92
Cash at period-end		27.447	9.905

Notes to consolidated interim financial statements

Summary of accounting principles

Basis of preparation

1. Pharmaco hf. (the Company) is a company domiciled in Iceland. The consolidated interim financial statements are prepared in accordance with the Icelandic financial statements act and regulation on the presentation and contents of financial statements and consolidated financial statements. The interim financial statements are presented in euro rounded to the nearest thousand. They are prepared on historical cost basis and are, in all main respects, based on the same accounting principles as in the previous year except for the change in the amortization of goodwill. Previously goodwill has been amortized by using the straight line method. From the beginning of the year 2003 the Company will use annual impairment tests to evaluate goodwill. If, as a result of impairment tests, the value of goodwill has decreased the reduction will be fully amortized in the period in question. This change in accounting for goodwill results in a 7,0 million euro higher net profit for the nine months ended 30 September 2003 than would have been if consistent rules had been applied.

Subsidiaries are those enterprises controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intra-group balances and transactions, and any unrealized gains arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Foreign currencies

2. Transactions in foreign currencies are translated to euro at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to euro at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to euro at foreign exchange rates ruling at the dates the values are determined.

Financial statements of foreign subsidiaries

3. The Group's foreign operations are not considered an integral part of the Company's operations. Accordingly, the assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated to euro at exchange rates ruling at the balance sheet date. The revenue and expenses of foreign operations are translated to euro at the average conversion rates for the period. Foreign exchange differences arising on translation are recognized directly in equity.

Notes - cont.:

Derivative financial instruments

4. The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities.

Intangible assets

5. Development expenditure is capitalized in the balance sheet as development expenditure and pharmaceutical know-how. If the development leads to a marketable drug being produced, capitalized costs are amortised over a period of five years. Development expenditure, that turns out to be unsuccessful, is recognized in the income statement when that becomes evident.
6. Goodwill arising on acquisition represents the excess of the cost of the acquisition over the fair value of the net identifiable assets acquired. Goodwill is stated at cost less amortization to year-end 2002. From the beginning of the year 2003 impairment tests will be used to calculate the value of goodwill instead of yearly amortization based on the straight line method. The first impairment test is scheduled to be conducted before year-end 2003.

Property and equipment

7. Property and equipment are valued at cost less depreciation. Depreciation is calculated as a fixed annual percentage based on the asset's expected economic life and its salvage value. Expected economic life is specified as follows:

Property and plant	14 - 50 years
Equipment	3 - 10 years

Investments

8. Investment in associated companies and other companies is valued at cost.

Inventories

9. Manufactured products are valued at their average production cost, consisting of both direct and indirect production cost. Inventories of purchased goods and materials are valued at the latest purchase price.

Accounts receivable and other receivables

10. Accounts receivable are reduced by an allowance for doubtful accounts. This allowance is not a final write-off, but a reserve to meet possible future losses. The allowance is deducted from appropriate balance sheet items. Receivables amounting to 80 million euro at period-end have been written down by 8 million euro in the balance sheet.

Notes - cont.:

Repurchase of share capital

11. When treasury shares are repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in equity. Treasury shares are classified as a deduction from total equity. Possible gains or losses on buying or selling treasury shares are not reported in the income statement.

Deferred tax assets and liabilities

12. Deferred tax liability amounted to 3,0 million euro at period-end, while deferred tax asset amounted to 8,6 million euro. Its calculation is based on the difference between balance sheet items as reported in the Group's financial statements on one hand and tax returns of all the companies within the Group on the other. This difference occurs because expenses, especially depreciation and amortisation, are generally expensed earlier for tax purposes than in the financial statements.

Income tax presented in the income statement is comprised of taxes payable and deferred tax liability.

Quarterly overview

13. The operation of the Company is specified as follows by quarters:

	1st Quarter 1.1 - 31.3	2nd Quarter 1.4 - 30.6	3rd Quarter 1.7 - 30.9	Total 1.1 - 30.9
Sales	79.152	77.722	72.434	229.308
Cost of goods sold	(47.558)	(43.091)	(39.987)	(130.636)
Gross profit	31.594	34.631	32.447	98.672
Operating expenses less other income	(12.255)	(18.773)	(35.000)	(66.028)
Net financial income (expenses)	645	544	(6.601)	(5.412)
Income tax	(2.458)	(1.405)	1.698	(2.165)
Minority interest	(639)	(687)	(412)	(1.738)
Net profit (loss)	16.887	14.310	(7.868)	23.329

Notes - cont.:

Net financial income

14. Financial income and expenses are specified as follows:

	2003	2002
	1.1-30.9	1.1-30.9
Interest earned	365	2.098
Interest expenses and indexation	(7.025)	(5.419)
Currency fluctuations	4.793	4.821
Gain on sale of investment and dividend received	144	8.087
	<u>(1.723)</u>	<u>9.587</u>

Intangible assets

15. Development cost for new products is capitalized in the balance sheet among intangible assets. Those assets are amortized over a period of five years. Changes during the period are specified as follows:

Balance at 1 January 2003	15.492
Additions due to acquisition	521
Additions during the period	9.815
Currency adjustments during the period	(859)
Sales and disposals during the period	(98)
Amortized during the period	<u>(3.476)</u>
Balance at 30 September 2003	<u>21.395</u>

16. Capitalized goodwill in the balance sheet is derived from the purchase of other companies. The goodwill is not amortized. Changes in goodwill during the period are specified as follows:

Balance at 1 January 2003	192.985
Difference due to purchase of subsidiary	(984)
Currency adjustments during the period	(1.154)
Other changes	<u>(36)</u>
Balance at 30 September 2003	<u>190.811</u>

Notes - cont.:

Fixed assets

17. Fixed assets and depreciation, which is calculated on a straight line basis, are specified as follows:

	Property and plant	Machinery and equipment	Total
Cost			
Balance at 1 January 2003	65.410	115.069	180.479
Additions due to acquisition	15.000	14.040	29.040
Additions during the period	9.030	10.369	19.399
Currency adjustments during the period	(5.119)	(9.760)	(14.879)
Sales and disposals during the period	(23.592)	(16.660)	(40.252)
Balance at 30 September 2003	<u>60.729</u>	<u>113.058</u>	<u>173.787</u>
Amortization and impairment losses			
Balance at 1 January 2003	15.144	63.365	78.509
Additions during the period	7.502	11.006	18.508
Depreciated during the period	15.618	12.324	27.942
Currency adjustments during the period	(1.417)	(5.824)	(7.241)
Depreciation of asset disposals	(23.592)	(15.223)	(38.815)
Balance at 30 September 2003	<u>13.255</u>	<u>65.648</u>	<u>78.903</u>
Carrying amount at 30 September 2003	<u>47.474</u>	<u>47.410</u>	<u>94.884</u>
Depreciation ratios	2 - 7%	10 - 33%	

18. Depreciation and amortization according to the income statement are specified as follows:

Amortization of intangible assets according to note 15	3.476
Other changes in goodwill according to note 16	36
Depreciation of fixed assets according to note 17	<u>27.942</u>
	<u>31.454</u>

Notes - cont.:

Investments

19. At period-end the Company owned twelve subsidiaries that are all included in the consolidation. The Company acquired 68,6% share in the Serbian pharmaceutical factory Zdravlje at the beginning of the year for 3,5 million euro. The Company is further committed to purchase additional 15% share over the next three years. At the end of June the Company invested 800.000 euro in the Danish pharmaceutical research company Colotech A/S. The Company's ownership after the new investment and other changes in the subsidiary's equity amounts to 77,2%. The Company is committed to invest further 4 million euro in the subsidiary during the next four years. The German subsidiary Medis GmbH was founded during the year. The Company's ownership is 60%. The subsidiaries at period-end are as follows:

Balkanpharma Holdings Ltd, Cyprus	NM Pharma ehf., Iceland
Dansk Lægemiddel Forsyning AS, Denmark	Omega Farma ehf., Iceland
Delta ehf., Iceland	United Nordic Pharma AS, Denmark
Medis Holland BV, Netherland	Zdravlje AD, Serbia
Medis Ltd., Isle of Man	Colotech A/S, Denmark
Medis ehf., Iceland	Medis GmbH, Germany

Inventories

20. Inventories are specified as follows:

	30.9.2003	31.12.2002
Raw materials and consumables	24.397	27.769
Work in progress	14.043	12.945
Finished goods	23.095	15.218
Inventories at end of period	<u>61.535</u>	<u>55.932</u>

Notes - cont.:

Stockholders' equity

21. Outstanding capital stock amounted to ISK 574 million at the beginning of the year. The Company's annual meeting agreed to increase the nominal value of the capital stock by issuing bonus shares. The annual meeting also agreed to increase the capital stock to meet stock options to employees. Changes in the nominal value of capital stock during the period are as follows in thousands of isk and thousands of euro:

	isk	euro
Outstanding capital stock at 1 January 2003	574.192	7.419
Bonus shares issued	2.268.768	29.339
New shares issued	8.410	98
Purchase of treasury shares	(7.000)	(84)
Sale of treasury shares	1.780	21
Outstanding capital stock at 30 September 2003	<u>2.846.150</u>	<u>36.793</u>

Total capital stock is as follows:

Total capital stock issued	2.993.781	38.522
Treasury stock	(147.631)	(1.729)
Outstanding capital stock at 30 September 2003	<u>2.846.150</u>	<u>36.793</u>

22. Reconciliation of movement in capital and reserves:

	Capital stock	Share premium	Translation reserve	Statutory reserve	Retained earnings	Total
Balance at 1 January 2003	7.419	162.240	(8.223)	950	73.389	235.775
Bonus issue	29.339	(29.339)				0
Treasury shares acquired	(84)	(6.811)				(6.895)
Treasury shares sold	21	383				404
New shares issued	98	1.808				1.906
Acc. currency adjustment			(12.649)			(12.649)
Dividends to shareholders					(673)	(673)
Net earnings					23.329	23.329
Balance at 30 September 2003 ...	<u>36.793</u>	<u>128.281</u>	<u>(20.872)</u>	<u>950</u>	<u>96.045</u>	<u>241.197</u>

Notes - cont.:

Deferred income tax

23. The Groups' deferred tax assets and deferred tax liabilities are specified as follows:

	Assets	Liabilities
Balance at 1 January 2003	3.217	3.722
Income tax posted to income statement	1.336	3.501
Income tax payable	791	(4.029)
Prepaid income tax	3.367	0
Other changes	(116)	(152)
Balance at 30 September 2003	<u>8.595</u>	<u>3.042</u>

Long-term liabilities

24. Long-term liabilities are specified as follows, by indexation and currency denominations:

Liabilities denominated in foreign currencies:

Loans in EUR	100.578
Loans in USD	39.391
Loans in GBP	2.731
Loans in JPY	14.391
Loans in CHF	12.619
Loans in SEK	1.458
Loans in MTL	8.504
Liabilities denominated in foreign currencies:	<u>1.817</u>
	181.489

Liabilities in Icelandic kronur:

Long-term debt, following the official consumer-price index	<u>3.759</u>
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Total long-term liabilities, including current maturities	185.248
Current maturities of long-term liabilities	<u>(12.186)</u>
Total long-term liabilities	<u>173.062</u>

Notes - cont.:

25. Annual maturities of long-term liabilities are specified as follows:

In the year 2003 (three months)	2.934
In the year 2004	14.409
In the year 2005	22.345
In the year 2006	33.255
In the year 2007	26.972
Subsequent payments	85.333
Total	<u>185.248</u>

Financial ratios

26. The main financial ratios for the Group are as follows:

	2003 1.1-30.9	2002 1.1-31.12
Equity ratio	0,49	0,52
Current ratio	2,45	0,95
Return on equity	12,9%	26,0%
EBITDA	64.098	45.609
EBITDA as a percentage of revenues	26,9%	21,7%
Working capital provided by operating activities	54.092	41.302