

**OJSC "Pharmstandard"**  
**Consolidated financial statements**  
*For the year ended 31 December 2011*

**OJSC "Pharmstandard"**

**Consolidated financial statements**

**For the year ended 31 December 2011**

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## Independent auditors' report

To the Shareholders and Management of OJSC "Pharmstandard"

We have audited the accompanying consolidated financial statements of OJSC "Pharmstandard" and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2011, and the consolidated statement of comprehensive income, consolidated cash flow statement and consolidated statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

### ***Management's responsibility for the consolidated financial statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditors' responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



**Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2011, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Ernst & Young LLC*

23 April 2012

**OJSC "Pharmstandard"**

**Consolidated statement of financial position as at 31 December 2011**

*(in thousands of Russian Roubles)*

	Notes	2011	2010
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	11	5,543,692	4,168,079
Intangible assets	12	6,717,624	6,686,210
Prepayment for subsidiary acquisition	5	-	184,072
		<u>12,261,316</u>	<u>11,038,361</u>
<b>Current assets</b>			
Inventories	13	7,145,291	7,466,214
Trade and other receivables	14	14,247,421	12,376,059
VAT recoverable		369,712	480,142
Prepayments	15	745,734	219,621
Short-term financial assets	17	3,446,041	3,682,023
Cash and short term deposits	16	5,383,072	4,156,258
		<u>31,337,271</u>	<u>28,380,317</u>
Non-current assets classified as held for sale	8	18,030	-
<b>Total assets</b>		<u><u>43,616,617</u></u>	<u><u>39,418,678</u></u>
<b>Equity and liabilities</b>			
<b>Equity attributable to equity holders of the parent</b>			
Share capital	21	37,793	37,793
Treasury shares	7	(1,825)	-
Foreign currency translation reserve		24,923	(245)
Retained earnings		29,718,088	26,409,993
		<u>29,778,979</u>	<u>26,447,541</u>
Non-controlling interests		514,968	428,214
<b>Total equity</b>		<u><u>30,293,947</u></u>	<u><u>26,875,755</u></u>
<b>Non-current liabilities</b>			
Deferred tax liability	28	581,790	642,334
Derivative financial instruments		-	11,249
Other non-current liabilities		9,265	-
		<u>591,055</u>	<u>653,583</u>
<b>Current liabilities</b>			
Trade and other payables	9,20	11,234,988	10,747,197
Short-term borrowings and loans	18	733,550	395,823
Income tax payable		163,792	223,006
Other taxes payable	19	599,285	523,314
		<u>12,731,615</u>	<u>11,889,340</u>
<b>Total liabilities</b>		<u><u>13,322,670</u></u>	<u><u>12,542,923</u></u>
<b>Total equity and liabilities</b>		<u><u>43,616,617</u></u>	<u><u>39,418,678</u></u>

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

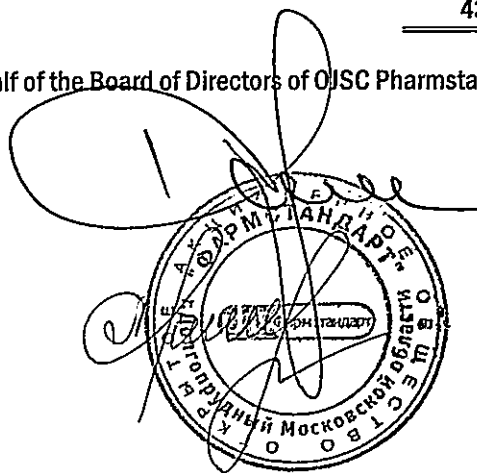
Chief Executive Officer

I.K. Krylov

Chief Financial Officer

E.V. Arkhangelskaya

23 April 2012



OJSC "Pharmstandard"

Consolidated statement of comprehensive income

For the year ended 31 December 2011

(in thousands of Russian Roubles)

	Notes	2011	2010
Revenue	22	42,653,887	29,686,636
Cost of sales	23	(26,728,419)	(16,700,838)
<b>Gross profit</b>		<b>15,925,468</b>	<b>12,985,798</b>
Selling and distribution costs	24	(3,642,115)	(2,916,202)
General and administrative expenses	25	(1,196,149)	(891,954)
Other income	26	294,693	188,025
Other expenses	26	(332,596)	(488,852)
Financial income	27	231,519	315,167
Financial expense	27	(43,235)	(47,680)
<b>Profit before income tax</b>		<b>11,237,585</b>	<b>9,144,302</b>
Income tax expense	28	(2,404,948)	(1,980,506)
<b>Profit for the year</b>		<b>8,832,637</b>	<b>7,163,796</b>
<b>Other comprehensive income</b>			
Exchange differences on translation of foreign operations		29,136	(245)
<b>Other comprehensive income for the year</b>		<b>29,136</b>	<b>(245)</b>
<b>Total comprehensive income for the year</b>		<b>8,861,773</b>	<b>7,163,551</b>
<b>Profit for the year</b>			
Attributable to:			
Equity holders of the Parent		8,780,520	7,149,543
Non-controlling interests		52,117	14,253
		<b>8,832,637</b>	<b>7,163,796</b>
<b>Total comprehensive income for the year</b>			
Attributable to:			
Equity holders of the Parent		8,805,688	7,149,298
Non-controlling interests		56,085	14,253
		<b>8,861,773</b>	<b>7,163,551</b>
Earnings per share (in Russian roubles)			
- basic and diluted, based on profit for the year attributable to equity holders of the Parent	21	242.07	189.18

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

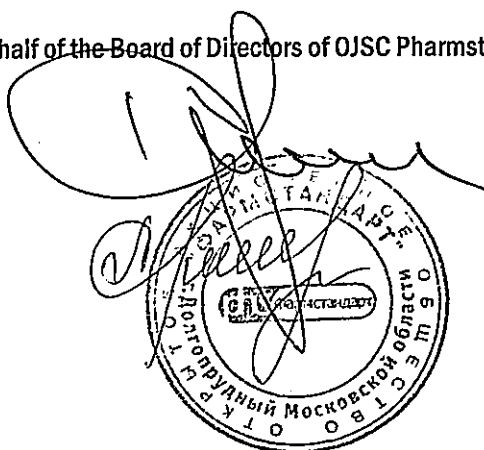
Chief Executive Officer

I.K. Krylov

Chief Financial Officer

E.V. Arkhangelskaya

23 April 2012



**OJSC "Pharmstandard"**

**Consolidated cash flow statement**

**For the year ended 31 December 2011**

*(in thousands of Russian Roubles)*

	Notes	2011	2010
<b>Cash flows from operating activities:</b>			
Profit before income tax		11,237,585	9,144,302
Adjustments for:			
Depreciation and amortisation	11,12	888,859	792,016
Change in allowance for impairment of financial assets	14,26	111,606	(42,815)
Write-down of inventories to net realizable value	13	52,778	43,068
Loss recognized on non-current assets classified as held for sale	8,26	16,537	-
Reversal of impairment - intangible assets	12,26	-	(29,258)
Impairment charge and reversal of impairment - property, plant and equipment	11,26	45,736	76,002
(Gain) loss from disposal of property, plant and equipment	26	(22,619)	5,311
Foreign exchange (gain) loss		(22,947)	4,412
Gain from disposal of financial assets	26	-	(47,487)
Expense related to the joint venture	6.1,26	53,142	248,298
Financial income	27	(231,519)	(315,167)
Financial expense	27	43,235	47,680
<b>Operating cash flows before working capital changes</b>		<b>12,172,393</b>	<b>9,926,362</b>
Increase in trade and other receivables	14	(1,800,534)	(2,956,557)
Decrease (increase) in inventories	13	416,459	(4,750,590)
Decrease (increase) in VAT recoverable		111,789	(221,210)
Increase in trade prepayments	15	(497,438)	(82,892)
(Decrease) increase in trade payables and other payables	20	(2,917)	6,815,907
Increase (decrease) increase in taxes payable other than income tax		76,069	(45,212)
<b>Cash generated from operations</b>		<b>10,475,821</b>	<b>8,685,808</b>
Income tax paid	28	(2,546,132)	(2,326,126)
Interest paid		(40,839)	(45,063)
Interest received		168,077	197,294
<b>Net cash from operating activities</b>		<b>8,056,927</b>	<b>6,511,913</b>
<b>Cash flows from investing activities:</b>			
Purchase of property, plant and equipment	11	(1,751,518)	(1,051,934)
Purchase of intangible assets	12	-	(806,032)
Cash paid for subsidiary acquisition	5	(202,226)	(184,072)
Cash in acquired subsidiary	5	5,702	-
Cash received from sale property, plant and equipment		42,213	5,783
Cash received from sale of short-term financial assets	17	2,012,351	772,048
Cash paid for short-term financial assets	17	(1,786,820)	(3,311,700)
Cash paid for other financial assets		-	(481,065)
Cash received from sale of other financial assets		-	528,552
Cash paid for acquisition of assets transferred to the joint venture	26	-	(248,298)
Loans provided to related parties		-	(1,400,000)
Loans repaid by related parties		-	1,400,000
<b>Net cash used in investing activities</b>		<b>(1,680,298)</b>	<b>(4,776,718)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from loans and borrowings	18	2,332,250	1,300
Repayment of loans and borrowings	18	(2,010,994)	(395,087)
Cash paid for treasury shares	7	(5,474,250)	-
Cash received from sale of treasury shares		-	16,690
<b>Net cash used in financing activities</b>		<b>(5,152,994)</b>	<b>(377,097)</b>
<b>Net increase in cash and cash equivalents</b>		<b>1,223,635</b>	<b>1,358,098</b>
<b>Net foreign exchange differences</b>		<b>3,179</b>	<b>-</b>
<b>Cash and cash equivalents at the beginning of the year</b>	16	<b>4,156,258</b>	<b>2,798,160</b>
<b>Cash and cash equivalents at the end of the year</b>	16	<b>5,383,072</b>	<b>4,156,258</b>

OJSC "Pharmstandard"

Consolidated statement of changes in equity

For the year ended 31 December 2011

(in thousands of Russian Roubles)

	Equity attributable to equity holders of the parent						Non-controlling Interests	Total equity
	Share capital	Treasury shares	Foreign currency translation reserve	Retained earnings	Total	Total		
<b>Balance at 31 December 2009</b>	37,793	(6)	-	19,243,766	19,281,553	4,13,961	19,695,514	
Profit for the year	-	-	-	7,149,543	7,149,543	14,253	7,163,796	
Other comprehensive income for the year	-	-	(245)	-	(245)	-	(245)	
<b>Total comprehensive income for the year</b>	-	-	(245)	7,149,543	7,149,298	14,253	7,163,551	
Sales of treasury shares	-	6	-	16,684	16,690	-	16,690	
<b>Balance at 31 December 2010</b>	<b>37,793</b>	-	(245)	<b>26,409,993</b>	<b>26,447,541</b>	<b>428,214</b>	<b>26,875,755</b>	
Profit for the year	-	-	-	8,780,520	8,780,520	52,117	8,832,637	
Other comprehensive income for the year	-	-	25,168	-	25,168	3,968	29,136	
<b>Total comprehensive income for the year</b>	-	-	25,168	8,780,520	8,805,688	56,085	8,861,773	
Acquisition of subsidiary (Note 5)	-	-	-	-	-	30,669	30,669	
Acquisition of treasury shares (Note 7)	-	(1,825)	-	(5,472,425)	(5,474,250)	-	(5,474,250)	
<b>Balance at 31 December 2011</b>	<b>37,793</b>	<b>(1,825)</b>	<b>24,923</b>	<b>29,718,088</b>	<b>29,778,979</b>	<b>514,968</b>	<b>30,293,947</b>	

The accompanying notes on pages 7-50 are an integral part of these consolidated financial statements.



# OJSC "Pharmstandard"

## Notes to the consolidated financial statements

For the year ended 31 December 2011

*(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 the Russian Federation. Since May 2007, the Company's shares are publicly traded (Note 21). 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, Tyumen (all Russian Federation) and Kharkov (Ukraine). The Company holds the shares in joint ventures and controlled the following subsidiaries consolidated within the Group as at 31 December 2011 and 2010:

Entity	Country of Incorporation	Activity	2011 % share	2010 % share
<b>Subsidiaries:</b>				
1. "Pharmstandard" LLC	Russian Federation	Central procurement	100	100
2. "Pharmstandard-Leksredstva" OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
3. "Pharmstandard-Tomskhimpharm" OJSC	Russian Federation	Manufacturing of pharmaceutical products	91	91
4. "Pharmstandard-Ufavita" OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
5. "Pharmstandard-Biolik" PJSC	Ukraine	Manufacturing of pharmaceutical products	55	-
6. "TZMOI" OJSC	Russian Federation	Manufacturing of medical equipment	100	100
7. Donelle Company Limited	Cyprus	Finance and holding Company	89	89
8. Aphopharm CJSC	Russian Federation	Assets holder	89	89
9. MDR Pharmaceuticals	Cyprus	Assets holder	50.05	50.05
10. Vindexpharm CJSC	Russian Federation	Assets holder	100	100
11. "Pharmstandard-Phitofarm-NN" LLC*	Russian Federation	Manufacturing of pharmaceutical products	99	99
<b>Joint ventures:</b>				
12. "NauchTechStroy Plus" LLC**	Russian Federation	Distributing of medical equipment	37.5	50
13. Moldildo Trading Limited***	Cyprus	Intermediary holding company	75	-
14. "Pharmstandard-Medtechnika" LLC***	Russian Federation	Research and development Company	75	-

\* As of 31 December 2011 this entity is classified as non-current asset held for sale (Note 8).

\*\* This joint venture was formed in February 2010 and it is in start up phase now (see Note 6.1).

\*\*\* This joint venture was formed in June 2011 and since 3<sup>rd</sup> Quarter 2011 started its activity (see Note 6.2).

These consolidated financial statements were authorised for issue by the Board of Directors of OJSC "Pharmstandard" on 23 April 2012.

## 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") as issued by the International Accounting Standards Board (IASB).

##### *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 Group's Ukrainian subsidiary maintains its accounting records in Ukrainian Hryvnia ("UAH") and prepares its statutory financial statements in accordance with the Provisions (Standards) of Accounting in Ukraine. 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 allowances, using fair values for certain assets and derivative instruments, acquisition accounting for business combinations and the resulting income tax effects, and also to consolidation of subsidiaries.

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 the following new and amended IFRS and IFRIC interpretations as of 1 January 2011.

The changes in accounting policies result from adoption of the following new or revised standards:

- Amendment to IAS 24 *Related Party Disclosures*;
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*;
- Amendment to IAS 32 *Financial Instruments: Presentation* – Classification of rights issues denominated in a foreign currency;
- Amendment to IFRIC 14/ IAS 19 - *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction* – Prepayment of a minimum funding requirement;
- Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards – Limited Exemption from Comparative IFRS 7 Disclosures for First-time Adopters*;

## 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)

##### *Changes in accounting policies (continued)*

- Improvements to IFRSs-2010, effective for annual periods beginning on or after 1 July 2010 or effective for annual periods beginning on or after 1 January 2011 – a new collection of amendments to IFRSs that will not be included as part of another major project. The following table shows the list of IFRSs where amendments have been made that can result in accounting changes for presentation, recognition or measurement purposes and the topics addressed by these amendments:

IFRS (amended in 2010)	Subject of amendment
IFRS 3R <i>Business Combinations</i> , effective from 1 July 2010	Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS Limiting the accounting policy choice to measure non-controlling interests upon initial recognition Un-replaced and voluntarily replaced share-based payment awards
IAS 27R <i>Consolidated and Separate Financial Statements</i> , effective from 1 July 2010	Clarifying that the amendments to IAS 21, IAS 28 and IAS 31 resulting from IAS 27R should be applied prospectively
IFRS 1 <i>First-time Adoption of IFRSs</i>	Accounting policy changes (IAS 8) in the year of adoption is not applicable Introducing guidance for entities that publish interim financial in the year of adoption Revaluation basis as deemed cost Use of deemed cost for operations subject to rate regulation
IFRS 7 <i>Financial Instruments: Disclosures</i>	Amending and removing existing disclosure requirements
IAS 1 <i>Presentation of Financial Statements</i>	Clarification of statement of changes in equity
IAS 34 <i>Interim Financial Reporting</i>	Events and transactions that require disclosure under IAS 34
IFRIC 13 <i>Customer Loyalty Programmes</i>	Clarification of fair value of award credits

The amendment to IAS 24 is twofold. The amendment clarified the definition of a related party, however, without changing the fundamental approach to related party disclosures. It emphasises a symmetrical view on related party relationships and clarifies how a person or key management personnel impacts related party relationships of an entity. Furthermore, the amendment provides for an exemption to related party disclosures for government-related entities. The amendment is effective for financial years beginning on or after 1 January 2011.

IFRIC 19 is effective for annual periods beginning on or after 1 July 2010 and it clarifies that equity instruments issued to a creditor to extinguish a financial liability are consideration paid in accordance with paragraph 41 of IAS 39 *Financial Instruments Recognition and Measurement*. The equity instruments issued are measured at their fair value, unless this cannot be reliably measured, in which case, they are measured at the fair value of the liability extinguished. Any gain or loss is recognized immediately 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)*

#### 2. Basis of preparation of the financial statements (continued)

##### *Changes in accounting policies (continued)*

Amendment to IAS 32 *Financial Instruments: Presentation – Classification of Rights Issues* classifies certain rights issues, options or warrants as equity instruments. This is applicable if the rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, in order to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency. The amendment is effective for financial years beginning on or after 1 February 2010.

Amendment to IFRIC 14/ IAS 19 – *The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction* – Prepayment of a minimum funding requirement was made to remove an unintended consequence when an entity is subject to minimum funding requirements and makes an early payment of contributions to cover those requirements. The amendment permits a prepayment of future service cost by the entity to be recognized as a pension asset. The amendment is effective for financial years beginning on or after 1 January 2011.

Amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* – Limited Exemption from Comparative IFRS 7 *Disclosures for First-time Adopters*. IFRS 1 has been amended to allow first-time adopters to utilize the transitional provisions of IFRS 7 *Financial Instruments: Disclosures* as they relate to the March 2009 amendments to the standard. These provisions give relief from providing comparative information in the disclosures required by amendments to IFRS 1 in the first year of application. The amendment is effective for financial years beginning on or after 1 July 2010.

There were no significant effects of these changes in accounting policies on the financial position or performance of the Group.

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

The following Standards and Interpretations were in issue up to the date of issuance of consolidated financial statements which were relevant to the Group's operations but not yet effective:

- IFRS 7 *Financial Instruments: Disclosures* – Requires additional disclosure about financial assets that have been transferred but not recognised and continuing involvement in derecognised assets (effective for annual periods beginning on or after 1 July 2011).
- IFRS 9 *Financial Instruments – Classification and Measurement* (effective for annual periods beginning on or after 1 January 2015).
- IAS 12 *Income Taxes – Deferred Tax: Recovery of Underlying Assets* (effective for annual periods beginning on or after 1 January 2012).
- IFRS 10 *Consolidated Financial Statements* replaces the consolidation guidance in IAS 27 *Consolidated and Separate Financial Statements* (effective for annual periods beginning on or after 1 January 2013).
- IFRS 11 *Joint Arrangements* – Introduces new accounting requirements for joint arrangements (effective for annual period beginning on or after 1 January 2013).

## 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)

##### *IFRSs and IFRIC interpretations not yet effective (continued)*

- IFRS 12 *Disclosure of Interests in Other Entities* – Requires enhanced disclosures about both consolidated and unconsolidated entities (effective for annual period beginning on or after 1 January 2013).
- IFRS 13 *Fair Value Measurement* – Definition, guidance and disclosure requirements about fair value measurements (effective for annual periods beginning on or after 1 January 2013).
- IAS 27 *Separate Financial Statements* – The consolidation guidance in IAS 27 is replaced by IFRS 10. The requirements relating to separate financial statements are unchanged (effective for annual periods beginning on or after 1 January 2013).
- IAS 28 *Investments in Associates and Joint Ventures* – Amendments for conforming changes based on the issuance of IFRS10, IFRS11 and IFRS12 (effective for annual periods beginning on or after 1 January 2013).
- IAS 1 *Presentation of Financial Statements* – Amendments to revise the way other comprehensive income is presented (effective for annual periods beginning on or after 1 July 2012).
- IAS 19 *Employee Benefits* – Amended standard resulting from the Post-Employment Benefits and Termination Benefit projects (effective for annual periods beginning on or after 1 January 2013).
- IAS 32 *Financial Instruments: Presentation* – Amendments for offsetting financial assets and financial liabilities (effective for annual periods beginning on or after 1 January 2014).

##### *Adoption of new and revised International Financial Reporting Standards*

Management anticipates that the adoption of these Standards and Interpretations in future periods will have no impact on the results and financial position presented in these consolidated financial statements other than changes to the disclosures required in the consolidated financial statements except for IFRS 9 *Financial Instruments* issued in November 2009 and amended in October 2010 and IFRS 11 *Joint Arrangements* issued in May 2011. The Group does not intend to adopt these standards before their effective date.

IFRS 9 introduces new requirements for the classification and measurement of financial assets and financial liabilities and for derecognition.

- IFRS 9 will change the categories of financial assets to those that are carried at amortised cost and those that are carried at fair value. This will mainly affect the classification of the Group's available for sale financial assets and held to maturity investments.
- IFRS 9 will also affect the accounting for changes in fair value of a financial liability (designated as at fair value through profit or loss) attributable to changes in the credit risk of that liability. In particular for financial liabilities that are designated as at fair value through profit or loss, the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is recognised in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at fair value through profit or 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)*

#### 2. Basis of preparation of the financial statements (continued)

##### *Adoption of new and revised International Financial Reporting Standards (continued)*

IFRS 11 *Joint Arrangements* will replace IAS 31 *Investments in Joint Ventures*. The standard will remove the option to proportionately recognise the assets and liabilities of jointly controlled entities and equity accounting will be the only accounting treatment. The standard which will be applied retrospectively will result in a reduction in all assets, liabilities, income and expenses leaving net assets and profit for the period unchanged. The Group is currently in the process of quantifying the effect of introduction of IFRS 11.

#### 3.1 Basis of consolidation

##### *Subsidiaries*

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such 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.

Non-controlling interest is the equity in a subsidiary not attributable, directly or indirectly, to the Group. The interests of non-controlling shareholders are initially measured at the non-controlling interests' proportionate share of the fair value of the acquiree's identifiable net assets. Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive income within a subsidiary is attributed to the non-controlling interest even if that results in a deficit balance.

Non-controlling interest is presented as an equity item, separately from the equity of the owners of the parent.

##### *Business combinations*

The acquisition 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 non-controlling interest. For each business combination, the Group measures the non-controlling interest in the acquired subsidiary at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses.

The excess of purchase consideration over the fair value of the Group's share of identifiable net assets is recorded as goodwill (Note 3.6). 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 profit or loss.

Prior to 1 January 2010, business combinations were accounted for using the purchase method. Transaction costs directly attributable to the acquisition formed part of the acquisition costs. The non-controlling interest (formerly known as minority interest) was measured at the proportionate share of the acquiree's identifiable net assets.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 3.1 Basis of consolidation (continued)

##### *Interest in joint ventures*

The Group has interests in joint ventures which are jointly controlled entities, whereby the ventures have a contractual arrangement that establishes joint control over the economic activities of the entities. The Group recognises its interests in the joint ventures using the proportionate consolidation method. The Group combines its proportionate share of each of the assets, liabilities, income and expenses of the joint venture with similar items, line by line, in its consolidated financial statements. The financial statements of the joint ventures are prepared for the same reporting period as the parent company. Adjustments are made where necessary to bring the accounting policies in line with those of the Group.

Adjustments are made in the Group's consolidated financial statements to eliminate the Group's share of intra group balances, income and expenses and unrealised gains and losses on transactions between the Group and its jointly controlled entity. Losses on transactions are recognised immediately if the loss provides evidence of a reduction in the net realisable value of current assets or an impairment loss. The joint venture is proportionately consolidated until the date on which the Group ceases to have joint control over the joint venture.

#### 3.2 Cash and short-term deposits

Cash and short-term deposits in the statement of financial position comprise cash at banks and in hand, short-term deposits with an original maturity of three months or less and cash deposits placed to secure participation in the state open auctions with an original maturity of three months or less.

For the purpose of the consolidated cash flow statement cash and cash equivalents consist of cash and short-term deposits as defined above net of outstanding bank overdrafts.

Interest receivable on deposits is classified as other receivables.

#### 3.3 Value added tax

The Russian and Ukrainian tax legislation permits settlement of value added tax ("VAT") on a net basis within one legal entity.

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 reporting 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.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 3.4 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.

#### 3.5 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, motor vehicles and other	2 to 7

The asset's residual values, useful lives and depreciation 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 profit or loss as incurred.

#### 3.6 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.



## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 3.7 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 profit or loss in the expense category consistent with the function of the intangible asset.

#### 3.8 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 and financial assets at fair value through profit or loss.

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.

##### *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 the 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 other categories. After initial measurement, 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 the profit or loss, is transferred from other comprehensive income 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 the 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.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 3.8 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 reporting 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.

##### *Impairment of financial assets*

The Group assesses at each reporting 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 the 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 the profit or loss. For more information in relation to trade receivables see Note 3.3.

#### 3.9 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.

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.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 3.10 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 reporting 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.

The effect from a change in tax rates is recognised in profit or loss except to the extent that it relates to items previously charged or credited to other comprehensive income.

#### 3.11 Leases

Operating lease payments are recognised as an expense in the profit or loss on a straight line basis over the lease term.

#### 3.12 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.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 3.12 Derecognition of financial assets and liabilities (continued)

##### *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 profit or loss.

#### 3.13 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 profit or loss. 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.

#### 3.14 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 reporting date only if they are declared before or on the reporting date. Such dividends are disclosed when they are proposed before the reporting date or proposed or declared after the reporting date but before the consolidated financial statements are authorised for issue.

##### *Treasury shares*

Own equity instruments that are reacquired are recognised at cost and deducted from equity. No gain or loss is recognised in the consolidated statement of comprehensive income on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the face value of shares and the consideration paid for treasury shares is recognised in retained earnings.

#### 3.15 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 excluding discounts and rebates.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 3.16 Employee benefits

In 2011, the Group allocated social contributions primarily under provisions of the Russian legislation.

In 2011, under provision of the Russian legislation, social contributions are made through a social tax ("ST") calculated by the Group by the application of a ST rate 34% to the gross remuneration of each employee. The rate 34% was applicable only to the gross remuneration of each employee not more than RR 463 calculated from the beginning of the year. The Group allocates the ST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund was 26% depending on the annual gross salary of each employee. The Group's contributions relating to ST are expensed in the year to which they relate.

Total contributions for ST amounted to RR 537,901 during the year ended 31 December 2011 (2010: RR 335,067) and they were classified as labour costs in these consolidated financial statements.

In addition, the Russian legislation provides for a decrease the current ST rate from 34% to 30% effective from 1 January 2012. Furthermore, the new ST rate 30% will be applicable to the gross remuneration of each employee not more than RR 512 calculated from the beginning of the year and ST rate 10% will be applicable in excess of the gross remuneration of RR 512 from the moment of excess until the year end.

#### 3.17 Foreign currency transactions

The consolidated financial statements are presented in Russian Roubles, 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 reporting date. All resulting differences are taken to profit or loss. 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.

At 31 December 2011, the exchange rates used for translation foreign currency balances were US\$ 1 = 32.20 roubles; Euro 1 = 41.67 roubles; 1 Ukrainian Hryvnia = 4.01 roubles (2010: US\$ 1 = 30.48 roubles; Euro 1 = 40.33 roubles).

The functional currency of the foreign operations of the Ukrainian subsidiary is the Ukrainian Hryvnia (Note 5). The functional currency of the other foreign operations is the United States dollar (US\$). As at the reporting date, the assets and liabilities of those subsidiaries are translated into the presentation currency of the Group (the Russian Rouble) at the rate of exchange ruling at the reporting date and its statement of comprehensive income 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.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 3.18 Impairment of non-financial assets

At each reporting date the Group assesses whether there is any indication that an asset or cash generating unit (CGU) may be impaired. The assets or CGUs 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 or CGU's recoverable amount. An asset's or CGU'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. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset or CGU 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 or CGUs.

#### 4. Significant accounting judgements and estimates

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting 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 and intangible assets*

The Group assesses the remaining useful lives of items of property, plant and equipment and intangible assets 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 intangible assets and on depreciation and amortization recognised in profit or loss.

##### *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 an asset or 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 asset or 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.

## 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)

##### *Impairment of non-financial assets (continued)*

- *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.

##### *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 2011 was RR 1,561,361 (2010: RR 1,180,469). More details are provided in Note 12.

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

The Group maintains an allowance for doubtful accounts receivable 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 receivable, 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 at 31 December 2011, allowances for doubtful accounts receivable amounted to RR 135,600 (2010: RR 48,781). More details are provided in Note 14.

##### *Allowance for write-down of inventories to net realizable value*

The Group determines the allowance for write-down of inventories to net realizable value 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.

##### *Fair value of derivatives*

The fair value of derivatives is determined using valuation techniques. These valuation techniques are based on assumptions such as future interest rate changes and the applicable notional amount. Management believes the estimated fair values resulting from the valuation technique which are recorded in the statement of financial position and the related changes in the fair values recorded in the profit or loss are reasonable and the most appropriate at the reporting date.

## 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)

##### *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 2011 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 29.

##### *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.

#### 5. Business combinations

##### *PJSC "Biolik" acquisition*

In 4<sup>th</sup> quarter 2010 the Company signed contracts with shareholders of Public Joint Stock Company "Kharkov Enterprise on Immunobiological and Medical Substances Production "Biolik" ("Biolik") with the purpose to acquire 55% of the ordinary voting shares of "Biolik", a company located in Ukraine involved in the production and distribution of various pharmaceutical products, for a total cash consideration of RR 397,017 (US\$ 13,086 thousand).

Of the total consideration amount, guarantee payment of RR 39,670 (US\$ 1,320 thousand) is contingent upon achievement by "Biolik" of certain operational and financial targets by 31 December 2011. In 2011 the amount of RR 28,951 (US\$ 990 thousand) from that guarantee payment was paid. More details about repayment of remaining amount of RR 10,625 (US\$ 330 thousand) are provided in Note 30. In January 2011, the Company finalized process of acquisition of 55% ordinary shares and on 18 January 2011, the acquired shares of "Biolik" were transferred to the Company. In June 2011, PJSC "Biolik" was renamed as PJSC "Pharmstandard-Biolik".

In 2011, the Group completed (i) the reorganization of management and organizational structure of "Biolik" and (ii) implemented changes in "Biolik" internal control procedures consistent with the Group's corporate policies and procedures.

PJSC "Pharmstandard-Biolik" is an entity that is not listed on any public exchange. "Biolik" maintains their accounting records in Ukrainian Hryvnia.



## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 5. Business combinations (continued)

##### *PJSC "Biolik" acquisition (continued)*

The fair value of identifiable assets and liabilities of "Biolik" as at the date of acquisition was as follows:

	Fair value recognised on acquisition
Property, plant and equipment	288,136
Cash and cash equivalents	5,702
Trade and other receivables	97,320
Inventories	136,679
Prepayments	28,111
	<b>555,948</b>
Deferred tax liability (Note 28)	19,449
Other long-term liabilities	8,783
Trade and other payables (Note 20)	418,924
Short-term borrowings and loans	25,461
Income tax and other taxes	15,176
	<b>487,793</b>
<b>Fair value of net assets</b>	<b>68,155</b>
Group's share of the fair value of net assets	37,486
Goodwill arising on acquisition (Note 12)	359,531
<b>Consideration paid</b>	<b>397,017</b>

The fair value and gross amount of the trade and other receivables at the date of acquisition is to RR 97,320. None of the trade and other receivables have been impaired and it is expected that the full contractual amounts can be collected.

The primary reason for the acquisition was the Group's intent to extend its operations to the Ukrainian market. This extension can be achieved both through proceeds from sales of own Biolik's products and by marketing and promotion of certain Pharmstandard's pharmaceutical brands.

The goodwill of RR 359,531 comprises the value of expected synergies arising from the acquisition and opportunity for the Group to extend its operations.

Biolik's operations are consolidated with the Group's results from 1 January 2011 which approximates the date of acquisition.

From the date of acquisition PSC "Pharmstandard-Biolik" has contributed RR 540,077 of revenue and RR 70,126 of profit before tax to the consolidated financial results of the Group in 2011.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 6. Joint ventures

##### 6.1. Joint venture "NauchTechStroy Plus"

In the 4<sup>th</sup> quarter of 2009, the management of the Group approved the plan for the foundation of a new joint venture. In February 2010, "NauchTechStroy Plus" LLC ("NTS+") was registered in the Russian Federation as a joint venture of the Company and another participant. Main purpose of "NTS+" is to build and commence its operations as a research and development center in the Vladimir region of the Russian Federation specialized in bioengineering medical products and universal diagnostic researches.

As at 31 December 2010 the Group held 50% interest in "NTS+" of RR 150,004, which was fully paid in cash. In May 2011, the Company and another participant of this joint venture approved the plan for a new participant to join "NTS+" by an increasing of share capital of "NTS+" by RR 366,200 which was fully paid in cash by all participants of that joint venture. In accordance with Russian legislation an increase in the share capital of the company must be done in proportion to ownership interests of its participants after this increase taking into account the amount of previously paid-up share capital. The Group paid RR 99,823 and in accordance with new charter documents the Group's interest in the joint venture "NTS+" decreased from 50% to 37.5%. The charter documents of "NTS+" require unanimous agreement for financial and operating decisions among the all participants.

Because the Group's share in net assets of NTS+ after the date of increase of share capital was less than the Group's share in net assets before the date of increase of share capital the Group recognized a loss RR 53,142 presented as other expenses for the year ended 31 December 2011 (Note 26).

NTS+ did not generate any revenues or income in 2010 and 2011. The Group's share in aggregate amounts of "NTS+" assets, liabilities and expenses proportionately included in the Group's consolidated financial statements are detailed below:

	<u>31 December 2011</u>	<u>31 December 2010</u>
Current assets	101,562	156,831
Long-term assets	332,745	223,600
Current liabilities	(42,332)	(6,586)
Expenses	(27,494)	(16,160)

Neither NTS+, nor the Group have any commitments in respect of the operations of the joint venture.

##### 6.2. Foundation of joint venture "Pharmstandard-Medtechnika"

In 2<sup>nd</sup> quarter 2011, the management of the Group approved the plan for the foundation of a new joint venture with 75% of Company's share in this joint venture. Hereinafter, the Company and another participant, the "DGM Trading Limited" ("DGM"), signed a shareholders' agreement for the foundation of that joint venture. On 28 June 2011 in accordance with the terms of shareholders' agreement "Pharmstandard-Medtechnika" LLC ("Pharmstandard-Medtechnika") was registered in the Russian Federation as a joint venture of the Company and "DGM".

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 6. Joint ventures (continued)

##### 6.2. Foundation of joint venture "Pharmstandard-Medtechnika" (continued)

"Pharmstandard-Medtechnika" was formed as a trading and distributing company for the purposes of distribution medical equipment as manufactured by the Group and by DGM.

Since 3<sup>rd</sup> quarter 2011 "Pharmstandard-Medtechnika" started its activity. The management of the Company considers the formation of new joint venture "Pharmstandard-Medtechnika" as an additional source of revenue and profitability in medical equipment operating segment.

The aggregate amounts of "Pharmstandard-Medtechnika" assets, liabilities, revenue and expenses excluding intra-group transactions and proportionately included in the Group's consolidated financial statements are detailed below:

	<u>31 December 2011</u>
Current assets	198,048
Current liabilities	(86,661)
Revenue	119,188
Expenses	(136,611)

Neither "Pharmstandard-Medtechnika", nor the Group have any commitments in respect of the operations of the joint venture.

#### 7. Offer for 4.9% of Company's ordinary shares

On 18 January 2011, OJSC "Pharmstandard-Leksredstva" proposed voluntary offer to purchase up to 1,850,000 ordinary shares of the Company with par value 1 (one) Russian Rouble representing about 4.9% of the Company's authorized share capital. Under the terms of the offer, all Company's shareholders were invited to sell their ordinary shares of the Company at a price of 3,000 Russian Roubles per one share. On 18 February 2011, OJSC "Pharmstandard-Leksredstva" closed this offer and purchased 1,824,750 ordinary shares of the Company representing about 4.8% of the Company's authorized share capital for a cash consideration of RR 5,474,250. The difference between the face value of these ordinary shares and consideration paid was debited directly to retained earnings.

#### 8. Non-current assets classified as held for sale

In 4<sup>th</sup> Quarter 2011, the Company's management approved a plan to dispose of "Pharmstandard-Phitopharm" LLC located in Nizhny Novgorod, Russia. This subsidiary did not conduct any operating activities during 2011 and has only minor assets (primarily property, plant and equipment) totalling RR 34,567 (Note 11). The fair value of these assets less the cost of sale of "Pharmstandard-Phitopharm" LLC is estimated based on the expected selling price, of RR 18,030. A loss on non-current assets classified as held for sale of RR 16,537 was recognized as part of other expense (Note 26 and 31).

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 9. Segment information

For the management purposes, the Group is organised into two reportable operating segments: (1) production and wholesale of pharmaceutical products and (2) production and wholesale of medical equipment. Before 30 June 2011, the medical equipment segment was primarily represented by OJSC "TZMOI", as production subsidiary, and by equipment department of OJSC "Pharmstandard", as managing and logistics division. Since 3<sup>rd</sup> quarter 2011 the staff of equipment department of OJSC "Pharmstandard" were transferred to "Pharmstandard-Medtechnika" LLC (Note 6.2). This joint venture is represented as managing, distributing and logistics company for the purpose of distribution of TZMOI and DGM products. In accordance with IAS 31 its financial results were proportionally included in the medical equipment segment's results.

No operating segments have been aggregated to form the above reportable operating segments.

Management monitors the segment s' assets, liabilities, sales, gross profit, segments' results and budgets of these business segments separately for the purpose of making decisions about resource allocation and performance assessment. For the management purposes, budgets of income and expense are planned and analyzed for each of operating segments separately.

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.

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, financial assets, receivables and operating cash. There were no assets unallocated to segments as of 31 December 2011 and 2010. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Capital expenditure comprises additions to property, plant and equipment.

No significant intercompany transactions have been existed between these operating segments.

The following table presents revenue and profit information regarding the Group's operating segments:

Year ended 31 December 2011	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Group
Sales to external customers	41,890,280	763,607	42,653,887
Total revenue	41,890,280	763,607	42,653,887
Gross profit	15,662,024	263,444	15,925,468
Segment result	10,954,221	95,080	11,049,301
Financial income, net			188,284
Profit before income tax			11,237,585
Income tax expense			(2,404,948)
Profit for the year			8,832,637
Segment assets	42,637,626	978,991	43,616,617
Total assets	42,637,626	978,991	43,616,617
Segment liabilities	12,404,977	172,111	12,577,088
Unallocated liabilities			745,582
Total liabilities			13,322,670
Acquisition of property, plant and equipment (Note 11)	1,755,710	14,732	1,770,442
Depreciation and amortisation	854,288	34,571	888,859
Impairment charge of property, plant and equipment (Note 11)	13,794	31,942	45,736

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 9. Segment information (continued)

As at 31 December 2011 the unallocated liabilities of RUR 745,582 consist of income tax payable of RR 163,792 and deferred tax liability of RR 581,790.

Year ended 31 December 2010	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Group
Sales to external customers	29,056,140	630,496	29,686,636
Total revenue	29,056,140	630,496	29,686,636
Gross profit	12,812,092	173,706	12,985,798
Segment result	8,885,953	(9,138)	8,876,815
Financial income, net			267,487
Profit before income tax			9,144,302
Income tax expense			(1,980,506)
Profit for the year			7,163,796
Segment assets	38,521,575	897,103	39,418,678
Total assets	38,521,575	897,103	39,418,678
Segment liabilities	11,224,770	45,741	11,270,511
Unallocated liabilities			1,272,412
Total liabilities			12,542,923
Acquisition of property, plant and equipment (Note 11)	1,032,007	18,125	1,050,132
Intangible assets acquisition (Note 12)	806,032	-	806,032
Depreciation and amortisation	738,026	53,990	792,016
Reversal of Impairment of Intangible assets (Note 12)	29,258	-	29,258
Impairment charge of property, plant and equipment (Note 11)	-	76,002	76,002

As at 31 December 2010 the unallocated liabilities of RUR 1,272,412 consist of income tax payable of RR 223,006, deferred tax liability of RR 642,334, derivative financial instruments of RR 11,249 and short-term borrowings and loans of RR 395,823.

Revenues from some individual customers in the pharmaceutical products segment approximately equalled or exceeded 10% of total Group's segment revenue.

The table below shows the revenue from these customers:

Customer	2011	2010
The Ministry of health and social department (state open auctions)	13,289,821	3,102,226
Customer 1 (only third party products, Note 22)	3,615,047	3,838,173
Customer 2	4,008,796	3,479,700
Customer 3	3,547,568	3,394,848
Customer 4	3,523,700	2,633,100

The Group's sales to the Ministry of health and social department represent about 30% of the Group's revenue for 2011 (2010: 10%).

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 9. Segment information (continued)

In 2011 and 2010, the Group purchased Velcade® in-bulk form from the Customer 1, packed it on production facilities of the OJSC "Pharmstandard-Ufavita" and sold back to the Customer 1 for RR 3,596,447 (2010: RR 3,838,173). Management applied judgment and concluded that all risks associated with ownership of goods were transferred to the Group upon purchase and to the Customer 1 upon sale. Therefore, these transactions were presented in the statement of comprehensive income on a gross basis.

#### 10. 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.

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 2011 and 2010 are detailed below.

##### *Balances with related parties*

	Short-term financial assets (a)	Cash and short-term deposits – (a) Note 16	Short-term loans and borrowings – (b)	Trade and other receivables – (a) Note 14	Trade payables, other payables and accruals – (c) Note 20
<b>2011</b>					
Other related parties <sup>1</sup>	200,000	5,285,895	32,900	20,922	1,391,371
<b>Total</b>	<b>200,000</b>	<b>5,285,895</b>	<b>32,900</b>	<b>20,922</b>	<b>1,391,371</b>
<b>2010</b>					
Other related parties	632,000	3,887,404	-	53,699	770,545
<b>Total</b>	<b>632,000</b>	<b>3,887,404</b>	<b>-</b>	<b>53,699</b>	<b>770,545</b>

(a) This balance primarily represented cash, short-term bank deposits and interest receivable at a bank controlled by a related party and immaterial trade receivables for agency fee from sales of certain products of the related party.

(b) This balance primarily represented non-interest loan received by "NauchTechStroy Plus" LLC from another participant of this joint-venture (Note 20). Since July 2011, this participant is a member of the Board of Directors of the Company.

(c) This balance represented obligation for the license fee, payables for marketing services, payables for supply of the third-party products and payables for other services described in section "Transactions with related parties" below.

<sup>1</sup> Other related parties, represent entities under control of the Company's shareholders and key management.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 10. Balances and transactions with related parties (continued)

##### *Balances with related parties (continued)*

Cash balances with the related bank carry no interest. Short-term financial assets at 31 December 2011 include cash deposits in the related bank and carry 6.5%-7.0% interest p.a. (for more details see Notes 16 and 17).

##### *Significant transactions with related parties*

Statement of comprehensive income caption	Relationship	2011	2010
Revenue	Other related parties	4,620	-
Interest income from deposits placed in a related bank (included in financial income)	Other related parties	23,349	122,083
License fee (included in distribution costs) (A)	Other related parties	(30,470)	(30,341)
Warehouse rental expenses (included in distribution costs) (B)	Other related parties	(86,816)	(74,636)
Office rental expenses (included in general and administrative expenses) (B)	Other related parties	(48,277)	(26,671)
Marketing and advertising expenses (included in distribution costs) (C)	Other related parties	-	(80,658)
Cost of sales (D)	Other related parties	(1,827,287)	(679,463)
Agency fee income (included in other income) (E)	Other related parties	89,755	-
Consulting expenses (included in general and administrative expenses)	Other related parties	(3,300)	-
Interest income from loan provided to majority shareholder	Majority shareholder	-	31,483

##### *(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 that is payable to the related parties.

##### *(C) Marketing and advertising expenses*

In 2010, the Group acquired the results of clinical research related to one of the Group pharmaceutical products developed by a Russian scientific institute from a related party. This research was performed in 2007-2010 and the related party acted as an intermediary between the scientific institute and the Group. The Group plans to use the research result to promote the product on the market and, accordingly, related cost was classified as marketing and advertising expenses in the consolidated financial statements.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 10. Balances and transactions with related parties (continued)

##### *Significant transactions with related parties (continued)*

##### *(D) Cost of sales*

In 2010, the Group signed purchase contracts for supply of third-party product Koagil VII manufactured by a related party. RR 1,608,196 (2010: RR 679,463) includes the cost of this product sold by the Group through open state auctions (Notes 22 and 23). As of 31 December 2011 the Group had no unsold inventory balances of Koagil VII. The remaining amount of RR 219,091 included in the cost of sales line primarily represents the cost of raw materials purchased from a related party.

##### *(E) Agency fee income*

In 2011, the Company held an agency contract with the related party for distribution and sales of certain products owned by a related party.

##### *Loan received from a related party*

In December 2011, the Company's joint-venture "NauchTechStroy Plus" received an interest-free short-term loan from another participant of this joint-venture (Note 20). Since July 2011, this participant is a member of the Board of Directors of the Company. In accordance with the Group's accounting policies the Group recognized RR 32,250 of the total amount of this loan as a proportional part of Group's liabilities in this joint-venture.

##### *Compensation to key management personnel*

Total compensation to key management personnel, amounted to RR 56,514 for the year ended 31 December 2011 (2010: RR 46,343). Such compensation represents the payroll and bonuses included in general and administrative expenses.



OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

11. Property, plant and equipment

Property, plant and equipment consist of the following:

31 December 2011	Land	Buildings	Plant and machinery	Equipment, motor vehicles and other	Assets under construction	Total
<b>Cost</b>						
Balance at 31 December 2010	33,912	2,246,158	2,713,592	416,169	846,848	6,256,679
Additions	-	16,867	28,256	100,672	1,624,647	1,770,442
Transfers	16,702	643,741	332,418	26,029	(1,018,890)	-
Disposals	-	(6,602)	(24,367)	(38,992)	(4,228)	(74,189)
Acquisition through business combination (Note 5)	-	123,249	109,546	7,374	47,967	288,136
Transfers to non-current assets classified as held for sale (Note 8)	-	(52,297)	(6,042)	(614)	(6,249)	(65,202)
Effect from change of Group's share in joint-venture (Note 6.1)	(4,461)	(2,622)	(4,591)	(523)	(41,148)	(53,345)
Foreign exchange differences	-	7,937	7,460	603	4,709	20,709
<b>Balance at 31 December 2011</b>	<b>46,153</b>	<b>2,976,431</b>	<b>3,156,272</b>	<b>510,718</b>	<b>1,453,656</b>	<b>8,143,230</b>
<b>Accumulated depreciation and impairment</b>						
Balance at 31 December 2010	-	342,769	1,495,846	214,324	35,661	2,088,600
Depreciation charge	-	74,775	380,920	83,686	-	539,381
Disposals	-	(1,101)	(11,709)	(33,063)	-	(45,873)
Impairment and reversal of impairment (a)	-	38,232	(7,333)	2	14,835	45,736
Transfers to non-current assets classified as held for sale (Note 8)	-	(26,943)	(3,104)	(588)	-	(30,635)
Effect from change of Group's share in joint-venture (Note 6.1)	-	(56)	(112)	(35)	-	(203)
Foreign exchange differences	-	597	1,520	208	207	2,532
<b>Balance at 31 December 2011</b>	<b>-</b>	<b>428,273</b>	<b>1,856,028</b>	<b>264,534</b>	<b>50,703</b>	<b>2,599,538</b>
<b>Net book value</b>						
Balance at 31 December 2010	33,912	1,903,389	1,217,746	201,845	811,187	4,168,079
<b>Balance at 31 December 2011</b>	<b>46,153</b>	<b>2,548,158</b>	<b>1,300,244</b>	<b>246,184</b>	<b>1,402,953</b>	<b>5,543,692</b>

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 11. Property, plant and equipment (continued)

31 December 2010	Land	Buildings	Plant and machinery	Equipment, motor vehicles and other	Assets under construction	Total
<b>Cost</b>						
Balance at 31 December 2009	32,986	2,204,001	2,518,059	282,375	205,512	5,242,933
Additions	-	3,867	81,951	132,931	831,383	1,050,132
Transfers	1,144	38,888	142,168	5,948	(188,148)	-
Disposals	(218)	(598)	(28,586)	(5,085)	(1,899)	(36,386)
<b>Balance at 31 December 2010</b>	<b>33,912</b>	<b>2,246,158</b>	<b>2,713,592</b>	<b>416,169</b>	<b>846,848</b>	<b>6,256,679</b>
<b>Accumulated depreciation and impairment</b>						
Balance at 31 December 2009	-	276,562	1,094,501	152,566	33,459	1,557,088
Depreciation charge	-	66,232	350,885	63,684	-	480,801
Disposals	-	(25)	(23,340)	(1,926)	-	(25,291)
Impairment (a)	-	-	73,800	-	2,202	76,002
<b>Balance at 31 December 2010</b>	<b>-</b>	<b>342,769</b>	<b>1,495,846</b>	<b>214,324</b>	<b>35,661</b>	<b>2,088,600</b>
<b>Net book value</b>						
Balance at 31 December 2009	32,986	1,927,439	1,423,558	129,809	172,053	3,685,845
<b>Balance at 31 December 2010</b>	<b>33,912</b>	<b>1,903,389</b>	<b>1,217,746</b>	<b>201,845</b>	<b>811,187</b>	<b>4,168,079</b>

- (a) Impaired assets primarily represent equipment for production of medical disposables, including syringes, removed from active use due to decline in customer demand and low profitability of these disposables. In 2011, the management of the Group approved the plan to discontinue the operations of production line of medical disposables. The impairment charge equals to the carrying value of those equipment and assets under construction.

In 2011 and 2010, the Group did not borrow money for capital construction and there were no new qualifying assets, therefore no interest expense was capitalized.

The Group assets include only a minor portion of 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. The lease agreements specify lease terms between 1 and 20 years. Long-term agreements have an option to prolong the lease term for another 10 years and 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 total amount of rental payments for the use of the land during 2011 was RR 9,833 (2010: RR 8,682). Such payments are reassessed by the state authorities on an annual basis. No such reassessment has been completed for 2012 and beyond as of the date of approval of these consolidated financial statements for issue.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

12. Intangible assets

	Goodwill	Trademarks and patents	Total
<b>Cost</b>			
Balance at 31 December 2010	1,180,469	6,730,141	7,910,610
Additions (Note 5)	359,531	-	359,531
Foreign exchange differences	21,361	-	21,361
<b>Balance at 31 December 2011</b>	<b>1,561,361</b>	<b>6,730,141</b>	<b>8,291,502</b>
<b>Accumulated amortisation and impairment</b>			
Balance at 31 December 2010	-	1,224,400	1,224,400
Amortisation expense	-	349,478	349,478
<b>Balance at 31 December 2011</b>	<b>-</b>	<b>1,573,878</b>	<b>1,573,878</b>
<b>Net book value</b>			
Balance at 31 December 2010	1,180,469	5,505,741	6,686,210
<b>Balance at 31 December 2011</b>	<b>1,561,361</b>	<b>5,156,263</b>	<b>6,717,624</b>
	Goodwill	Trademarks and patents	Total
<b>Cost</b>			
Balance at 31 December 2009	1,180,469	5,924,109	7,104,578
Additions (a)	-	806,032	806,032
<b>Balance at 31 December 2010</b>	<b>1,180,469</b>	<b>6,730,141</b>	<b>7,910,610</b>
<b>Accumulated amortisation and impairment</b>			
Balance at 31 December 2009	-	942,443	942,443
Reversal of impairment	-	(29,258)	(29,258)
Amortisation expense	-	311,215	311,215
<b>Balance at 31 December 2010</b>	<b>-</b>	<b>1,224,400</b>	<b>1,224,400</b>
<b>Net book value</b>			
Balance at 31 December 2009	1,180,469	4,981,666	6,162,135
<b>Balance at 31 December 2010</b>	<b>1,180,469</b>	<b>5,505,741</b>	<b>6,686,210</b>

(a) In 2010, additions represent acquisition of Acipol trade mark.

Carrying amount and remaining amortization period of major trade marks as of 31 December are as follows:

Name	Carrying amount		Remaining amortization period (years)	
	2011	2010	2011	2010
Afobazol®	1,747,256	1,851,570	17	18
Arbidol®	1,508,393	1,611,825	14	15
Acipol®	734,385	788,120	14	15
Flucostat®	586,786	627,023	14	15

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 12. Intangible assets (continued)

##### *Impairment testing of goodwill*

Goodwill acquired through business combinations 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").

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

	Pharmaceuticals		Equipment		Total	
	2011	2010	2011	2010	2011	2010
Carrying amount of goodwill	1,342,507	961,615	218,854	218,854	1,561,361	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 developed on the basis of financial budgets approved by management covering a five-year period and cash flows beyond the five-year period are extrapolated using a 5% growth rate that is the same as the mid-term average growth rate for pharmaceuticals and medical equipment market (2010: 5%). The discount rate applied to cash flow projections is 14.3% (2010: 14.7%).

##### *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;
- Currency rates changes;
- 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 unit. 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 Capital Assets Pricing Model calculation at the reporting date.

*Raw material price inflation* - past actual raw materials price movements, including the effect of the devaluation of the Russian Rouble for US dollar denominated raw materials, have been used as an indicator of future price movements.

*Currency exchange rates changes* - estimated based on current trends on the foreign currency market.

*Growth rate estimates* - rates are based on published industry research.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 12. Intangible assets (continued)

##### *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.

#### 13. Inventories

Inventories consist of the following:

	2011	2010
Raw materials - at cost	3,369,275	1,931,686
Work in progress - at cost	211,645	304,338
Finished goods - at net realisable value (a)	3,564,371	5,230,190
	7,145,291	7,466,214

(a) On 31 December 2010, finished goods balance included third party products in the amount of RR 2,566,037 designated for sale under the terms of the state open auctions won by the Company.

The write-downs of inventories to net realisable value and reversal of write-downs were as follows:

	2011	2010
Balance at 1 January	41,164	20,002
Additional write-downs	53,453	43,534
Unused amounts reversed	(675)	(466)
Utilised during the year	(34,959)	(21,906)
Foreign exchange differences	(64)	-
Balance at 31 December	58,919	41,164

#### 14. Trade and other receivables

	2011	2010
Trade receivables (net of allowance for impairment of receivables of RR 135,600 (2010: RR 48,781))	13,973,032	12,271,212
Interest receivable - third parties	145,744	51,148
Interest receivable - related parties (Note 10)	8,450	53,699
Other receivables (a)	120,195	-
	14,247,421	12,376,059

(a) Other receivables represent cash rebates on procurement due from vendors.

At 31 December 2011 RR 287,216 (2010: RR 153,236) of trade receivables were denominated in currencies other than Russian Roubles, primarily in US\$ (RR: 163,302) and Ukrainian Hryvnia (RR: 122,976).

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 14. Trade and other receivables (continued)

Movements in allowance for impairment of trade receivables were as follows:

	2011	2010
Balance at 1 January	48,781	94,910
Additional allowance	94,046	3,017
Unused amounts reversed	(7,440)	(45,832)
Utilised during the year	(819)	(3,314)
Translation differences	1,032	-
<b>Balance at 31 December</b>	<b>135,600</b>	<b>48,781</b>

#### 15. Prepayments

	2011	2010
Trade prepayments for services and materials	245,734	219,621
Trade prepayments for third parties products	500,000	-
	<b>745,734</b>	<b>219,621</b>

#### 16. Cash and short-term deposits

Cash and short-term deposits consist of the following:

	2011	2010
Cash in bank – Russian Roubles	5,273,076	3,898,237
Cash in bank – Ukrainian Hryvnia	7,072	-
Cash in bank – US\$ and Euro	41,614	8,021
Short-term bank deposits with original maturity less than 90 days – Russian Roubles	-	250,000
Short-term bank deposits with original maturity less than 90 days – Ukrainian Hryvnia	30,042	-
(a)	31,268	-
Cash deposits on state open auctions – Russian Roubles (b)	31,268	-
	<b>5,383,072</b>	<b>4,156,258</b>

(a) Short-term bank deposits bear an interest rate of 10.5% p.a. on average.

(b) This item represents cash deposits restricted for use placed to secure participation in state open auctions announced by the Government of the Russian Federation. These cash deposits are interest free and released within 30 days from the date of deposit.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 17. Short-term financial assets

	2011	2010
<i>Accounted for as loans and receivables:</i>		
Promissory notes	586,820	614,700
Short-term bank deposits – Russian Roubles -Note 10 (a)	2,500,000	2,697,000
Short-term bank deposits – US\$	321,961	304,769
Short-term loans (b)	25,000	50,000
<i>Accounted for as available for sale:</i>		
Securities	9,340	11,866
Other	2,920	3,688
	3,446,041	3,682,023

- (a) This item includes cash deposits of RR 200,000 (31 December 2010: RR 632,000) restricted for use and placed in the related bank to secure certain bank guarantees obtained by the Group for participation in state open auctions announced by the Government of the Russian Federation.
- (b) In 2011, the Group recognized an impairment loss in the amount of RR 25,000 for loan provided by the Company in 2009. The impairment loss was recognised in other expenses (Note 26).

The short-term bank deposits as of 31 December 2011 bear interest at a rate from 6.5% p.a. to 10% p.a. The short-term loan provided to third parties as of 31 December 2011 bears interest at 14% p.a.

#### 18. Borrowings and loans

	2011	2010
<b>Short-term borrowings and loans</b>		
Short-term loan – Russian Roubles (a)	700,000	-
Loan from related party – Russian Roubles (Note 10)	32,250	-
Current portion of long-term borrowings and loans	1,300	395,823
	733,550	395,823
<b>Long-term borrowings and loans</b>		
Citibank loan (b)	-	394,523
Other loans – Russian Roubles (Note 10)	1,300	1,300
Less: Current portion of long-term borrowings and loans	(1,300)	(395,823)
	-	-

- (a) This unsecured loan was raised in November 2011 to provide the Company's participation in certain state open auctions announced by the Government of the Russian Federation. This loan bore a fixed interest rate of 8.5% p.a. and was fully repaid by the Company in January 2012.
- (b) 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 (on 18 December 2009 this facility was repaid); and
  - Facility B in the total amount of US\$ 55 million with maturity period of 5 years (on 18 December 2011 this facility was repaid).

In 2011, the Group repaid US\$ 12,945 thousand (RR 386,252 at the exchange rate as of the date of payment) of the Citibank loan (2010: US\$ 12,940 thousand (RR 395,087)).

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 19. Other taxes payable

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

	2011	2010
Value-added tax	512,696	445,634
Property and other taxes	86,589	77,680
	599,285	523,314

#### 20. Trade and other payables and accruals, and advances received

	2011	2010
Trade payables	1,412,990	2,140,639
Payables for products procurement – third parties (a)	7,346,166	5,972,929
Payables for products procurement and other payables – related parties (Note 10, a)	1,391,371	770,545
Advances received (b)	103,359	1,337,032
Issued promissory notes – US\$ (c)	277,030	-
Other payables and accruals	704,072	526,052
	11,234,988	10,747,197

- (a) These balances represent payables for branded third parties products manufactured by other pharmaceutical companies.
- (b) Advances received as of 31 December 2010 represented advances received from the Ministry of health and social department under state open auctions. The Company made deliveries and recorded sales in respect of these advances in 2011.
- (c) This balance primarily represents the interest free promissory notes issued by the Company's subsidiary "Pharmstandard-Biolik" before the date of acquisition. The promissory notes are payable to the companies affiliated with the non-controlling shareholders of Biolik. These payables have arisen prior to the acquisition of Biolik by the Company in January 2011. These notes remain outstanding as of 31 December 2011 and are payable on demand (Note 5).

At 31 December 2011 RR 1,597,538 of total payables were denominated in currencies other than Russian Rouble, primarily in US\$ (2010: RR 1,620,292).

#### 21. 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 Rouble. All authorised shares are issued and fully paid. There were no other transactions with own shares during 2011 except for the acquisition of Company's treasury shares by "Pharmstandard-Leksredstva" as described in Note 7.



## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 21. Share capital (continued)

As of 31 December 2011 and 2010 more than half of voting shares of OJSC "Pharmstandard" were held by Augment controlled by Victor Kharitonin, a Russian citizen.

In May 2007, 16,349,408 ordinary shares representing 43.3% 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% of the shares were offered and at the London stock exchange (LSE) where the remaining 25% were offered.

In 2008 and 2009, 969,815 ordinary shares representing 2.56% of share capital of the Company were sold by Augment and were offered at LSE. Also, in 2009 Augment reacquired 55,000 ordinary shares. In 1<sup>st</sup> Quarter 2011, approximately 4.8% of the Company's shares were acquired by the Company's subsidiary "Pharmstandard-Leksredstva" and were recognized as treasury share (for more details see Note 7).

After these transactions, "Pharmstandard-Leksredstva" holds 4.83% of issued shares as treasury shares, Augment holds 54.32% of share capital and 40.85% of share capital is publicly listed of which 27.56% is on the LSE.

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 20,559,281 (unaudited) of undistributed and unreserved earnings as of 31 December 2011 (2010: RR 14,179,754 – unaudited). In addition, the Company's share in the undistributed and unreserved earnings of the subsidiaries and joint ventures was approximately RR 14,883,682 (unaudited) as at 31 December 2011 (2010: RR 11,809,047 – unaudited).

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

#### Earnings per share

Earnings per share are as follows:

	2011	2010
Weighted average number of ordinary shares outstanding (Note 7)	36,271,978	37,792,603
Profit for the year attributable to the shareholders	8,780,520	7,149,543
Basic and diluted earnings per share, Russian Roubles	242.07	189.18

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 22. Revenue

Revenue breakdown by product groups comprised the following:

	2011	2010
<b>Pharmaceutical products</b>		
<b>Over the Counter ("OTC")</b>		
Branded	13,270,489	13,338,950
Non-branded	2,226,822	2,242,147
	15,497,311	15,581,097
<b>Prescription</b>		
Branded	3,509,433	2,806,909
Non-branded	769,996	487,271
	4,279,429	3,294,180
<b>Third parties products (a)</b>	21,725,971	9,893,825
<b>Other – substances and APIs</b>	387,569	287,038
<b>Total pharmaceutical products</b>	41,890,280	29,056,140
<b>Medical equipment</b>	763,607	630,496
	42,653,887	29,686,636

(a) Third parties products sales include sales of branded pharmaceutical products such as Velcade® (for more details see Note 9), Mildronate®, Coagil VII, IRS®-19, Imudon®, Prezista®, Mabtera® and Pulmozyme® manufactured by other pharmaceutical companies.

#### 23. Cost of sales

The components of cost of sales were as follows:

	2011	2010
Materials and components	6,137,034	6,653,267
Third parties products	18,323,186	8,272,386
Production overheads	1,170,378	813,178
Depreciation and amortisation	792,840	718,937
Direct labour costs	304,981	243,070
	26,728,419	16,700,838

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 24. Selling and distribution costs

Selling and distribution costs were as follows:

	2011	2010
Advertising	1,692,558	1,427,340
Labour costs	1,092,143	826,242
Freight, communication and insurance of goods in transit	207,107	164,331
Trainings and other services	78,100	43,413
Certification expenses	87,620	54,290
Rent	88,034	75,803
Commission and license fee	78,987	57,819
Materials, maintenance and utilities	128,909	96,739
Travel and entertainment	92,295	80,114
Depreciation	59,860	53,659
Other expenses	36,502	36,452
	3,642,115	2,916,202

The Group entered into a number of operating lease agreements for warehouses. Rental agreements are revised on an annual basis.

#### 25. General and administrative expenses

General and administrative expenses were as follows:

	2011	2010
Labour costs	769,209	551,189
Services, legal, audit and consulting expense	97,698	75,491
Travel and entertainment	27,584	20,712
Taxes other than income tax	21,300	16,353
Property insurance	18,403	17,275
Freight and communication	28,169	28,811
Depreciation	36,159	19,420
Rent	58,928	34,963
Materials, maintenance and utilities	104,317	91,524
Other	34,382	36,216
	1,196,149	891,954

The Group entered into a number of operating lease agreements for office premises. Rental agreements are revised on an annual basis.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 26. Other income and other expenses

Other income comprised the following:

	2011	2010
Foreign exchange gain, net	9,370	-
Gain from disposal of property, plant and equipment	22,619	-
Gain from disposal financial assets	-	47,487
Income from non-core operations (a)	166,247	82,820
Cash rebates (b)	63,478	-
Reversal of impairment – property, plant and equipment (Note 11)	7,333	-
Reversal of impairment – intangible assets (Note 12)	-	29,258
Reversal of impairment of receivables (c)	-	28,460
Other income	25,646	-
	294,693	188,025

- (a) Income from non-core operations primarily includes (i) agency fee earned by the Group in respect of sale of certain third-parties products, including products manufactured by related parties (ii) income from sale of materials and other assets not included in other categories (iii) income from tolling operation (iv) income from other non-core services.
- (b) Cash rebates represent vendor rebates on procurement of several products which were purchased and realized in 2010. These cash rebates were recognized in accordance with the terms of rebate contracts agreed with vendors in 2011 after the date of release of consolidated financial statements for the year ended 31 December 2010.
- (c) This amount represents reversal of impairment initially recorded to other expenses. The total reversal amount presented in Note 14 also included reversal of impairment initially recorded to cost of sales.

Other expenses comprised the following:

	2011	2010
Foreign exchange loss, net	-	16,393
Loss from disposal of property, plant and equipment	-	5,311
Expense related to the joint venture – Note 6.1 (a)	53,142	248,298
Charity	30,062	22,425
Bank charges (b)	32,878	32,433
Other taxes and penalties	60,128	50,250
Expenses for personnel reduction incurred in connection with closure of disposables production	-	7,411
Impairment of property, plant and equipment (Note 11)	53,069	76,002
Impairment of short-term financial assets (c)	25,000	-
Loss recognized on non-current assets classified as held for sale (Note 8)	16,537	-
Other	61,780	30,329
	332,596	488,852

- (a) In May 2011 the Group's share in "NTS+" decreased from 50% to 37.5% (Note 6.1). As a result of a decrease of the Group's share in net assets of the joint venture, the Group recognised a loss in the amount of RR 53,142 presented as other expenses.  
In 1<sup>st</sup> half 2010, the Group made an additional cash contribution of RR 480,000 to the joint-venture "NTS+". This contribution was provided by the Group to allow the joint venture to commence its research and development activities. The excess of the contribution over Group's interest in the joint venture in the amount of RR 240,000 was considered as non-refundable assistance to the joint venture and, accordingly, recognized as an expense as at 31 December 2010.
- (b) Bank charges includes (i) commission for daily banking operations (ii) commission for certain bank guarantees obtained by the Group.
- (c) In 2011, the Group recognized an impairment loss in the amount of RR 25,000 for loan provided by the Company in 2009 (Note 17).

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 27. Financial Income and expense

Financial income and expense comprised the following:

	2011	2010
Interest income:		
Income from changes in fair value of Interest Rate Swap (a)	11,249	23,502
Interest income from loans and deposits	220,270	289,409
Other	-	2,256
	231,519	315,167
Interest expense:		
Loss from Interest Rate Swap (a)	10,453	29,736
Interest expense on borrowings and loans	30,139	17,944
Other	2,643	-
	43,235	47,680

(a) In December 2011 the terms of the Group's interest swap agreement expired.

#### 28. Income tax

	2011	2010
Income tax expense - current	2,484,941	2,145,172
Deferred tax benefit- origination and reversal of temporary differences	(79,993)	(164,666)
Income tax expense	2,404,948	1,980,506

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

	2011	2010
Profit before income tax	11,237,585	9,144,302
Theoretical tax charge at Russian statutory rate of 20%	2,247,517	1,828,860
Effect of the difference in tax rates in countries other than the Russia	701	-
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	156,730	151,646
Income tax expense	2,404,948	1,980,506

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 28. Income tax (continued)

Movements in deferred tax balances were as follows:

	31 December 2009	Temporary differences recognition and reversal in profit and loss	Other differences in other comprehensive income	31 December 2010	Temporary differences recognition and reversal in profit and loss	Effect of business combination in 2011 (Note 5)	31 December 2011
Tax effects of deductible temporary differences – asset (liability):							
Property, plant and equipment (Note 11)	(307,862)	21,905	–	(285,957)	15,713	(15,241)	(285,485)
Intangible assets (Note 12)	(514,323)	29,826	–	(484,497)	30,540	–	(453,957)
Trade and other receivables	(32,376)	56,347	–	23,971	(29,723)	3,389	(2,363)
Inventories	12,331	79,526	–	91,857	51,060	(11,036)	131,881
Trade and other payables	16,358	(11,462)	–	4,896	13,224	1,992	20,112
Financial Instruments	6,950	(4,700)	–	2,250	2,963	45	5,258
Other	11,860	(6,776)	62	5,146	(3,784)	1,402	2,764
<b>Total net deferred tax liability</b>	<b>(807,062)</b>	<b>164,666</b>	<b>62</b>	<b>(642,334)</b>	<b>79,993</b>	<b>(19,449)</b>	<b>(581,790)</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;
- fair value of financial instruments in excess of the cost of these instruments for tax purpose;
- impairment of trade receivables;
- write down of inventory 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 and joint ventures for which deferred tax liabilities have not been recognised was approximately RR 10,534,712 as at 31 December 2011 (2010: RR 8,096,339).

#### 29. Contingencies, commitments and operating risks

##### *Operating environment of the Group*

Russia, where majority of the Group's operations are located, 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)*

#### 29. Contingencies, commitments and operating risks (continued)

##### *Operating environment of the Group (continued)*

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. In 2011, the Russian Government continued to take measures to support the economy in order to overcome the consequences of the global financial crisis. Despite some indications of recovery there continues to be uncertainty regarding further economic growth, access to capital and cost of capital, which could negatively affect the Group's future financial position, results of operations and business prospects.

While management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances, unexpected further deterioration in the areas described above could negatively affect the Group's results and financial position in a manner not currently determinable.

##### *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 2011 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 2011. 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 the 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 these consolidated 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)*

#### 29. Contingencies, commitments and operating risks (continued)

##### *Commitment liabilities*

In December 2011, the Group provided certain unsecured guaranties in the total amount of RR 137,104 with maturity period of one year for one of the Company's key customers to allow certain distribution activities to be performed by this customer. The management believes that provided guarantees have remote financial risks for the Group. No liability related to guarantees was recognised in the statement of financial position as of 31 December 2011.

#### 30. Financial instruments and financial risk management objectives and policies

##### *Fair values*

Management believes that fair value of cash and cash equivalents, loans receivable, promissory notes, short-term deposits, other receivable or payables and securities approximate their carrying amounts due to their short maturity.

Fair values of short-term borrowings and loans are approximately equal to their carrying value. Fair value of derivative financial instruments has been calculated by discounting the expected future cash flows at prevailing interest rates. The Group has no long-term borrowings and loans and derivative financial instruments as of 31 December 2011.

##### *Fair value hierarchy*

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly;

Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

The table below shows the assets measured at fair value as at 31 December 2011:

	Total	Level 1	Level 2	Level 3
<b>Assets measured at fair value</b>				
Financial assets				
Securities (Note 17)	9,340	8,380	-	960
<b>31 December 2010:</b>				
	Total	Level 1	Level 2	Level 3
<b>Assets measured at fair value</b>				
Financial assets				
Securities (Note 17)	11,866	11,029	-	837
<b>Liabilities measured at fair value</b>				
Interest rate swap	11,249	-	11,249	-



## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 30. Financial instruments and financial risk management objectives and policies (continued)

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

The Group's principal financial instruments comprise bank loans, short-term bank deposits and cash and cash equivalents. The main purpose of these financial instruments is 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, trade and other 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 may enter 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.

##### *Interest rate risk*

In December 2011 the terms of the Group's interest swap agreement expired and the Group fully repaid Citibank loan (Note 18). Therefore, management believes that the Group does not have significant interest rate risk as of 31 December 2011. In 2010 the Group was exposed to interest rate risk through interest cash flow and market value fluctuations as the interest rate on Citibank loan was floating and based on LIBOR.

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:

	Increase/decrease in basis points	Effect on profit or loss (interest expense)	Effect on profit or loss (due to fair value change)
As at 31 December 2011	-	-	-
	-	-	-
As at 31 December 2010	100	(2,440)	1,552
	(30)	732	(469)

##### *Foreign exchange risk*

The Group has certain US dollar denominated cash and cash equivalents, short-term bank deposits, trade payables, issued promissory notes and other payables (Note 18), trade receivables (Note 14) and other liabilities. 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)

30. Financial Instruments and financial risk management objectives and policies (continued)

*Foreign exchange risk (continued)*

The tables 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:

	Increase/decrease in US\$ rate	Effect on profit before tax
<b>As at 31 December 2011</b>		
US\$/Roubles exchange rate	+10%	(51,621)
US\$/Roubles exchange rate	-10%	51,621
<b>As at 31 December 2010</b>		
US\$/Roubles exchange rate	+10%	(111,185)
US\$/Roubles exchange rate	-10%	111,185
	Increase/decrease in US\$ rate	Effect on profit before tax
<b>As at 31 December 2011</b>		
US\$/Ukrainian Hryvnia exchange rate	+2%	(6,371)
US\$/Ukrainian Hryvnia exchange rate	-2%	6,371

*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 and other payables which normally have average maturity periods shorter than 4 months.

	Total	Less than 3 months	3 to 6 months	6 to 12 months
<b>As at 31 December 2011</b>				
Guarantee payment for Biolik acquisition (Note 5)	10,625	10,625	-	-
Borrowings and loans (Note 10 and 18)	735,828	702,278	-	33,550
Other current liabilities	26,669	26,669	-	-
<b>Total</b>	<b>773,122</b>	<b>739,572</b>	<b>-</b>	<b>33,550</b>
	Total	Less than 3 months	3 to 6 months	6 to 12 months
<b>As at 31 December 2010</b>				
Borrowings and loans (Note 18)	400,499	100,975	100,399	199,125
Other current liabilities	38,434	-	-	38,434
<b>Total</b>	<b>438,933</b>	<b>100,975</b>	<b>100,399</b>	<b>237,559</b>

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 30. Financial Instruments and financial risk management objectives and policies (continued)

##### *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 daily 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.

The table below summarises the Group's trade and other receivables aging.

	Total	Neither impaired nor past due	Not impaired but past due				
			less 1 month	1-2 months	2-3 months	3 to 6 months	>6 months (a)
31 December 2011	14,247,421	12,055,149	1,948,540	165,888	23,543	7,964	46,337
31 December 2010	12,376,059	11,078,443	1,125,873	161,614	8,504	1,482	143

(a) Trade receivables were fully paid in January 2012.

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

The Group works with seven distributors that together represent more than 50% of the Group's revenue<sup>2</sup> for 2011 (five distributors in 2010). It is common practice of the Russian pharmaceutical market to work with the limited number of large distributors.

##### *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.

<sup>2</sup> Excluding sales to the Ministry of health and social department under state open auctions.

## OJSC "Pharmstandard"

### Notes to the consolidated financial statements (continued)

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

#### 30. Financial Instruments and financial risk management objectives and policies (continued)

##### *Capital risk management (continued)*

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.

	2011	2010
Borrowings and loans	733,550	395,823
Trade and other payables	11,131,629	9,410,165
Less: cash and short-term deposits	(5,383,072)	(4,156,258)
Net debt	6,482,107	5,649,730
Equity	29,778,979	26,447,541
Capital and net debt	36,261,086	32,097,271
Gearing ratio	18%	18%

#### 31. Events after the reporting period

##### *Sale of non-current assets classified as held for sale*

Non-current assets classified as held for sale reflected in the consolidated statement of financial position as of 31 December 2011 of RR 18,030 were sold in March 2012 for a cash consideration of RR 17,850 (for more details see Note 8).

##### *Loan provided to majority shareholder*

In April 2012, the Company's majority shareholder "Augment Investments Limited" ("Augment"), a company registered under the laws of Cyprus (see Note 21), applied to the Company with request to provide short-term interest loan for the purpose of financing the current business activity of Augment not related to the Group. The Company provided a short-term loan to Augment with maturity date not later than 4 October 2012 in the amount of US\$ 27,500 thousand (RR 810,167) with fixed interest rate of 3.5% per annum.