

**OJSC “PHARMSTANDARD”**

Consolidated Financial Statements

*For the year ended 31 December 2007*

OJSC “Pharmstandard”

Consolidated Financial Statements

For the Year Ended 31 December 2007

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OJSC “Pharmstandard”

Consolidated Balance Sheet at 31 December 2007

(in thousands of Russian Roubles)

	Notes	2007	2006
<b>ASSETS</b>			
<b>Non-current assets</b>			
Property, plant and equipment	8	3,691,266	3,788,581
Investment property		–	14,522
Intangible assets	9	4,468,477	4,473,639
Long-term financial assets	14	245,398	–
		<u>8,405,141</u>	<u>8,276,742</u>
<b>Current assets</b>			
Inventories	11	1,760,195	1,406,952
Trade receivables	12	4,176,200	3,373,741
VAT recoverable		358,767	222,675
Prepayments		130,479	169,232
Short-term financial assets	14	111,899	104,866
Cash and cash equivalents	13	192,589	192,966
		<u>6,730,129</u>	<u>5,470,432</u>
Non-current assets classified as held for sale	10	158,855	22,655
<b>Total assets</b>		<u><u>15,294,125</u></u>	<u><u>13,769,829</u></u>
<b>EQUITY AND LIABILITIES</b>			
<b>Equity attributable to equity holders of the parent</b>			
Share capital	18	37,793	37,793
Retained earnings		9,004,021	5,838,906
		<u>9,041,814</u>	<u>5,876,699</u>
<b>Minority interest</b>		<u>560,879</u>	<u>463,664</u>
<b>Total equity</b>		<u><u>9,602,693</u></u>	<u><u>6,340,363</u></u>
<b>Non-current liabilities</b>			
Long-term borrowings and loans	15	1,954,576	3,523,997
Deferred tax liability	25	1,047,799	1,080,828
Derivative financial instruments	15,27	44,598	–
Other non-current liabilities		36,826	47,767
		<u>3,083,799</u>	<u>4,652,592</u>
<b>Current liabilities</b>			
Trade and other payables and accruals	17	1,046,520	2,092,882
Current portion of long-term borrowings	15	1,310,374	351,415
Income tax payable		37,934	184,118
Other taxes payable	16	212,806	148,459
		<u>2,607,633</u>	<u>2,776,874</u>
Total liabilities		<u>5,691,432</u>	<u>7,429,466</u>
<b>Total equity and liabilities</b>		<u><u>15,294,125</u></u>	<u><u>13,769,829</u></u>

Signed and authorised for release on behalf of the Board of Directors of OJSC PHARMSTANDARD

General Director

I.K. Krylov

Chief Financial Officer

E.V. Arkhangelskaya

10 April 2008

The accompanying notes on pages 8-47 are an integral part of these consolidated financial statements.

OJSC “Pharmstandard”

Consolidated Statement of Operations

For the Year Ended 31 December 2007

(in thousands of Russian Roubles)

	Notes	2007	2006
Revenue - sale of goods	19	11,371,345	8,522,780
Cost of sales	20	(4,519,749)	(3,581,237)
<b>Gross profit</b>		<b>6,851,596</b>	4,941,543
Selling and distribution costs	21	(1,626,041)	(1,268,160)
General and administrative expenses	22	(570,519)	(498,929)
Other income	23	274,142	–
Other expenses	23	(315,591)	(206,996)
Financial income	24	28,729	23,987
Financial expense	24	(320,367)	(291,363)
<b>Profit before income tax</b>		<b>4,321,949</b>	2,700,082
Income tax expense	25	(1,058,709)	(664,014)
<b>Profit for the year</b>		<b>3,263,240</b>	2,036,068
Attributable to:			
Equity holders of the Parent		3,227,895	1,897,671
Minority interests		35,345	138,397
		<b>3,263,240</b>	<b>2,036,068</b>
Earnings per share (in Russian roubles) - basic and diluted, for profit of the year attributable to equity holders of the parent	18	85.41	50.21

**Signed and authorised for release on behalf of the Board of Directors of OJSC PHARMSTANDARD**

General Director

I.K. Krylov

Chief Financial Officer

E.V. Arkhangelskaya

10 April 2008

*The accompanying notes on pages 8-47 are an integral part of these consolidated financial statements.*

OJSC “Pharmstandard”

Consolidated Statement of Cash Flows  
For the Year Ended 31 December 2007

(in thousands of Russian Roubles)

	Notes	2007	2006
<b>Cash flows from operating activities:</b>			
Profit before income tax		4,321,949	2,700,082
Adjustments for:			
Depreciation and amortisation	8,9	527,600	284,797
Allowances for impairment of receivables, inventories and financial assets	11,12,23	152,364	43,202
Loss recognised on non-current assets classified as held for sale	23	24,101	–
Impairment charge	8,23	42,403	–
(Gain) loss on disposal of property, plant and equipment and investments property and non-current assets classified as held for sale	23	(15,044)	160,145
Foreign exchange gain	23	(259,098)	–
Gain from revaluation of short-term financial assets	24	(10,578)	–
Financial income	24	(18,151)	(23,987)
Financial expense	24	320,367	291,363
<b>Operating cash flows before working capital changes</b>		<b>5,085,913</b>	<b>3,455,602</b>
Increase in trade receivables	12	(892,491)	(1,099,267)
Increase in inventories	11	(385,398)	(74,735)
(Increase) decrease in VAT recoverable		(136,091)	151,436
Decrease in prepayments		38,753	109,937
Decrease in trade payables, other payables and advances received	17	(184,189)	(109,509)
Increase (decrease) in taxes payable other than income tax		64,346	(212,060)
<b>Cash generated from operations</b>		<b>3,590,843</b>	<b>2,221,404</b>
Income tax paid	25	(1,237,928)	(702,129)
Interest paid		(282,917)	(322,940)
Interest received		11,361	23,987
<b>Net cash from operating activities</b>		<b>2,081,359</b>	<b>1,220,322</b>
<b>Cash flows from investing activities:</b>			
Purchase of property, plant and equipment and intangible assets	8,9	(686,802)	(889,911)
Cash paid for subsidiaries acquisition	5	–	(3,945,860)
Cash in acquired subsidiaries		–	76,097
Cash paid for long-term financial assets	14	(246,308)	–
Cash paid to settle the obligation for OJSC “TZMOI” shares acquired in 2005	7	(824,723)	(707,000)
Cash received from sale of investment property and property, plant and equipment	8	17,574	135,346
Cash received from sale of short-term financial assets	14	32,513	158,670
Cash paid for short-term financial assets	14	(81,300)	(34,466)
Cash received from sale of non-current assets classified as held for sale	10	34,133	370,466
Deposits repaid by related bank, net	7	–	71,649
Loans repaid by related parties	7	25,153	283,743
<b>Net cash used in investing activities</b>		<b>(1,729,760)</b>	<b>(4,481,266)</b>
<b>Cash flows from financing activities:</b>			
Capital contribution from the Participant of the Company		–	802,400
Cash paid for minority interest in OJSC “Pharmstandard Ufavita”		–	(802,400)
Proceeds from loans and borrowings	15	–	3,875,412
Repayment of loans and borrowings	15	(351,976)	(513,530)
Repayment of loans to related parties		–	(3,994,242)
Proceeds from loans from related parties		–	3,924,242
Repayment of finance lease liabilities		–	(81,955)
<b>Net cash from (used in) financing activities</b>		<b>(351,976)</b>	<b>3,209,927</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(377)</b>	<b>(51,017)</b>
<b>Cash and cash equivalents at the beginning of the year</b>	13	<b>192,966</b>	<b>243,983</b>
<b>Cash and cash equivalents at the end of the year</b>	13	<b>192,589</b>	<b>192,966</b>

The accompanying notes on pages 8-47 are an integral part of these consolidated financial statements.

## Consolidated Statement of Changes in Equity

For the Year Ended 31 December 2007

*(in thousands of Russian Roubles)*

	<b>Equity attributable to equity holders of the parent</b>					
			<b>Net assets attributable to the Participant of the Company</b>			
	<b>Share capital</b>	<b>Retained earnings</b>	<b>Total</b>	<b>Minority interests</b>	<b>Total equity</b>	
<b>Balance at 31 December 2005</b>	–	–	<b>2,790,388</b>	<b>2,790,388</b>	<b>1,134,474</b>	<b>3,924,862</b>
Profit for the period	–	1,265,114	632,557	1,897,671	138,397	2,036,068
Contribution from the Participant of the Company for acquisition of additional shares in OJSC “Pharmstandard Ufavita”	–	–	802,400	802,400	–	802,400
Acquisition of additional shares in OJSC “Pharmstandard Ufavita” by minority shareholders	–	–	–	–	11,986	11,986
Effect of acquisition of additional shares in OJSC “Pharmstandard Ufavita” by the Company	–	–	199,291	199,291	(199,291)	–
Issuance of shares in connection with legal reorganization	37,793	4,386,843	(4,424,636)	–	–	–
Effect of acquisition of minority interest in OJSC “TZMOI”	–	186,949	–	186,949	(621,902)	(434,953)
<b>Balance at 31 December 2006</b>	<b>37,793</b>	<b>5,838,906</b>	<b>–</b>	<b>5,876,699</b>	<b>463,664</b>	<b>6,340,363</b>

*(Continued on next page)*

*The accompanying notes on pages 8-47 are an integral part of these consolidated financial statements.*

OJSC “Pharmstandard”

Consolidated Statement of Changes in Equity (continued)

For the Year Ended 31 December 2007

*(in thousands of Russian Roubles)*

Equity attributable to equity holders of the parent

	<b>Share capital</b>	<b>Retained earnings</b>	<b>Total</b>	<b>Minority interests</b>	<b>Total equity</b>
<b>Balance at 31 December 2006</b>	<b>37,793</b>	<b>5,838,906</b>	<b>5,876,699</b>	<b>463,664</b>	<b>6,340,363</b>
Profit for the period	–	3,227,895	3,227,895	35,345	3,263,240
Disposal of part of an ownership interests in subsidiaries	–	(66,476)	(66,476)	66,476	–
Effect of acquisition of minority interest	–	3,696	3,696	(4,606)	(910)
<b>Balance at 31 December 2007</b>	<b>37,793</b>	<b>9,004,021</b>	<b>9,041,814</b>	<b>560,879</b>	<b>9,602,693</b>

*The accompanying notes on pages 8-47 are an integral part of these consolidated financial statements.*

# OJSC “Pharmstandard”

## Notes to the Consolidated Financial Statements

For the Year Ended 31 December 2007

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

### 1. Corporate Information

OJSC “Pharmstandard” (“the Company”) and its subsidiaries (“the Group”) principal activities are production and wholesale distribution of pharmaceutical and medical products. The Company is incorporated in Russian Federation. Prior to 5 May 2006, the Company was registered as a limited liability company under the name of “Biovit”. In May 2006, the Company was renamed as “Pharmstandard” and reorganised into an open joint stock company. Since May 2007, the Company's shares are publicly traded (Note 18). The Group’s corporate office is in Dolgoprudny, Likhachevsky proezd, 5B, Moscow region, Russian Federation and its manufacturing facilities are based in Kursk, Tomsk, Ufa, Nizhny Novgorod and Tyumen. The Company held shares of voting interests in the following subsidiaries consolidated within the Group as of 31 December 2007 and 2006, respectively:

<b>Entity</b>	<b>Country of incorporation</b>	<b>Activity</b>	<b>2007 % share</b>	<b>2006 % share</b>
1. “Pharmstandard” LLC (*)	Russian Federation	Central procurement	<b>100</b>	99
2. “Pharmstandard-Leksredstva” OJSC	Russian Federation	Manufacturing of pharmaceutical products	<b>99</b>	99
3. “Pharmstandard-Tomskhimpharm” OJSC	Russian Federation	Manufacturing of pharmaceutical products	<b>91</b>	91
4. “Pharmstandard-Ufavita” OJSC	Russian Federation	Manufacturing of pharmaceutical products	<b>94</b>	97
5. “Pharmstandard-Octyabr” OJSC	Russian Federation	Manufacturing of pharmaceutical products	<b>93</b>	93
6. “Pharmstandard-Phitofarm-NN” LLC	Russian Federation	Manufacturing of pharmaceutical products	<b>99</b>	99
7. “TZMOI” OJSC	Russian Federation	Manufacturing of medical equipment	<b>89</b>	90
8. “TMK” LLC**	Russian Federation	Manufacturing of medical equipment	<b>100</b>	100
9. “Masterlek” CJSC	Russian Federation	Manufacturing pharmaceutical products	<b>100</b>	100
10. “Black Bird Investment Enterprises Corp”	British Virgin Islands	Finance company	<b>100</b>	100

\* Before 1 April 2007, this entity performed the functions of managing company and trading house of the Group, which were then transferred to the Company. Since 1 April 2007, Pharmstandard LLC is specialized in procurement activities, primarily representing purchase of API (raw materials) for the Group production entities.

\*\*As of 31 December 2007 this entity is classified as non-current asset held for sale (Note 10).

These consolidated financial statements were authorised for issue by the Board of Directors of the OJSC “Pharmstandard” on 10 April 2008.



## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **2. Basis of Preparation of the Financial Statements**

##### *Statement of compliance*

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

##### *Basis of accounting*

The Group’s Russian entities maintain their accounting records in Russian Roubles (“RR”) and prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation. The statutory financial statements have been adjusted to present these consolidated financial statements in accordance with IFRS. These adjustments principally relate to valuation and depreciation of property, plant and equipment, valuation and amortisation of intangible assets, certain valuation reserves, using fair values for certain assets and derivative instruments, purchase accounting for business combinations and the resulting income tax effects and also to consolidation.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, derivative instruments and certain short-term assets are recorded at fair value and non-current assets classified as held for sale are recorded at the lower of carrying amount and fair value less costs to sell.

##### *Changes in accounting policies*

The accounting policies adopted are consistent with those of the previous financial period except that the Group has adopted those new/revised standards mandatory for financial years beginning on or after 1 January 2007.

The changes in accounting policies result from adoption of the following new or amended standards and interpretations:

- IFRS 7 “Financial Instruments: Disclosures”;
- IAS 1 (amended 2005) “Presentation of Financial Statements – Capital Disclosures”;
- IFRIC 8 “Scope of IFRS 2”;
- IFRIC 9 “Reassessment of Embedded Derivatives”;
- IFRIC 10 “Interim Financial Reporting and Impairment”.

IFRS 7 “Financial Instruments: Disclosures” requires disclosures that enable users to the financial statements to evaluate the significance of the Group’s financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included in these consolidated financial statements. While there has been no effect on the financial position or results, comparative information has been revised where needed.

The amendment of IAS 1 “Presentation of Financial Statements – Capital Disclosures” requires disclosures regarding an entity’s objectives, policies and processes for managing capital. These new disclosures are shown in Note 27.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **2. Basis of Preparation of the Financial Statements (continued)**

IFRIC 8 clarifies that IFRS 2 applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. If the identifiable consideration given appears to be less than the fair value of the equity instrument granted, under IFRIC 8 this situation typically indicates that other consideration has been or will be received. IFRS 2 therefore applies.

IFRIC 9 clarifies, that an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.

IFRIC 10 “Interim Financial Reporting and Impairment” requires that an entity must not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. As the Group had no impairment losses previously reversed, this interpretation had no impact on the financial position of the Group.

There were no significant effects of these changes in policies on these consolidated financial statements. However, the adoption of IFRS 7 will significantly affect the disclosures relating to financial instruments as presented in the Note 27 of these consolidated financial statements.

#### *IFRSs and IFRIC Interpretations not yet effective*

The Group has not applied the following IFRSs and IFRIC Interpretations that have been issued but are not yet effective:

- IFRIC 11 “IFRS 2 - Group and Treasury Share Transactions”;
- IFRIC 12 “Service Concession Arrangements”;
- IFRIC 13 “Customer Loyalty Programmes”;
- IFRIC 14 “The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction”;
- IFRS 8 “Operating segments”;
- IAS 23 (amended 2007) “Borrowing costs”.
- IFRS 2 “Share-based Payments” – Vesting Conditions and Cancellations;
- IFRS 3R “Business Combinations” and IAS 27R “Consolidated and Separate Financial Statements”;
- IAS 1 Revised “Presentation of Financial Statements”;
- Amendments to IAS 32 and IAS 1 “Puttable Financial Instruments”

IFRIC 11 addresses the issues whether the certain transactions should be accounted for as equity-settled or as cash-settled under the requirements of IFRS 2, and concerns the accounting treatment for share-based payment arrangements that involve two or more entities within the same group. An entity shall apply this interpretation for annual periods beginning on or after 1 March 2007.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **2. Basis of Preparation of the Financial Statements (continued)**

IFRIC 12 addresses the accounting issues relating to the service concession arrangements. An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2008.

IFRIC 13 “Customer Loyalty Programmes” was issued in June 2007 and becomes effective for financial years beginning on or after 1 July 2008. This Interpretation requires customer loyalty credits to be accounted for as a separate component of the sales transaction in which they are granted.

IFRIC 14 “The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction” was issued in July 2007 and becomes effective for financial years beginning on or after 1 January 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 19 “Employee benefits”.

IFRS 8 “Operating segments” was issued in November 2006 and becomes effective for financial years beginning on or after 1 January 2009. IFRS 8 requires disclosure of information about the Group’s operating segments and replaced the requirements of disclosures of IAS 14 “Segment reporting”. Entities that do not early adopt IFRS 8 will continue to apply IAS 14 “Segment reporting”.

IAS 23 (amended 2007) “Borrowing costs” is effective for financial years beginning on or after 1 January 2009 and requires capitalization of borrowing costs that relate to a qualifying asset.

IFRS 2 “*Share-based Payments*” – Vesting Conditions and Cancellations.

This amendment to IFRS 2 *Share-based payments* was published in January 2008 and becomes effective for financial years beginning on or after 1 January 2009. The Standard restricts the definition of “vesting condition” to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as a cancellation.

IFRS 3R *Business Combinations* and IAS 27R *Consolidated and Separate Financial Statements*

The revised standards were issued in January 2008 and become effective for financial years beginning on or after 1 July 2009. IFRS 3R introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. IAS 27R requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by IFRS 3R and IAS 27R must be applied prospectively and will affect future acquisitions and transactions with minority interests.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **2. Basis of Preparation of the Financial Statements (continued)**

##### *IAS 1 Revised Presentation of Financial Statements*

The revised IAS 1 *Presentation of Financial Statements* was issued in September 2007 and becomes effective for financial years beginning on or after 1 January 2009. The Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of income and expense recognised in profit or loss, together with all other items of recognised income and expense, either in one single statement, or in two linked statements. The Group is still evaluating whether it will have one or two statements.

##### *Amendments to IAS 32 and IAS 1 Puttable Financial Instruments*

Amendments to IAS 32 and IAS 1 were issued in February 2008 and become effective for annual periods beginning on or after 1 January 2009. The amendment to IAS 32 requires certain puttable financial instruments and obligations arising on liquidation to be classified as equity if certain criteria are met. The amendment to IAS 1 requires disclosure of certain information relating to puttable instruments classified as equity.

The Group expects that the adoption of the pronouncements listed above will have no significant impact on the Group’s result of operations and financial position in the period of initial application.

#### **3. Summary of Significant Accounting Policies**

##### **3.1 Principles of Consolidation**

###### *Subsidiaries*

Subsidiaries, which are those entities in which the Group has an interest of more than 50 percent of the voting rights, or otherwise has power to exercise control over their operations, are consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group and are no longer consolidated from the date that control ceases. All intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

Minority interest is the interest in subsidiaries with equity not held by the Group. Minority interest at the balance sheet date represents the minority shareholders' portion of the fair value of the identifiable assets and liabilities of the subsidiary at the acquisition date and the minorities' portion of movements in equity since the date of the combination. Minority interest is presented as an equity item.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **3. Summary of Significant Accounting Policies (continued)**

##### **3.1 Principles of Consolidation (continued)**

###### *Business combinations*

The purchase method of accounting is used to account for business combinations by the Group. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest.

The excess of purchase consideration over the fair value of the Group’s share of identifiable net assets is recorded as goodwill (Note 3.8). If the cost of the acquisition is less than the fair value of the Group’s share of identifiable net assets of the subsidiary acquired the difference is recognised directly in the statement of operations.

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the Group.

###### *Increases in ownership interests in subsidiaries*

The differences between the carrying values of net assets attributable to interests in subsidiaries acquired and the consideration given for such increases are charged or credited to retained earnings

###### *Acquisition of subsidiaries from parties under common control*

Purchases of subsidiaries from parties under common control are accounted for using the pooling of interest method. The assets and liabilities of the subsidiary transferred under common control are recorded in these consolidated financial statements at the carrying amounts of the transferred entity (the Predecessor) at the date of the transfer. Related goodwill inherent in the Predecessor’s original acquisition is also recorded in these consolidated financial statements. Any difference between the total book value of net assets, including the Predecessor's goodwill, and the consideration paid is accounted for in these consolidated financial statements as an adjustment to equity.

These consolidated financial statements, including corresponding figures, are presented as if the subsidiary had been acquired by the Group on the date it was originally acquired by the Predecessor.

##### **3.2 Cash and Cash Equivalents**

Cash and cash equivalents in the balance sheet comprise cash at banks and in hand and short-term deposits with an original maturity of three months or less.

# OJSC “Pharmstandard”

## Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

### 3. Summary of Significant Accounting Policies (continued)

#### 3.3 Trade Receivables

Trade receivables, which generally have a short term, are carried at original invoice amount less an allowance for any uncollectible amounts. Allowance is made when there is objective evidence that the Group will not be able to collect the debts. Impaired debts are derecognised when they are assessed as uncollectible.

#### 3.4 Value Added Tax

The Russian tax legislation permits settlement of value added tax (“VAT”) on a net basis.

VAT is payable upon invoicing and delivery of goods, performing work or rendering services, as well as upon collection of prepayments from customers. VAT on purchases, even if they have not been settled at the balance sheet date, is deducted from the amount of VAT payable.

Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT.

#### 3.5 Inventories

Inventories are recorded at the lower of cost and net realisable value. Cost is determined on a first in, first out basis. The cost of finished goods and work in progress comprises raw material, direct labour, other direct costs and related production overheads (based on normal operating capacity) but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

#### 3.6 Non-current Assets Held for Sale

An item is classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. Non-current assets held for sale are measured at the lower of carrying amount and fair value less costs to sell.

#### 3.7 Property, Plant and Equipment

Property, plant and equipment are stated at cost or deemed cost at the date of transition to IFRS (herein referred to as cost) less accumulated depreciation and impairment losses. Deemed cost was determined for property, plant and equipment at 1 January 2004 by reference to their fair value through valuation by an independent appraisal company. Depreciation is calculated on a straight-line basis. The depreciation periods, which represent the estimated useful economic lives of the respective assets, are as follows:

	<u>Number of years</u>
Buildings	10 to 50
Plant and machinery	5 to 30
Equipment and motor vehicles	3 to 7

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **3. Summary of Significant Accounting Policies (continued)**

##### **3.7 Property, Plant and Equipment (continued)**

The asset’s residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year end. Land is not depreciated.

Repair and maintenance expenditure is expensed as incurred. Major renewals and improvements are capitalised, and the assets replaced are derecognised. Gains and losses arising from the retirement of property, plant and equipment are included in the statement of operations as incurred.

##### **3.8 Goodwill**

Goodwill on an acquisition of a subsidiary is included in intangible assets. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Group’s cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the Group are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

Impairment is determined by assessing the recoverable amount of the cash-generating unit (group of cash-generating units), to which the goodwill relates. Where the recoverable amount of the cash-generating unit (group of cash-generating units) is less than the carrying amount, an impairment loss is recognised. Where goodwill forms part of a cash-generating unit (group of cash-generating units) and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the cash-generating unit retained.

##### **3.9 Other Intangible Assets**

Intangible assets acquired separately from business combinations are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination are initially recognised at fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. Intangible assets with a finite life are amortised on a straight-line basis over the useful economic lives (for trade marks useful economic life is estimated between 15 and 20 years) and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **3. Summary of Significant Accounting Policies (continued)**

##### **3.10 Investments and Other Financial Assets**

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. The Group does not have held-to-maturity investments.

When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets on initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year end. All regular way purchases and sales of financial assets are recognised on the trade date, which is the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the market place.

##### *Financial assets at fair value through profit or loss*

Financial assets at fair value through profit or loss includes financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated as effective hedging instruments or a financial guarantee contract. Gains or losses on investments held for trading are recognised in profit or loss.

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement loans and receivables are carried at amortised cost using the effective interest method less any allowance for impairment. Gains and losses are recognised in profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

##### *Available-for-sale financial investments*

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial measurement, available-for-sale financial assets are measured at fair value with unrealised gains or losses recognised directly in equity until the investment is derecognised or determined to be impaired at which time the cumulative gain or loss previously recorded in equity is recognised in profit or loss.



## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **3. Summary of Significant Accounting Policies (continued)**

##### **3.10 Investments and Other Financial Assets (continued)**

###### *Fair value*

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm’s length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis or other valuation models.

###### *Amortised cost*

Loans and receivables are measured at amortised cost. This is computed using the effective interest method less any allowance for impairment. The calculation takes into account any premium or discount on acquisition and includes transaction costs and fees that are an integral part of the effective interest rate.

The Group assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

###### *Assets carried at amortised cost*

If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset’s carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss shall be recognised in profit or loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date. Any subsequent reversal of an impairment loss is recognised in profit or loss. For more information in relation to trade receivables see Note 3.3.

###### *Available-for-sale financial investments*

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as available-for-sale are not recognised in profit or loss. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **3. Summary of Significant Accounting Policies (continued)**

##### **3.11 Borrowings**

Borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are measured at amortised cost using the effective interest method; any difference between the fair value of the consideration received (net of transaction costs) and the unwinding of discount is recognised as an interest expense over the period of the borrowings.

Interest costs on borrowings to finance the construction of property, plant and equipment are capitalised, during the period of time that is required to complete and prepare the asset for its intended use. All other borrowing costs are expensed.

##### **3.12 Income Taxes**

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

Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

A deferred tax asset is recorded only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilised. Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and deferred tax liabilities can be offset only if: (a) a Group entity has a legally enforceable right to set off current tax assets against current tax liabilities; and (b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either: (i) the same taxable entity; or (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and joint ventures, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **3. Summary of Significant Accounting Policies (continued)**

##### **3.13 Leases**

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are reflected in the statement of operations.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Operating lease payments are recognised as an expense in the statement of operations on a straight line basis over the lease term.

##### **3.14 Derecognition of Financial Assets and Liabilities**

###### *Financial assets*

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when the rights to receive cash flows from the asset have expired.

###### *Financial liabilities*

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires. Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

##### **3.15 Provisions**

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

Expense relating to any provision is presented in statement of operations. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects where appropriate the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **3. Summary of Significant Accounting Policies (continued)**

##### **3.16 Equity**

###### *Share capital*

Ordinary shares are classified as equity.

###### *Dividends*

Dividends declared by Group subsidiaries are recognised as a liability and deducted from equity at the balance sheet date only if they are declared before or on the balance sheet date. Such dividends are disclosed when they are proposed before the balance sheet date or proposed or declared after the balance sheet date but before the consolidated financial statements are authorised for issue.

##### **3.17 Revenue Recognition**

Revenues are recognised when the title passes to the customer, assuming that collection is reasonably assured and sales price to final customers is fixed or determinable. Revenues are measured at the fair value of the consideration received or receivable.

##### **3.18 Employee Benefits**

Under provision of the Russian legislation, social contributions are made through a unified social tax (“UST”) calculated by the Group by the application of a regressive rate (from 26% to 2%) to the annual gross remuneration of each employee. The Group allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund varies from 20% to 2% depending on the annual gross salary of each employee. The Group’s contributions relating to UST are expensed in the year to which they relate. Total contributions for UST amounted to RR 244,179 during the year ended 31 December 2007 (2006: RR 203,187) and they were classified as labour costs in these consolidated financial statements.

##### **3.19 Foreign Currency Transactions**

The consolidated financial statements are presented in the national currency of the Russian Federation, Russian Rouble (RR), which is the functional currency of the Company and its Russian subsidiaries. Transactions in foreign currencies are initially recorded in the functional currency at the exchange rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the consolidated statement of operations. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **3. Summary of Significant Accounting Policies (continued)**

##### **3.19 Foreign Currency Transactions (continued)**

The functional currency of the foreign operations is the United States Dollar (US\$). As at the reporting date, the assets and liabilities of that subsidiary are translated into the presentation currency of the Group (the Russian Rouble) at the rate of exchange ruling at the balance sheet date and its statement of operations is translated at the weighted average exchange rate for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. In 2007 and 2006, the foreign subsidiary did not perform any operations and held minor assets and liabilities, therefore its translation into the presentation currency had no effect on these consolidated financial statements.

##### **3.20 Impairment of Non-Financial Assets**

The Group assesses at each reporting date whether there is any indication that an asset may be impaired. The assets subject to such assessment are primarily property, plant and equipment and trade marks. If any such indication exists, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or group of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. 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 assessment of the time value of money and the risks specific to the assets.

#### **4. Significant Accounting Judgements and Estimates**

##### **4.1 Judgements**

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimates, which have the most significant effect on the amounts recognised in the consolidated financial statements:

###### *Lease agreements*

A lease is classified as finance lease if it transfers substantially all the risks and rewards incidental to ownership, otherwise it is classified as operating lease. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. If the lease term is for longer than 75 percent of the economic life of the asset, or that at the inception of the lease the present value of the minimum lease payments amount to at least 90 percent of the fair value of the leased asset, the lease is classified by the Group as finance lease, unless it is clearly demonstrated otherwise.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **4. Significant Accounting Judgements and Estimates (continued)**

##### **4.1 Judgements (continued)**

The Group has entered into several lease agreements with the state municipal bodies for land on which the Group’s factories and buildings, comprising the Group’s principal manufacturing facilities, are located. The lease agreements specify lease terms between 10 and 50 years with an option to prolong the lease term for another 10 years. In addition, the lease agreements include a purchase option after termination of the lease. Purchase price will be determined based on fair value of the land as determined by the municipal authorities. The Group has classified these lease agreements as operating leases. More details are provided in Note 8.

##### **4.2 Estimation Uncertainty**

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

###### *Useful life of property, plant and equipment*

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end. If expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”. These estimates may have a material impact on the amount of the carrying values of property, plant and equipment and on depreciation recognised in the statement of operations.

###### *Impairment of non-financial assets*

The determination of impairments involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods, which require the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. These estimates, including the methodologies used, may have a material impact on the fair value and ultimately the amount of any asset impairment.

The following factors are considered in assessing impairment of major specific assets of the Group:

- *Property, plant and equipment*: changes in current competitive conditions, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, technological obsolescence, discontinuance of service, current replacement costs and other changes in circumstances that indicate impairment exists.
- *Trade marks*: changes in current competitive conditions, changes in the regulations, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, introduction of alternative products on the market and other changes in circumstances that indicate impairment exists.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **4. Significant Accounting Judgements and Estimates (continued)**

##### **4.2 Estimation Uncertainty (continued)**

###### *Fair values of assets and liabilities acquired in business combinations*

The Group is required to recognize separately, at the acquisition date, the identifiable assets, liabilities and contingent liabilities acquired or assumed in the business combination at their fair values, which involves estimates. Such estimates are based on valuation techniques, which require considerable judgment in forecasting future cash flows and developing other assumptions.

###### *Impairment of goodwill*

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2007 and 2006 was RR 1,180,469. More details are provided in Note 9.

###### *Allowance for doubtful accounts*

The Group maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected. As of 31 December 2007, allowances for doubtful accounts have been created in the amount of RR 167,933 (2006: RR 79,308).

###### *Inventory provision*

The Group determines the provisions for obsolete or slow moving items of inventories based on their expected future use and realizable value. The net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of sale or distribution. Selling prices and costs to sale are subject to change as new information becomes available. Revisions to the estimates may significantly affect future operating results.

###### *Current taxes*

Russian tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group's entities may be assessed additional taxes, penalties and interest, which can be significant. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As of 31 December 2007 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. More details are provided in Note 26.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 5. Business Combinations

The Group acquired 100% interest in CJSC “Masterlek” (“Masterlek”) which is involved in the marketing and sale of pharmaceutical products and a related immaterial company on 1 August and 22 September 2006, respectively.

The aggregated effect of these acquisitions is presented in the following table:

	<b>Fair value recognised on acquisition</b>	<b>IFRS carrying value immediately before the acquisition</b>
Property, plant and equipment	4,851	4,851
Intangible assets (Note 9)	3,278,151	4,232
Cash and cash equivalents	76,097	76,097
Trade and other receivables	443,810	443,810
Inventories	307,080	307,080
Other current assets	29,187	24,955
	<b>4,139,176</b>	<b>861,025</b>
Trade and other payables	367,589	367,589
Deferred tax liability (Note 25)	787,342	586
	<b>1,154,931</b>	<b>368,175</b>
Fair value of net assets	<b>2,984,245</b>	<b>492,850</b>
Goodwill arising on acquisition (Note 9)	<b>961,615</b>	
Consideration paid	<b>3,945,860</b>	

Goodwill related to the acquisition of Masterlek represents the fair value of the expected synergies and other benefits from combining the Masterlek’s trade marks with production assets of the Group.

From the date of the acquisition to 31 December 2006, CJSC “Masterlek” contributed RR 264,883 (adjusted for the interest expense relating to cost of financing the acquisition) to the net profit of the Group. If the acquisition had taken place at the beginning of the year, the profit of the Group in 2006 would have been RR 2,006,339 (i.e. aggregate profit of the Group and Masterlek as adjusted for the additional interest expense relating to cost of financing the acquisition) and revenue of the Group in 2006 would have been RR 9,374,153.

#### 6. Segment Information

The Group is organised into two main business segments: (1) production and wholesale of pharmaceutical products and (2) production and wholesale of medical equipment. The second segment arose as a result of the acquisition of OJSC TZMOI in 2005 and is entirely represented by OJSC “TZMOI”.



OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**6. Segment Information (continued)**

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, receivables and operating cash. There were no assets unallocated to segments as of 31 December 2007 and 2006. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Segment result is segment revenue less segment expenses. Segment expenses consist of cost of sales, selling and distribution costs, general and administrative expenses and other income and expenses that can be directly attributed to the segment on a reasonable basis. Capital expenditure comprises additions to property, plant and equipment. Impairment loss and provisions relate only to those charges made against allocated assets.

The following table presents revenue and profit and certain asset and liability information regarding the Group’s business segments:

Year ended 31 December 2007	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Eliminations	Group
Sales to external customers	9,762,637	1,608,708	–	11,371,345
<b>Total revenue</b>	<b>9,762,637</b>	<b>1,608,708</b>	<b>–</b>	<b>11,371,345</b>
Gross profit	6,127,524	724,072	–	6,851,596
<b>Segment result</b>	<b>4,163,254</b>	<b>450,333</b>	<b>–</b>	<b>4,613,587</b>
Financial expense, net				(291,638)
<b>Profit before income tax</b>				4,321,949
Income tax expense				(1,058,709)
<b>Net profit</b>				<b>3,263,240</b>
Segment assets	13,711,609	1,582,516	–	15,294,125
<b>Total assets</b>	<b>13,711,609</b>	<b>1,582,516</b>	<b>–</b>	<b>15,294,125</b>
Segment liabilities	1,208,628	96,362	–	1,304,990
Unallocated liabilities				4,386,442
<b>Total liabilities</b>				<b>5,691,432</b>
Capital expenditure (Note 8)	446,758	37,375	–	484,133
Intangible assets acquisition (Note 9)	165,220	–	–	165,220
Non-current financial asset acquisition (Note 14)	245,398	–	–	245,398
Depreciation and amortisation	466,755	60,845	–	527,600

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 6. Segment Information (continued)

Year ended 31 December 2006	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Eliminations	Group
Sales to external customers	7,326,380	1,196,400	–	8,522,780
Inter-segment sales	–	15,867	(15,867)	–
<b>Total revenue</b>	<b>7,326,380</b>	<b>1,212,267</b>	<b>(15,867)</b>	<b>8,522,780</b>
Gross profit	4,551,045	396,091	(5,593)	4,941,543
<b>Segment result</b>	<b>2,817,508</b>	<b>155,543</b>	<b>(5,593)</b>	<b>2,967,458</b>
Financial expense, net				(267,376)
<b>Profit before income tax</b>				2,700,082
Income tax expense				(664,014)
<b>Net profit</b>				<b>2,036,068</b>
Segment assets	12,106,791	1,663,038	–	13,769,829
<b>Total assets</b>	<b>12,106,791</b>	<b>1,663,038</b>	<b>–</b>	<b>13,769,829</b>
Segment liabilities	1,380,061	115,395	–	1,495,456
Unallocated liabilities				5,934,010
<b>Total liabilities</b>				<b>7,429,466</b>
Capital expenditure (Note 8)	882,139	58,455	–	940,594
Intangible assets acquisition (Note 9)	84,317	–	–	84,317
Depreciation and amortisation	226,076	58,721	–	284,797

The Group considers that there is only one geographical segment – Russian Federation and does not present information on secondary segments.

#### 7. Balances and Transactions with Related Parties

In accordance with IAS 24 “Related Party Disclosures”, 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 or operational decisions or if parties are under common control (this includes parents, subsidiaries and fellow subsidiaries). In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not enter, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**7. Balances and Transactions with Related Parties (continued)**

The nature of the related party relationships for those related parties with whom the Group entered into transactions or had balances outstanding at 31 December 2007 and 2006 are detailed below.

*Balances with related parties:*

2007	Trade receivables Note 12	Short-term financial assets Note 14	Cash and cash equivalents Note 13 (c)	Trade payables, other payables and accruals – (a) Note 17
Other related parties <sup>1</sup>	–	5,111	168,836	6,990
<b>Total</b>	<b>–</b>	<b>5,111</b>	<b>168,836</b>	<b>6,990</b>

2006	Trade receivables Note 12	Short-term financial assets Note 14	Cash and cash equivalents Note 13 (c)	Trade payables, other payables and accruals – (b) Note 17
Other related parties <sup>1</sup>	18,974	30,264	124,632	824,723
<b>Total</b>	<b>18,974</b>	<b>30,264</b>	<b>124,632</b>	<b>824,723</b>

- (a) This balance represented obligation for the license fee, described in section “Transactions with related parties” below.
- (b) This balance represented obligation for the voting shares of OJSC “TZMOI” originated from their acquisition in 2005 and 2006 which was fully paid in 2007.
- (c) This balance represented cash at a bank controlled by a related party.

Major conditions of the loans included in short-term financial assets above are as follows:

Caption	Interest rate %		Maturity period	
	2007	2006	2007	2006
Current loans and deposits to related parties	2%	2%	3 months	1-12 months

Cash balances with related bank carry no interest. Cash equivalents represented by deposits with related bank carry 9% interest p.a.

<sup>1</sup> - other related parties represent entities under control of the Company's shareholders having the significant influence over the Company.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 7. Balances and Transactions with Related Parties (continued)

*Transactions with related parties included in the statement of operations:*

<b>Statement of operations caption</b>	<b>Relationship</b>	<b>2007</b>	<b>2006</b>
Sales of medical equipment	Other related parties <sup>1</sup>	–	4,167
License fee (included in distribution costs) (A)	Other related parties <sup>1</sup>	<b>24,522</b>	18,686
Warehouse rental expenses (included in distribution costs) (B)	Other related parties <sup>1</sup>	<b>30,532</b>	19,915
Office rental expenses (included in general and administrative expenses) (B)	Other related parties <sup>1</sup>	<b>14,473</b>	9,494

*(A) License fee*

License fee is paid for use of several trade marks owned by an entity under common control. The license fee is paid on a quarterly basis as 5% of the licensed products output applying the standard price list of the Group.

*(B) Rental expenses*

The Group incurred warehouse and office rental expenses to an other related party.

*Acquisition of intangible assets*

In 2007, the Group acquired an intangible asset (trade mark) for RR 160,000 (2006: RR 84,317) from an other related party.

*Sale of OJSC “Pharmstandard-Octyabr” buildings*

In 2006, the Group terminated operations of “Pharmstandard-Octyabr” OJSC. As a result, buildings of “Pharmstandard-Octyabr” OJSC with the carrying value of RR 103,000 were sold to an other related party in 2006 for cash consideration equal to their carrying value.

*Shareholder’s loan for Masterlek acquisition*

On 2 August 2006, the Group received a loan from the Company’s shareholder in the amount of US\$ 146,200 thousand (RR 3,912,385) for CJSC “Masterlek” acquisition (Note 5). The loan attracted interest rate of 12% per annum.

In December 2006 this shareholder’s loan was refinanced by the syndicated borrowing organised by Citibank (Note 15). Total interest expense incurred in respect of the shareholder’s loan was RR 176,057.

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**7. Balances and Transactions with Related Parties (continued)**

*Compensation to key management personnel*

Key management personnel comprise 3 persons as of 31 December 2007 and 2006. Total compensation to key management personnel, amounted to RR 82,257 for the year ended 31 December 2007 (2006: RR 16,129). Such compensation represented the following short-term employee benefits: (i) payroll and bonuses included in general and administrative expenses and (ii) one-off remuneration for achievement of the IPO-related targets (Notes 18 and 23) included in other expenses in the statement of operations.

**8. Property, Plant and Equipment**

Property, plant and equipment and related accumulated depreciation consist of the following:

	Land	Buildings	Plant and machinery	Equipment and motor vehicles	Assets under construction	Total
<b>31 December 2007</b>						
<b>Cost</b>						
Balance at 31 December 2006	37,654	1,813,350	1,933,214	146,531	228,168	4,158,917
Additions	8,059	–	17,598	67,086	391,390	484,133
Transfers to non-current assets classified as held for sale	(12,731)	–	(81,983)	(1,408)	(79,079)	(175,201)
Transfers	–	–	89,815	10,309	(100,124)	–
Disposals	–	(2,515)	(18,817)	(15,822)	(9,494)	(46,648)
<b>Balance at 31 December 2007</b>	<b>32,982</b>	<b>1,810,835</b>	<b>1,939,827</b>	<b>206,696</b>	<b>430,861</b>	<b>4,421,201</b>
<b>Accumulated Depreciation</b>						
Balance at 31 December 2006	–	111,325	228,123	30,888	–	370,336
Depreciation charge	–	48,890	273,907	34,421	–	357,218
Transfers to non-current assets classified as held for sale	–	–	(13,579)	(378)	–	(13,957)
Disposals	–	(1,636)	(15,686)	(8,743)	–	(26,065)
Impairment charge (a)	–	–	42,403	–	–	42,403
<b>Balance at 31 December 2007</b>	<b>–</b>	<b>158,579</b>	<b>515,168</b>	<b>56,188</b>	<b>–</b>	<b>729,935</b>
<b>Net Book Value</b>						
Balance at 31 December 2006	37,654	1,702,025	1,705,091	115,643	228,168	3,788,581
<b>Balance at 31 December 2007</b>	<b>32,982</b>	<b>1,652,256</b>	<b>1,424,659</b>	<b>150,508</b>	<b>430,861</b>	<b>3,691,266</b>

(a) Impaired assets represented equipment for production of needles for syringes which was terminated by the Group due to low profitability. The impairment charge presented in the table equals to the carrying value of that equipment.

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**8. Property, Plant and Equipment (continued)**

<b>31 December 2006</b>	<b>Land</b>	<b>Buildings</b>	<b>Plant and machinery</b>	<b>Equipment and motor vehicles</b>	<b>Assets under construction</b>	<b>Total</b>
<b>Cost</b>						
Balance at 31 December 2005	49,101	1,591,342	1,162,705	55,521	689,091	3,547,760
Additions	12,738	–	235,693	71,806	620,357	940,594
Acquisition through business combination (Note 5)	–	–	–	4,851	–	4,851
Transfers	–	456,593	590,275	27,869	(1,074,737)	–
Disposals	(24,185)	(234,585)	(55,459)	(13,516)	(6,543)	(334,288)
<b>Balance at 31 December 2006</b>	<b>37,654</b>	<b>1,813,350</b>	<b>1,933,214</b>	<b>146,531</b>	<b>228,168</b>	<b>4,158,917</b>
<b>Accumulated Depreciation</b>						
Balance at 31 December 2005	–	71,929	109,759	17,144	–	198,832
Depreciation charge	–	55,034	146,536	13,929	–	215,499
Transfers	–	79	(7,234)	7,155	–	–
Disposals	–	(15,717)	(20,938)	(7,340)	–	(43,995)
<b>Balance at 31 December 2006</b>	<b>–</b>	<b>111,325</b>	<b>228,123</b>	<b>30,888</b>	<b>–</b>	<b>370,336</b>
<b>Net Book Value</b>						
Balance at 31 December 2005	49,101	1,519,413	1,052,946	38,377	689,091	3,348,928
<b>Balance at 31 December 2006</b>	<b>37,654</b>	<b>1,702,025</b>	<b>1,705,091</b>	<b>115,643</b>	<b>228,168</b>	<b>3,788,581</b>

The Group did not use borrowings to finance capital expenditures, thus no interest expense was capitalized in 2007 and 2006.

The Group assets include only a minor portion of the land on which the Group’s factories and buildings, comprising the Group’s principal manufacturing facilities, are located, whilst the major portion of the land is held under operating lease agreements with the state municipal bodies (Note 4). The total amount of rental payments for the use of the land during 2007 was RR 8,382 (2006: RR 7,962). Such payments are assessed by the state authorities on an annual basis. No such assessment has been completed for 2008.

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

9. Intangible Assets

	<b>Goodwill</b>	<b>Trademarks</b>	<b>Total</b>
<b>Cost</b>			
Balance at 31 December 2006	1,180,469	3,362,468	4,542,937
Additions (Note 7)	–	165,220	165,220
<b>Balance at 31 December 2007</b>	<b>1,180,469</b>	<b>3,527,688</b>	<b>4,708,157</b>
<b>Accumulated Amortisation</b>			
Balance at 31 December 2006	–	69,298	69,298
Amortisation expense	–	170,382	170,382
<b>Balance at 31 December 2007</b>	<b>–</b>	<b>239,680</b>	<b>239,680</b>
<b>Net Book Value</b>			
Balance at 31 December 2006	1,180,469	3,293,170	4,473,639
<b>Balance at 31 December 2007</b>	<b>1,180,469</b>	<b>3,288,008</b>	<b>4,468,477</b>
	<b>Goodwill</b>	<b>Trademarks</b>	<b>Total</b>
<b>Cost</b>			
Balance at 31 December 2005	<b>218,854</b>	<b>2,645</b>	<b>221,499</b>
Additions	–	84,317	84,317
Acquisition through business combination (Note 5)	961,615	3,278,151	4,239,766
Disposals	–	(2,645)	(2,645)
<b>Balance at 31 December 2006</b>	<b>1,180,469</b>	<b>3,362,468</b>	<b>4,542,937</b>
<b>Accumulated Amortisation</b>			
Balance at 31 December 2005	–	–	–
Amortisation expense	–	69,298	69,298
<b>Balance at 31 December 2006</b>	<b>–</b>	<b>69,298</b>	<b>69,298</b>
<b>Net Book Value</b>			
Balance at 31 December 2005	218,854	2,645	221,499
<b>Balance at 31 December 2006</b>	<b>1,180,469</b>	<b>3,293,170</b>	<b>4,473,639</b>

*Impairment testing of goodwill*

Goodwill acquired through business combinations before 2007 has been allocated for impairment testing purposes to the following groups of cash-generating units, which are also reportable segments of the Group:

- production and wholesale of pharmaceutical products group of units (“Pharmaceuticals”); and
- production and wholesale of medical equipment group of units (“Equipment”).

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 9. Intangible Assets (continued)

Carrying amount of goodwill allocated to each group of cash generating units:

	<b>Pharmaceuticals</b>		<b>Equipment</b>		<b>Total</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Carrying amount of goodwill	<b>961,615</b>	961,615	<b>218,854</b>	218,854	<b>1,180,469</b>	1,180,469

The recoverable amount of the cash-generating units has been determined based on a value in use calculation using cash flow projections based on financial budgets approved by management covering a five-year period and cash flows beyond the five-year period are extrapolated using a 20% and 5% growth rate that is the same as the mid-term average growth rate for Pharmaceuticals and Equipment groups of cash-generating units, respectively. The discount rate applied to cash flow projections is 13%.

#### *Key assumption used in value in use calculations*

The calculation of value in use for both Pharmaceuticals and Equipment groups of cash-generating units are most sensitive to the following assumptions:

- Discount rates;
- Raw material price inflation;
- Growth rate used to extrapolate cash flows beyond the budget period.

*Discount rates* - Discount rates reflect management’s estimate of the risks specific to each group of units. This is the benchmark used by management to assess operating performance and to evaluate future investment proposals. In determining appropriate discount rates for each group of units, regard has been given to the interbank interest rate approved by Central Bank of Russian Federation at the beginning of the budgeted year.

*Raw material price inflation* – past actual raw materials price movements have been used as an indicator of future price movements.

*Growth rate estimates* – Rates are based on published industry research.

#### *Sensitivity to changes in assumptions*

Management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of the group of units to materially exceed its recoverable amount.



## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 10. Non-Current Assets Classified as Held for Sale

The Company’s management approved a plan to dispose “TMK” LLC in 2007. “TMK” LLC represents a minor part of the medical equipment and disposables business segment with a total net assets (primarily property, plant and equipment) of RR 164,101. The fair value less the cost of sale of “TMK” LLC is estimated based on the selling price, preliminarily agreed with a third party, amounting to RR 140,000 (Note 28). A loss on non-current assets classified as held for sale amounting to RR 24,101 was recognised in the statement of operations (Note 23).

The remainder of the non-current Assets Classified as Held for Sale amounting to RR 18,855 represent some non-current assets located in St-Petersburg where the Group terminated production operations in 2006. The Group has approved plan for their disposal.

Non-current assets classified as held for sale reflected in the balance sheet as of 31 December 2006 amounting to RR 22,655 were sold in February 2007 for a cash consideration of US\$ 1,311 thousand (RR 34,133).

#### 11. Inventories

Inventories consist of the following:

	2007	2006
Raw materials - at cost	841,703	748,619
Work in progress - at cost	134,554	96,948
Finished goods:		
- at cost	851,052	596,992
- at net realisable value	783,938	561,385
	1,760,195	1,406,952

The amount of write-down of inventories recognised as an expense in 2007 is RR 43,224 (2006: RR 32,606). This expense is included in the cost of sales line item as a cost of materials and components, which is disclosed in Note 20.

#### 12. Trade Receivables

	2007	2006
Trade receivables (net of allowance for impairment of receivables of RR 167,933 (2006: RR 79,308))	4,176,200	3,373,741
	4,176,200	3,373,741

At 31 December 2007 RR 129,304 of trade receivables were denominated in currencies other than Russian Roubles, primarily in US\$ (2006: RR 68,549).

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 12. Trade Receivables (continued)

Movements in allowance for impairment of trade receivables consist of the following:

	<b>2007</b>	<b>2006</b>
Balance at 1 January	79,308	83,049
Additional allowance	95,483	10,596
Written off during the year	(6,858)	(14,337)
Balance at 31 December	<b>167,933</b>	<b>79,308</b>

#### 13. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	<b>2007</b>	<b>2006</b>
Cash in bank – Russian Roubles	119,126	158,239
Cash in bank – US\$ and Euro	13,463	34,727
Short-term bank deposits with original maturity less than 90 days – Russian Roubles	60,000	–
	<b>192,589</b>	<b>192,966</b>

Short term deposits carry interest at 9% per annum.

#### 14. Financial Assets

##### *Short-term financial assets*

	<b>2007</b>	<b>2006</b>
Promissory notes	81,300	34,466
Loans to related parties (Note 7)	5,111	30,264
Trading securities and other	25,488	40,136
	<b>111,899</b>	<b>104,866</b>

##### *Long-term financial assets*

	<b>2007</b>	<b>2006</b>
Non-listed shares	245,398	–
	<b>245,398</b>	<b>–</b>

In December 2007, the Group acquired 19.88% of “Dipaka Trading Limited”, a company registered under the laws of Cyprus, for cash consideration of US\$10 million (RR 245,398). This company is the sole shareholder of the Russian company “Mirpharm” which is involved in pharmaceutical production and distribution and researching. Also, “Dipaka Trading Limited” owns several medical patents and trade marks.

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**15. Borrowings and Loans**

	<u>2007</u>	<u>2006</u>
Long-term borrowings and loans		
(a) Syndicated borrowing organised by Citibank (“Citibank loan”)	<b>3,256,151</b>	3,844,341
(b) Other loans	<b>8,799</b>	31,071
Less: Current portion of long-term borrowings and loans	<b>(1,310,374)</b>	(351,415)
	<b><u>1,954,576</u></b>	<b><u>3,523,997</u></b>

Long-term debt is repayable as follows:

	<u>2007</u>
1 to 2 years	<b>1,319,198</b>
2 to 3 years	<b>317,628</b>
3 to 4 years	<b>317,750</b>
	<b><u>1,954,576</u></b>

As at 31 December 2007 and 2006 all the borrowings are US\$ denominated. The foreign exchange risk in this respect is not covered by any derivative instruments.

- (a) The Citibank loan was provided in December 2006 in two credit facilities:
- Facility A in the total amount of US\$ 91 million with maturity period of 3 years; and
  - Facility B in the total amount of US\$ 55 million with maturity period of 5 years.

Interest rate for facility A was established as 3 month LIBOR plus margin of 1.50% p.a.

Interest rate for facility B was established as 3 month LIBOR plus margin of 1.90% p.a.

In September 2007, when LIBOR rate interest was approximately 5.7%, the Group entered into an Interest Rate Swap agreement in respect to all interest payments due in respect to the Citibank loan basically swapping the LIBOR rate interest obligations into a fixed rate of 4.932% per annum. In this manner the Group protect itself against fluctuations of LIBOR rates. For more details see Note 27.

In addition to interest, the Group is obliged to reimburse mandatory administrative costs, if any incurred by Citibank in connection with the Citibank loan.

The Citibank loan is secured by guarantees issued by all the Group’s subsidiaries.

The Citibank loan agreement establishes certain financial ratios, restrictions on disposal of assets and distribution of dividends.

In 2007, the Group repaid US\$ 13,346 thousand (RR 329,726) of the Citibank loan.

- (b) Other loans mature in September 2009 and bear fixed interest rate 7% per annum.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 16. Other Taxes Payable

Taxes payable, other than income tax, are comprised of the following:

	2007	2006
Value-added tax	157,585	112,482
Property and other taxes	55,221	35,977
	212,806	148,459

#### 17. Trade and Other Payables and Accruals

	2007	2006
Trade payables	766,007	1,071,596
Other payables – related party (Note 7)	6,990	824,723
Other payables and accruals	273,523	196,563
	1,046,520	2,092,882

At 31 December 2007 RR 274,167 of trade payables were denominated in currencies other than Russian Rouble, primarily in US\$ (2006: RR 414,022).

#### 18. Share Capital

In accordance with its charter documents the share capital of the Company is RR 37,793. The authorised number of ordinary shares is 37,792,603 with par value of 1 (one) Russian Ruble. All authorised shares are issued and fully paid. There were no transactions with own shares during 2007.

As at 31 December 2007 and 2006 more than half of voting shares of OJSC “Pharmstandard” were held by “Augment Investments Limited” (“Augment”), a company registered under the laws of Cyprus. None of Augment participants held more than 50% interest in the Company and as a result no individual party ultimately controlled the Group as at 31 December 2007 and 2006 (Note 28).

In May 2007, 16,349,408 ordinary shares representing 43.3 percent of share capital of the Company were sold by Augment to public investors as a result of the Initial Public Offering conducted simultaneously at Russian stock exchanges (RTS and MICEX) where 18.3 percent of the shares were offered and at London stock exchange (LSE) where the remaining 25 percent were offered.

In accordance with Russian legislation, dividends may only be declared from accumulated undistributed and unreserved earnings as shown in Russian statutory financial statements. The Company had approximately RR 3,782,223 of undistributed and unreserved earnings as at 31 December 2007 (2006: RR 2,114,304). In addition, the Company’s share in the undistributed and unreserved earnings of the subsidiaries was approximately RR 7,698,340 as at 31 December 2007 (2006: RR 5,938,296).

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**18. Share Capital (continued)**

In accordance with the Citibank loan agreement (Note 15) the Group shall not pay, make or declare any dividend or other distribution without the prior written consent of the lenders.

Earnings per share are calculated by dividing the net income attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period. The Group has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal basic earnings per share.

**Earnings per Share**

Earnings per share calculated retrospectively are as follows:

	<u>2007</u>	<u>2006</u>
Weighted average number of ordinary shares outstanding	37,793,603	37,793,603
Profit for the year attributable to the shareholders	3,227,895	1,897,671
Basic and diluted earnings per share, Russian Roubles	85.41	50.21

**19. Revenue - Sale of Goods**

The Group’s products are divided into pharmaceuticals, including products sold in the OTC (“Over-the-counter”) market or with a prescription, and medical equipment and disposables.

Sales breakdown by product groups comprised the following:

<u>Product group</u>	<u>2007</u>	<u>2006</u>
<b>Pharmaceutical products</b>		
<b>OTC</b>		
Branded	7,547,567	5,340,643
Non-branded	687,630	690,844
	<u>8,235,197</u>	<u>6,031,487</u>
<b>Prescription</b>		
Branded	1,207,026	899,273
Non-branded	265,836	299,240
	<u>1,472,862</u>	<u>1,198,513</u>
<b>Other</b>	<u>54,578</u>	<u>96,380</u>
<b>Total pharmaceutical products</b>	<u>9,762,637</u>	<u>7,326,380</u>
<b>Medical equipment and disposables</b>	<u>1,608,708</u>	<u>1,196,400</u>
	<u><u>11,371,345</u></u>	<u><u>8,522,780</u></u>

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 20. Cost of Sales

The components of cost of sales were as follows:

	<b>2007</b>	<b>2006</b>
Materials and components	<b>2,997,475</b>	2,360,659
Production overheads	<b>815,557</b>	757,616
Depreciation and amortisation	<b>481,309</b>	260,285
Direct labour costs	<b>225,408</b>	202,677
	<b>4,519,749</b>	3,581,237
	<b>4,519,749</b>	3,581,237

#### 21. Selling and Distribution Costs

Selling and distribution costs were as follows:

	<b>2007</b>	<b>2006</b>
Advertising	<b>753,580</b>	665,108
Labour costs	<b>397,082</b>	215,607
Freight, communication and insurance of goods in transit	<b>126,817</b>	129,831
Utilities and other services	<b>27,031</b>	17,428
Certification expenses	<b>29,092</b>	32,300
Rent	<b>35,211</b>	39,593
Commission and license fee	<b>105,681</b>	75,922
Materials and maintenance	<b>43,430</b>	28,587
Travel and entertainment	<b>43,986</b>	23,397
Depreciation	<b>27,920</b>	10,485
Other expenses	<b>36,211</b>	29,902
	<b>1,626,041</b>	1,268,160
	<b>1,626,041</b>	1,268,160

The Group entered into a number operating lease agreements for warehouses. Rental agreements are revised on an annual basis. Future minimum operating lease payments classified as selling and distribution costs will not substantially change in 2008 compared to 2007.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 22. General and Administrative Expenses

General and administrative expenses were as follows:

	2007	2006
Labour costs	356,500	288,016
Utilities and services	48,050	87,637
Taxes other than income tax	17,589	18,362
Property insurance	13,481	15,772
Freight and communication	20,142	16,159
Depreciation	18,371	14,027
Rent	34,286	22,534
Materials and maintenance	19,745	11,005
Other	42,355	25,417
	570,519	498,929

The Group entered into a number operating lease agreements for office premises. Rental agreements are revised on annual basis. Future minimum operating lease payments classified as are general and administrative expense will not substantially change in 2008 compared to 2007.

#### 23. Other Income and Other Expenses

Other income comprised the following:

	2007	2006
Gain from sale of non-current assets classified as held for sale (Note 10)	11,478	–
Gain from disposal of property, plant and equipment and investments property	3,566	–
Foreign exchange gain	259,098	–
	274,142	–

Other expenses comprised the following:

	2007	2006
Impairment of equipment (Note 8)	42,403	–
Legal, audit, one-off management remuneration (Note 7) and other non-recurring expenses incurred in connection with IPO (Note 18)	110,016	–
Loss from disposal of property, plant and equipment	–	160,145
Charity	4,114	13,082
Other taxes	56,381	32,027
Write-off other short-term financial assets	13,657	–
Loss recognised on non-current assets classified as held for sale (Note 10)	24,101	–
Other	64,919	1,742
	315,591	206,996

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**24. Financial Income and Expense**

Financial income and expense comprised the following:

	<u>2007</u>	<u>2006</u>
Interest income:		
Income from changes of fair value of financial assets recognised in the statement of operations	10,578	–
Income from Interest Rate Swap (Notes 15 and 27)	6,790	–
Interest income from loans and deposits	11,361	23,987
	<u>28,729</u>	<u>23,987</u>
Interest expense:		
Expense from changes in fair value of the Interest Rate Swap (Notes 15 and 27)	44,598	–
Interest expenses on finance lease	–	18,356
Interest expense on borrowings and loans	275,769	273,007
	<u>320,367</u>	<u>291,363</u>

**25. Income Tax**

	<u>2007</u>	<u>2006</u>
Income tax expense – current	1,106,218	811,991
Correction of prior periods after reconciliation with tax authorities (a)	(14,480)	–
Deferred tax expense – origination and reversal of temporary differences	(33,029)	(147,977)
<b>Income tax expense</b>	<u>1,058,709</u>	<u>664,014</u>

(a) The Group identified overpayment of income tax in prior periods as a result of routine reconciliation with tax authorities. As a result, the respective receivable from the budget was recognised.

Income before taxation for financial reporting purposes is reconciled to tax expense as follows:

	<u>2007</u>	<u>2006</u>
<b>Profit before income tax</b>	<u>4,321,949</u>	<u>2,700,082</u>
Theoretical tax charge at statutory rate of 24%	1,037,268	648,020
Correction of prior periods after reconciliation with tax authorities	(14,480)	–
Tax effect of items which are not deductible or assessable for taxation purposes:		
Interest rate swap	10,704	–
Non-deductible expenses and other	25,217	15,994
<b>Income tax expense</b>	<u>1,058,709</u>	<u>664,014</u>



OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**25. Income Tax (continued)**

Movements in deferred tax balances were as follows:

	31 December 2005	Differences recognition and reversal	Effect of business combination in 2006 (Note 5)	31 December 2006	Differences recognition and reversal	31 December 2007
<b>Tax effects of deductible temporary differences – asset (liability):</b>						
Property, plant and equipment (Note 8)	(375,982)	34,994	–	(340,988)	(19,371)	(360,359)
Intangible assets (Note 9)	–	64,990	(786,756)	(721,766)	24,740	(697,026)
Trade and other receivables	(51,646)	6,689	–	(44,957)	49,356	4,399
Inventories	(13,835)	17,522	(3,482)	205	(18,483)	(18,278)
Trade and other payables	–	18,628	2,896	21,524	(1,868)	19,656
Other	–	5,154	–	5,154	(1,345)	3,809
<b>Total net deferred tax liability</b>	<b>(441,463)</b>	<b>147,977</b>	<b>(787,342)</b>	<b>(1,080,828)</b>	<b>33,029</b>	<b>(1,047,799)</b>

The recognition and reversals of temporary differences primarily relates to the following:

- depreciation of property, plant and equipment in excess of the depreciation for tax purposes;
- fair value adjustments on acquisition;
- impairment of trade receivables;
- provisions to write inventory down to net realizable value;
- amortisation of trade marks in excess of the amortisation for tax purposes; and
- deemed cost adjustments upon conversion to IFRS.

The aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognised was approximately RR 7,698,340 as at 31 December 2007 (2006: RR 5,938,296).

**26. Contingencies, Commitments and Operating Risks**

*Operating environment of the group*

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russian Federation continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **26. Contingencies, Commitments and Operating Risks (continued)**

##### *Taxation*

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

As at 31 December 2007 management believes that its interpretation of the relevant legislation is appropriate and that the Group's tax, currency and customs positions will be sustained.

Because of the uncertainties associated with the Russian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as of 31 December 2007. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Should the Russian tax authorities decide to issue a claim and prove successful in the court, they would be entitled to recover the amount claimed, together with fines amounting to 20% of such amount and interest at the rate of 1/300 of the Central Bank of Russian Federation rate for each day of delay for late payment of such amount. Management believes that it is not probable that the ultimate outcome of such matters would result in a liability. Therefore, no provision for these contingencies was recorded in the accompanying financial statements.

##### *Insurance policies*

The Group holds insurance policies in relation to its property, plant and equipment, which cover majority of property, plant and equipment items. The Group holds no insurance policies in relation to its operations, or in respect of public liability.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 27. Financial Instruments and Financial Risk Management Objectives and Policies

##### *Fair values*

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments except trade receivables and trade and other payables. Management believes that fair value of trade receivables and trade and other payables equal their carrying value.

	2007		2006	
	Fair value	Net carrying value	Fair value	Net carrying value
<b>Financial assets</b>				
Cash and cash equivalents (Note 13)	192,589	192,589	192,966	192,966
Short-term loans to related parties (Note 7)	5,111	5,111	30,264	30,264
Promissory notes (Note 14)	81,300	81,300	34,466	34,466
Other short-term investments (Note 14)	25,488	25,488	40,136	40,355
Long-term investment in non-listed shares (Note 14)	245,398	245,398	–	–
<b>Financial liabilities</b>				
Borrowings and loans (Note 15)	3,264,950	3,264,950	3,875,412	3,875,412
Derivative financial instruments	44,598	44,598	–	–
Other non-current liabilities	36,826	36,826	47,767	47,767

Fair values of long-term borrowings and loans are approximately equal to their carrying value as they are based on variable interest rates (LIBOR). Fair value of other non-current liabilities and derivative financial instruments (see below) has been calculated by discounting the expected future cash flows at prevailing interest rates. Fair value of long-term investment in non-listed shares has been determined by reference to its recent purchase price (see Note 14). Fair values of other items above approximate their carrying amounts due to their short maturity.

##### *Financial risk management objectives and policies*

The Group's principal financial instruments comprise bank loans and cash and cash equivalents. The main purposes of these financial instruments are to raise finance for the Group's operations and investment activities. The Group has various other financial assets and liabilities such as promissory notes, trade receivables and trade payables, which relate directly to its operations. During the year the Group did not undertake active trading in financial instruments. To reduce the risk of interest fluctuations related to long term LIBOR borrowings, the Group entered into an interest rate swap agreement (more details see below).

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk, foreign currency risk and credit risk. Management reviews and agrees policies for managing each of these risks which are summarised below.

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

**27. Financial Instruments and Financial Risk Management Objectives and Policies (continued)**

*Interest rate risk*

The Group is exposed to interest rate risk through interest cash flow and market value fluctuations as the majority of interest rates on long-term borrowings are floating and based on LIBOR as disclosed in Note 15.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit before tax for one year assuming the parallel shifts in the yield curves (through the impact on floating rate borrowings and changes in fair value in respect of the Interest Rate Swap):

	<b>Increase/decrease in basis points</b>	<b>Effect on statement of operations (interest expense), US\$ thousand</b>	<b>Effect on statement of operations (due to fair value change), US\$ thousand</b>
<b>As at 31 December 2007</b>			
US Dollar	200	(2,653)	2,093
US Dollar	(200)	2,653	(3,288)
<b>As at 31 December 2006</b>			
US Dollar	200	(2,920)	–
US Dollar	(200)	2,920	–

*Foreign exchange risk*

The Group has US\$ denominated long-term borrowings (see Note 15) and also certain US\$ denominated trade payables (Note 17) and trade receivables (Note 12). Therefore, the Group is exposed to foreign exchange risk.

The Group monitors the foreign exchange risk by following changes in exchange rates in the currencies in which its cash, payables and borrowings are denominated. However, the Group does not have formal arrangements to mitigate this foreign exchange risk.

OJSC “Pharmstandard”

Notes to the Consolidated Financial Statements (continued)

(All amounts are in thousands of Russian Roubles, if not otherwise indicated)

**27. Financial Instruments and Financial Risk Management Objectives and Policies (continued)**

The table below shows the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of the Group's profit before tax:

	<u>Increase/decrease in US\$ rate</u>	<u>Effect on profit before tax, RR</u>
<b>As at 31 December 2007</b>		
US\$/Roubles exchange rate	+7%	(233,902)
US\$/Roubles exchange rate	-7%	233,902
<b>As at 31 December 2006</b>		
US\$/Roubles exchange rate	+7%	(291,473)
US\$/Roubles exchange rate	-7%	291,473

*Liquidity risk*

The Group’s policy is to maintain sufficient cash and cash equivalents or have available funding through an adequate amount of committed credit facilities to meet its operating and financial commitments. The Group performs continuous monitoring of cash deficit risks and continuous monitoring of repayment of its financial liabilities on time. The Group performs daily planning and control cash flow procedures.

The table below summarises the maturity profile of the Group's non-derivative financial liabilities based on contractual undiscounted payments including interest except for trade payables which normally have maturity periods shorter than 90 days.

<b>As at 31 December 2007</b>	<b>Total</b>	<b>Less than 3 months</b>	<b>3 to 6 months</b>	<b>6 to 12 months</b>	<b>1 to 5 years</b>
Borrowings (a)	3,709,520	379,335	379,335	758,669	2,192,181
Other non-current liabilities	79,825	–	–	12,347	67,478
<b>Total</b>	<b>3,789,345</b>	379,335	379,335	771,016	2,259,659
<b>As at 31 December 2006</b>	<b>Total</b>	<b>Less than 3 months</b>	<b>3 to 6 months</b>	<b>6 to 12 months</b>	<b>1 to 5 years</b>
Borrowings (a)	4,525,693	67,427	67,427	486,268	3,904,571
Financial liabilities (b)	824,723	389,770	434,953	–	–
Other non-current liabilities	99,110	–	–	11,665	87,446
<b>Total</b>	<b>5,449,526</b>	457,197	502,380	497,933	3,992,017

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### 27. Financial Instruments and Financial Risk Management Objectives and Policies (continued)

- (a) The Citibank loan received in 2006 (see Note 15 for details) is including contractual principal amount of a debt and interests at the LIBOR rate interest calculated at 31 December 2007 and 2006.
- (b) This balance represents the obligation for the voting shares of OJSC “TZMOI” originated from their acquisition in 2005 and 2006 which was fully paid in 2007 (see Note 7).

#### *Credit Risk*

Financial assets, which potentially are subject to credit risk, consist principally of trade receivables. The Group has policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. Sales to customers are made in accordance with annually approved Marketing and Credit policy. The Group regularly monitors sales and receivables conditions using effective internal control procedures.

The carrying amount of accounts receivable, net of allowance for impairment of receivables, represents the maximum amount exposed to credit risk. Although collection of receivables could be affected by economic factors, management believes that there is no significant risk of loss to the Group beyond the allowance already recorded.

Cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

The table below summarises the Group’s trade receivables aging. The allowances for doubtful accounts is allocated on aggregate basis with the Group’s allowances for doubtful accounts policy (see Note 4).

	<b>Total</b>	<b>Neither impaired nor past due</b>	<b>Not impaired but past due</b>				
			<b>less 1 month</b>	<b>1-2 months</b>	<b>2-3 months</b>	<b>3 to 6 months</b>	<b>&gt; 6 months</b>
31 December 2007	<b>4,176,200</b>	<b>3,240,772</b>	<b>792,664</b>	<b>66,548</b>	<b>49,989</b>	<b>22,335</b>	<b>3,892</b>
31 December 2006	3,373,741	2,682,810	340,278	109,186	60,650	156,240	24,577

#### *Sales concentration to a small group of customers*

The Group works with five distributors that together represent about 50% of the Group’s revenue for 2007 and 2006. Given the Russian market structure limited number of large distributors is not unusual and due to the strong relationships with these distributors, management considers the related credit risk concentration as normal. The Group has no other significant concentrations of credit risk.

## OJSC “Pharmstandard”

### Notes to the Consolidated Financial Statements (continued)

*(All amounts are in thousands of Russian Roubles, if not otherwise indicated)*

#### **27. Financial Instruments and Financial Risk Management Objectives and Policies (continued)**

##### *Capital Risk Management*

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt (while taking into consideration terms and conditions set by the Citibank Loan Agreement, Note 15).

The Group monitors capital using a gearing ratio, which is net debt divided by total capital plus net debt. The Group's policy is to keep the gearing ratio not more than 60%. The Group includes within net debt borrowings and loans, trade and other payables less cash and cash equivalents. Capital includes equity attributable to the equity holders of the parent.

	<b>2007</b>	<b>2006</b>
Borrowings and loans	<b>3,264,950</b>	3,875,412
Trade and other payables	<b>1,046,520</b>	2,092,882
Less: cash and cash equivalents	<b>(192,589)</b>	(192,966)
Net debt	<b>4,118,881</b>	5,775,328
Equity	<b>9,041,814</b>	5,876,699
Capital and net debt	<b>13,160,695</b>	11,652,027
<b>Gearing ratio</b>	<b>31%</b>	50%

#### **28. Post Balance Sheet Events**

##### *Ultimate controlling party*

On 26 March 2008, Victor Kharitonin, a Russian citizen obtained control over more than a half of voting shares of the Company. Therefore he became the Group's ultimate controlling party since that date.

##### *Sale of non-current assets*

The non-current assets classified as held for sale carried in the balance sheet as at 31 December 2007 in the amount of RR 140,000 and represented by TMK LLC (Note 1), were sold in March 2008 for cash consideration of RR 140,000.