

OJSC "Pharmstandard"

Consolidated financial statements

For the year ended 31 December 2012

OJSC "Pharmstandard"

Consolidated financial statements

For the year ended 31 December 2012

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Independent auditor's report

To the Shareholders and Management of OJSC "Pharmstandard"

We have audited the accompanying consolidated financial statements of OJSC "Pharmstandard" and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2012, and the consolidated statement of comprehensive income, consolidated cash flow statement and consolidated statement of changes in equity for the year 2012, and a summary of significant accounting policies and other explanatory information.

Audited entity's responsibility for the consolidated financial statements

Management of the audited entity 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.

Auditor's responsibility

Our responsibility is to express an opinion on the fairness of these consolidated financial statements based on our audit.

We conducted our audit in accordance with the federal standards on auditing effective in the Russian Federation and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The audit procedures selected depend on the auditor's 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 auditor considers internal control relevant to the 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 of the audited entity, 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 OJSC "Pharmstandard" and its subsidiaries as at 31 December 2012, and their financial performance and cash flows for the year 2012 in accordance with International Financial Reporting Standards.



A.B. Khorovitch
Partner
Ernst & Young LLC

25 April 2013

Details of the audited entity

Name: OJSC "Pharmstandard"
Information about the State Register of Legal Entities Concerning a Legal Entity:
O2N#005162109 or 05.05.2006
Address: 141701, Russia, Moscow region, Dolgoprudny, Likhachevsky drive, 5 "b".

Details of the auditor

Name: Ernst & Young LLC
Main State Registration Number 1027739707203.
Address: Russia 115035, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.
Ernst & Young LLC is a member of Non Profit partnership "Russian Audit Chamber" ("NP APR").
Ernst & Young LLC is registered in the register of auditors and audit organizations of NP APR, number 3028, and also included in the control copy of the register of auditors and audit organizations, main registration number 10201017420.

OJSC "Pharmstandard"

Consolidated statement of financial position as at 31 December 2012

(in thousands of Russian Roubles)

	Notes	2012	2011
Assets			
Non-current assets			
Property, plant and equipment	10	8,034,486	5,543,692
Intangible assets	11	8,042,938	6,717,624
		<u>16,077,424</u>	<u>12,261,316</u>
Current assets			
Inventories	12	8,529,963	7,145,291
Trade and other receivables	13	14,977,062	14,247,421
VAT recoverable		336,318	369,712
Prepayments	14	280,448	745,734
Short-term financial assets	16	4,469,872	3,446,041
Cash and short term deposits	15	8,663,983	5,383,072
		<u>37,257,646</u>	<u>31,337,271</u>
Non-current assets classified as held for sale		12,599	18,030
Total assets		<u><u>53,347,669</u></u>	<u><u>43,616,617</u></u>
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	21	37,793	37,793
Treasury shares	7	(3,190)	(1,825)
Foreign currency translation reserve		(1,922)	24,923
Retained earnings		37,533,953	29,718,088
		<u>37,566,634</u>	<u>29,778,979</u>
Non-controlling interests		1,651,138	514,968
Total equity		<u><u>39,217,772</u></u>	<u><u>30,293,947</u></u>
Non-current liabilities			
Long-term loans	9,17	48,750	-
Deferred tax liability	28	774,983	581,790
Other non-current liabilities	20	88,920	9,265
		<u>912,653</u>	<u>591,055</u>
Current liabilities			
Trade and other payables and accruals, and advances received	8,19	11,597,293	11,234,988
Short-term borrowings and loans	9,17	33,550	733,550
Income tax payable		495,776	163,792
Other taxes payable	18	1,090,625	599,285
		<u>13,217,244</u>	<u>12,731,615</u>
Total liabilities		<u><u>14,129,897</u></u>	<u><u>13,322,670</u></u>
Total equity and liabilities		<u><u>53,347,669</u></u>	<u><u>43,616,617</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

25 April 2013

The accompanying notes on pages 7-55 are an integral part of these consolidated financial statements.

OJSC "Pharmstandard"
Consolidated statement of comprehensive income

For the year ended 31 December 2012

(in thousands of Russian Roubles)

	Notes	2012	2011
Revenue	22	51,391,475	42,653,887
Cost of sales	23	(32,488,245)	(26,728,419)
Gross profit		18,903,230	15,925,468
Selling and distribution costs	24	(5,105,140)	(3,642,115)
General and administrative expenses	25	(1,506,604)	(1,196,149)
Other income	26	449,695	294,693
Other expenses	26	(261,891)	(332,596)
Financial income	27	126,767	231,519
Financial expense	27	(35,648)	(43,235)
Profit before income tax		12,570,409	11,237,585
Income tax expense	28	(2,606,403)	(2,404,948)
Profit for the year		9,964,006	8,832,637
Other comprehensive income			
Exchange differences on translation of foreign operations		(31,227)	29,136
Other comprehensive income for the year		(31,227)	29,136
Total comprehensive income for the year		9,932,779	8,861,773
Profit for the year			
Attributable to:			
Equity holders of the Parent		9,790,915	8,780,520
Non-controlling interests		173,091	52,117
		9,964,006	8,832,637
Total comprehensive income for the year			
Attributable to:			
Equity holders of the Parent		9,764,070	8,805,688
Non-controlling Interests		168,709	56,085
		9,932,779	8,861,773

Earnings per share (in Russian roubles)

- basic and diluted, based on profit for the year attributable to equity holders of the Parent	21	276.69	242.07
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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

25 April 2013

The accompanying notes on pages 7-55 are an integral part of these consolidated financial statements.

OJSC "Pharmstandard"

Consolidated cash flow statement

For the year ended 31 December 2012

(in thousands of Russian Roubles)

	Notes	2012	2011
Cash flows from operating activities:			
Profit before income tax		12,570,409	11,237,585
Adjustments for:			
Depreciation and amortisation	10,11	988,249	888,859
Change in allowance for impairment of financial assets	13,26	734	111,606
Write-down of inventories to net realizable value	12	244,754	52,778
Loss recognized on non-current assets classified as held for sale (Reversal of impairment) and Impairment charge – property, plant and equipment	26 10,26	- (20,935)	16,537 45,736
Reversal of impairment – intangible assets	11,26	(25,000)	-
Loss (gain) from disposal of property, plant and equipment	26	3,436	(22,619)
Foreign exchange loss (gain)		102,450	(22,947)
Expense related to the joint venture	26	-	53,142
Financial income	27	(126,767)	(231,519)
Financial expense	27	35,648	43,235
Operating cash flows before working capital changes		13,772,978	12,172,393
Increase in trade and other receivables	13	(467,236)	(1,800,534)
(Increase) decrease in Inventories	12	(1,288,011)	416,459
Decrease in VAT recoverable		43,413	111,789
Decrease (increase) in trade prepayments	14	476,036	(497,438)
Increase (decrease) in trade payables and other payables	19	234,733	(2,917)
Increase in taxes payable other than income tax		452,431	76,069
Cash generated from operations		13,224,344	10,475,821
Income tax paid	28	(2,438,060)	(2,546,132)
Interest paid		(35,477)	(40,839)
Interest received		206,946	168,077
Net cash from operating activities		10,957,753	8,056,927
Cash flows from investing activities:			
Purchase of property, plant and equipment	10	(1,461,910)	(1,751,518)
Payments for development expenditures	11	(28,760)	-
Net cash used in acquisition of subsidiaries, net of cash acquired	5	(2,495,317)	(196,524)
Proceeds from government grants	20	38,665	-
Cash received from sale of property, plant and equipment		34,061	42,213
Cash received from sale of non-current assets held for sale		17,850	-
Cash received from sale of short-term financial assets	16	3,126,872	2,012,351
Cash paid for short-term financial assets	16	(2,645,728)	(1,786,820)
Loans provided to related parties	9,16	(1,537,945)	-
Net cash used in investing activities		(4,952,212)	(1,680,298)
Cash flows from financing activities:			
Proceeds from loans and borrowings	17	3,048,750	2,332,250
Repayment of loans and borrowings	17	(3,793,189)	(2,010,994)
Cash paid for acquisition of treasury shares	7	(1,976,415)	(5,474,250)
Net cash used in financing activities		(2,720,854)	(5,152,994)
Net increase in cash and cash equivalents		3,284,687	1,223,635
Net foreign exchange differences		(3,776)	3,179
Cash and cash equivalents at the beginning of the year	15	5,383,072	4,156,258
Cash and cash equivalents at the end of the year	15	8,663,983	5,383,072

The accompanying notes on pages 7-55 are an integral part of these consolidated financial statements.

OJSC "Pharmstandard"

Consolidated statement of changes in equity

For the year ended 31 December 2012

(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			
Balance at 1 January 2011	37,793	-	(245)	26,409,993	26,447,541	428,214	26,875,755	
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	
Total comprehensive income for the year	-	-	25,168	8,780,520	8,805,688	56,085	8,861,773	
Acquisition of subsidiary (Note 5)	-	(1,825)	-	(5,472,425)	(5,474,250)	30,669	30,669	
Acquisition of treasury shares (Note 7)	-	(1,825)	-	-	-	-	(5,474,250)	
Balance at 31 December 2011	37,793	(1,825)	24,923	29,718,088	29,778,979	514,968	30,293,947	
Profit for the year	-	-	-	9,790,915	9,790,915	173,091	9,964,006	
Other comprehensive income for the year	-	-	(26,845)	-	(26,845)	(4,382)	(31,227)	
Total comprehensive income for the year	-	-	(26,845)	9,790,915	9,764,070	168,709	9,932,779	
Acquisition of subsidiaries (Note 5)	-	-	-	-	-	967,813	967,813	
Disposal of subsidiary	-	-	-	-	-	(352)	(352)	
Acquisition of treasury shares (Note 7)	-	(1,365)	-	(1,975,050)	(1,976,415)	-	(1,976,415)	
Balance at 31 December 2012	37,793	(3,190)	(1,922)	37,533,953	37,566,634	1,651,138	39,217,772	

The accompanying notes on pages 7-55 are an integral part of these consolidated financial statements.

OJSC "Pharmstandard"

Notes to the consolidated financial statements

For the year ended 31 December 2012

(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 products and medical equipment. 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 Moscow region, Vladimir region, Kursk, Tomsk, Ufa, Tyumen (all Russian Federation) and Kharkov (Ukraine). The Company holds the shares in joint ventures and controlled the following major subsidiaries consolidated within the Group as at 31 December 2012 and 2011:

Entity	Country of incorporation	Activity	2012 % share	2011 % share
Subsidiaries:				
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	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. Bigpearl Trading Limited*	Cyprus	Assets holder	50.005	-
12. "Pharmapark" LLC*	Russian Federation	Manufacturing of pharmaceutical products	50.005	-
13. "Biomed named after I.I.Mechnikov" OJSC*	Russian Federation	Manufacturing of pharmaceutical products	49.795	-
14. "Pharmatsevticheskiye innovatsii"*	Russian Federation	Assets holder	50.005	-
15. "PKB named after I.I.Mechnikov" CJSC*	Russian Federation	Assets holder	49.795	-
16. "EKK" OJSC	Russian Federation	Auxiliary company	35.255	-
17. "Lekko" CJSC	Russian Federation	Manufacturing of pharmaceutical products	100	-
18. "Pharmstandard-Phitofarm-NN" LLC	Russian Federation	Manufacturing of pharmaceutical products	-	99
Joint ventures:				
19. "NauchTechStroy Plus" LLC	Russian Federation	Research and development Company	37.5	37.5
20. Moldildo Trading Limited	Cyprus	Intermediary holding company	75	75
21. "Pharmstandard-Medtechnika" LLC	Russian Federation	Distributing of medical equipment	75	75

* These subsidiaries were incorporated in "Bioprocess" group of companies acquired by the Company in July 2012. The Group exercises control over these entities through its controlling interest in Bigpearl Trading Limited. (see Note 5.2).

These consolidated financial statements were authorised for issue by the Board of Directors of OJSC "Pharmstandard" on 25 April 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

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 IFRS (Provisions (Standards) of Accounting of Ukraine – prior to 2012). When necessary 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 2012.

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

- Amendment to IFRS 7 *Financial Instruments: Disclosures – Transfer of Financial Assets*.
- Amendment to IAS 12 *Income Taxes – Deferred Tax: Recovery of Underlying Assets*.
- Amendment to IFRS 1 *First time adoption of IFRS – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters*.

The amendment to IFRS 7 requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Group's consolidated financial statements to understand the relationship with their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the user to evaluate the nature of, and risks associated with, such involvement. The amendment is effective for annual periods beginning on or after 1 July 2011.

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)

The amendment to IAS 12 clarifies the determination of deferred tax on investment property measured at fair value. The amendment introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. Furthermore, it introduces the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 should always be measured on a sale basis of the assets. The amendment is effective for annual periods beginning on or after 1 January 2012.

The amendment to IFRS 1 clarifies that, when an entity's date of transition to IFRS is on or after the functional currency normalisation date, the entity may elect to measure all assets and liabilities held before the functional currency normalisation date, at fair value on the date of transition to IFRS. This fair value may be used as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position. However, this exemption may only be applied to assets and liabilities that were subject to severe hyperinflation. The amendment is effective for annual periods beginning on or after 1 July 2011 with early adoption permitted.

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

- IFRS 9 *Financial Instruments – Classification and Measurement* (effective for annual periods beginning on or after 1 January 2015) – Reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39.
- IFRS 10 *Consolidated Financial Statements (amended in July 2012)* replaces the consolidation guidance in IAS 27 *Consolidated and Separate Financial Statements* (effective for annual periods beginning on or after 1 January 2013) – Establishes a single control model that applies to all entities including special purpose entities.
- IFRS 11 *Joint Arrangements (amended in July 2012)* – Introduces new accounting requirements for joint arrangements (effective for annual period beginning on or after 1 January 2013).
- IFRS 12 *Disclosure of Interests in Other Entities (amended in July 2012)* – 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 IFRS 10, IFRS 11 and IFRS 12 (effective for annual periods 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)

- 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).
- Amendments to IFRS 7 *Disclosures* and IAS 32 *Financial Instruments: Presentation* – Amendments for converged disclosures and offsetting financial assets and financial liabilities (effective for annual periods beginning on or after 1 January 2013 and on or after 1 January 2014, respectively).
- Amendment to IFRS 1 *First time adoption of IFRS – Government loans*. This amendment was issued in March 2012 to provide relief from the retrospective application of IFRSs in relation to government loans (effective for annual periods beginning on or after 1 January 2013).
- IFRIC 20 *Stripping Costs in the Production Phase of a Surface Mine* applies to waste removal (stripping) costs incurred in surface mining activity, during the production phase of the mine.
- In May 2012, the final 2009-2011 annual improvements of IFRSs were issued (with effective dates of annual periods on or after 1 January 2013). The table below shows the list of IFRSs where these narrow amendments have been made:

IFRS (amended in 2012)	Subject of amendment
IFRS 1 <i>First time adoption of IFRS</i>	Clarifying that an entity may apply IFRS 1 more than once under certain circumstances
IFRS 1 <i>First time adoption of IFRS</i>	Clarifying that an entity can choose to adopt IAS 23 <i>Borrowing costs</i> , either from its date of transition or from an earlier date
IAS 1 <i>Presentation of financial statements</i>	The amendment to IAS 1 clarifies the disclosure requirements for comparative information when an entity provides a third statement of financial position either as required by IAS 8 <i>Accounting policies, changes in accounting estimates and errors</i> , or voluntarily
IFRS 1 <i>First time adoption of IFRS</i> as a result of the above amendment to IAS 1	The consequential amendment to IFRS 1 clarifies that a first-time adopter should provide the supporting notes for all statements presented
IAS 16 <i>Property, plant and equipment</i>	Clarifying that spare parts and servicing equipment are classified as property, plant and equipment rather than inventory when they meet the definition of property, plant and equipment
Amendment to IAS 32 <i>Financial instruments: Presentation</i>	Clarifying the treatment of income tax relating to distributions and transaction costs
Amendment to IAS 34 <i>Interim financial reporting</i>	Clarifying the disclosure requirements for segment assets and liabilities in interim financial statements

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

The Group has not early adopted any other standards, interpretations or amendments that has been issued but is not yet effective. The Group does not intend to adopt these standards before their effective date.

Management anticipates that the adoption of these Standards and Interpretations in future periods will have no impact on the results and financial position of the Group presented in these consolidated financial statements except for IFRS 11 *Joint Arrangements* issued in May 2011.

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 but the management believes that the adoption of this Standard will have no significant effect on the results and financial position of the Group.

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.

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)

Business combinations (continued)

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.

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.

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 allowance 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. The cost of third parties products comprise expenditures directly attributable to purchase of these products. 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.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

3.6 Goodwill (continued)

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

3.7 Intangible assets other than goodwill

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 trademarks useful economic life is estimated between 15 and 20 years; for patents useful economic life is estimated accordingly to period which is reflected in patent, but not more than 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.

Development is the application of research findings or other knowledge to a plan or design for the production of a new product before commercial production or use of the product has begun. Development costs are all directly attributable costs necessary to create, produce and prepare the asset to be capable of operating in the manner intended by management. Development costs are capitalised as an intangible asset if all of the following criteria are met:

- a) The technical feasibility of completing the asset so that it will be available for use or sale;
- b) The intention to complete the asset and use or sell it;
- c) The ability to use or sell the asset;
- d) The asset will generate probable future economic benefits and demonstrate the existence of a market or the usefulness of the asset if it is to be used internally;
- e) The availability of adequate technical, financial and other resources to complete the development and to use or sell it; and
- f) The ability to measure reliably the expenditure attributable to the intangible asset.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

3.7 Intangible assets other than goodwill (continued)

Amortisation of development costs starts upon receipt of regulatory approval when the asset becomes available for use and transferred to the designated category of intangible assets other than goodwill.

Expenditure on an intangible item that was initially recognised as an expense shall not be recognised as part of the cost of an intangible asset at a later date.

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. Interest receivable on deposits is classified as other receivables.

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 available-for-sale investments are measured at fair value with changes in fair value recognised in other comprehensive income. 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 13.

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.

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the asset. 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 the Company 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 Company's own equity instruments. Any difference between the face value of shares and the consideration paid for treasury shares is recognised in retained earnings.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

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.

3.16 Employee benefits

In 2012, the Group allocated social contributions for the Russian entities of the Group under provisions of the Russian legislation.

In 2012, 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 30% to the gross remuneration of each employee. The rate 30% was applicable only to the gross remuneration of each employee not more than RR 512 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 22% depending on the annual gross salary of each employee (i.e. above RR 512 of annual gross salary in 2012 the contribution to pension fund is 10%, to social and medical funds – 0%). The Group's contributions relating to ST are expensed in the year to which they relate.

Total contributions for ST amounted to RR 689,718 during the year ended 31 December 2012 (2011: RR 537,901) and they were classified as labour costs in these consolidated financial statements.

In addition, in 2013 the Russian legislation primarily provides for a maintaining of the current ST rate at 30%. Furthermore, the ST rate of 30% will be applicable to the gross remuneration of each employee not more than RR 568 calculated from the beginning of the year and ST rate 10% will be applicable in excess of the gross remuneration of RR 568 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 2012, the exchange rates used for translation foreign currency balances were US\$ 1 = 30.37 roubles; Euro 1 = 40.23 roubles; 1 Ukrainian Hryvnia = 3.76 roubles (2011: US\$ 1 = 32.20 roubles; Euro 1 = 41.67 roubles; Ukrainian Hryvnia = 4.01 roubles).

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

3.17 Foreign currency transactions

The functional currency of the Ukrainian subsidiary is the Ukrainian Hryvnia (Note 5). The functional currencies of the other foreign operations are the United States dollar (US\$) and the Russian Rouble (RR). 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 exchange rate prevailing at the date of transaction. The exchange differences arising on the translation are taken directly to a separate component of equity.

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 trademarks. 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.

3.19 Government grants

Government grants are recognised where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognised as income on a systematic basis over the periods that the costs, which it is intended to compensate, are expensed. When the grant relates to an asset, it is recognised as income in equal amounts over the expected useful life of the related asset.

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.

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, except for goodwill

The determination of impairments involves the use of estimates that include, but are not limited to, the cause, timing and amount of the cash flow. 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.
- *Trademarks:* 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 2012 is RR 2,584,302 (2011: RR 1,561,361). More details are provided in Note 11.

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 conditions of customers were to deteriorate, actual write-offs might be higher than expected. As at 31 December 2012, allowances for doubtful accounts receivable amounted to RR 107,410 (2011: RR 135,600). More details are provided in Note 13.

Write-down of inventories to net realizable value

The Group determines the adjustment 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.

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 and Ukrainian 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. In Russia and Ukraine 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 2012 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

5.1 "Biolik" PJSC acquisition

In 4th 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).

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

Of the total consideration amount, guarantee payment of RR 39,670 (US\$ 1,320 thousand) was contingent upon achievement by Biolik of certain operational and financial targets by 31 December 2011. In 2011 and 2012 that guarantee payment was fully settled by the Group (2011: RR 10,625). 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, "Biolik" PJSC was renamed as "Pharmstandard-Biolik" PJSC.

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.

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)

5.1 "Biolik" PJSC 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
	<u>555,948</u>
Deferred tax liability	19,449
Other long-term liabilities	8,783
Trade and other payables	418,924
Short-term borrowings and loans	25,461
Income tax and other taxes	15,176
	<u>487,793</u>
Fair value of net assets	<u>68,155</u>
Group's share of the fair value of net assets	37,486
Goodwill arising on acquisition	<u>359,531</u>
Consideration paid	<u>397,017</u>

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.

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

5.2. Acquisition of Bioprocess

On 25 June 2012, the Company signed contracts with shareholders of "Bigpearl Trading Limited" ("Bigpearl"), a company registered under the law of Cyprus with the purpose of acquiring 50.005% of the outstanding Bigpearl shares for the total cash consideration of US\$ 57 million (RR 1,910,589).

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)

5.2. Acquisition of Bioprocess (continued)

Bigpearl is the controlling shareholder in several companies involved in the production of various pharmaceutical products, vaccines and active production ingredients registered under the law of Russian Federation jointly known as "Bioprocess", including two primary entities "Biomed named after I.I.Mechnikov" OJSC ("Biomed") "Pharmapark" LLC ("Pharmapark") and three minor auxiliary companies ("Pharmatsevticheskiye innovatsii", "EKK" OJSC and "PKB named after I.I.Mechnikov" CJSC).

On 20 July 2012, the Company finalized the acquisition and obtained control over Bioprocess.

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

	Fair value recognised on acquisition
Intangible assets	342,959
Property, plant and equipment	1,467,981
Trade and other receivables	252,337
Prepayments	10,798
Inventories	276,331
Cash and short-term deposits	83,819
Short-term financial assets	96,623
	<u>2,530,848</u>
Deferred tax liability	(303,572)
Other long-term liabilities	(45,077)
Trade and other payables	(139,073)
Short-term loans	(93,189)
Income tax and other taxes	(42,353)
	<u>(623,264)</u>
Fair value of net assets	<u>1,907,584</u>
Group's share of the fair value of net assets	939,771
Goodwill arising on acquisition	970,818
	<u>1,935,719</u>
Purchase consideration	1,935,719
Minus pre-existing relationship settlements at fair value	(25,130)
Less cash acquired with acquisition of subsidiary	(83,819)
Net cash used in acquisition, net of cash acquired	<u>1,826,770</u>

The fair value of the trade and other receivables at the date of acquisition approximated their gross carrying amount of RR 252,337. None of the trade and other receivables have been impaired and it is expected that the full contractual amounts can be collected.

The goodwill of RR 970,818 comprises the value of expected synergies arising from the acquisition and opportunity for the Group to conclude sale contracts related to the existing and developing products of the acquired entities resulting in substantial growth of the business.

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)

5.2. Acquisition of Bioprocess (continued)

From the date of the acquisition to 31 December 2012, Bioprocess contributed RR 351,920 to the profit before income tax of the Group and RR 739,355 to the revenue of the Group. If the acquisition had taken place at the beginning of the year, the Group's profit before income tax in 2012 would have been RR 12,218,489 (i.e. aggregate profit of the Group and Bioprocess) and revenue of the Group in 2012 would have been RR 51,855,947.

5.3. "Lekko" CJSC acquisition

On 20 November 2012, the Company signed contracts with shareholders of "Lekko" CJSC ("Lekko"), a company registered under the law of Russian Federation with the purpose of acquiring of 100% of the outstanding Lekko shares for the total cash consideration of US\$ 21.8 million (RR 691,206).

Lekko's manufacturing facilities are based in Vladimir region and this company is involved in the production of various pharmaceutical products. Prior to the acquisition Lekko was the Group's related party and manufactured at the Group's order certain pharmaceutical products (e.g. Acipol and Altevir). The management believes that this acquisition will expand the Group's portfolio and reduce manufacturing costs of the products manufactured by Lekko. The Company obtained control over Lekko on 21 November 2012

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

	Fair value Recognised on acquisition
Intangible assets	264,698
Property, plant and equipment	190,614
Trade and other receivables	121,354
Inventories	89,974
Cash and short-term deposits	33,457
Other current assets	5,348
	705,445
Deferred tax liability	(41,502)
Trade and other payables	(45,135)
Income tax and other taxes	(8,165)
	(94,802)
Fair value of net assets	610,643
Goodwill arising on acquisition	75,563
Purchase consideration	686,206
Plus pre-existing relationship settlements at fair value	5,173
Less cash acquired with acquisition of subsidiary	(33,457)
Net cash used in acquisition, net of cash acquired	657,922

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)

5.3. "Lekko" CJSC acquisition (continued)

The fair value and gross amount of the trade and other receivables at the date of acquisition is RR 121,354. None of the trade and other receivables have been impaired and it is expected that the full contractual amounts can be collected.

The goodwill of RR 75,563 comprises the value of expected synergies arising from the acquisition and opportunity for the Group to extend its operating activity and portfolio of pharmaceutical products and to decrease manufacturing costs.

From the date of the acquisition to 31 December 2012, Lekko contributed RR 15,325 to the profit before income tax of the Group and RR 31,844 to the revenue of the Group. If the acquisition had taken place at the beginning of the year, the Group's profit before income tax in 2012 would have been RR 12,491,452 and revenue of the Group in 2012 would have been RR 51,807,027.

6. Joint ventures

6.1. Joint venture "NauchTechStroy Plus" LLC

The Group's share in aggregate amounts of "NauchTechStroy Plus" LLC assets, liabilities and expenses proportionately included in the Group's consolidated financial statements are detailed below:

	31 December 2012	31 December 2011
Current assets	35,011	101,562
Long-term assets	418,419	332,745
Current liabilities	(38,531)	(42,332)
Non-current liabilities	(43,045)	-
Income from non-core operations included in other income (Note 26)	2,842	-
Expenses	(24,021)	(27,494)

Neither "NauchTechStroy Plus" LLC, nor the Group have any commitments in respect of the operations of the joint venture.

6.2. Joint venture "Pharmstandard-Medtechnika" LLC

In 2nd 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. Joint venture "Pharmstandard-Medtechnika" LLC (continued)

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

Since 3rd quarter 2011 Pharmstandard-Medtechnika started its activity. The management of the Company considered 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:

	31 December 2012	31 December 2011
Current assets	368,225	198,048
Current liabilities	(177,392)	(86,661)
Revenue	609,474	119,188
Expenses	(616,986)	(136,611)

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

7. Treasury shares purchase

On 18 January 2011, "Pharmstandard-Leksredstva" OJSC 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, "Pharmstandard-Leksredstva" OJSC closed this offer and purchased 1,824,750 ordinary shares of the Company representing about 4.83% of the Company's authorized share capital for a cash consideration of RR 5,474,250.

In 2012, the management of the Group approved a plan to purchase the Company's ordinary shares at Russian stock exchanges by the Company's subsidiary "Pharmstandard-Leksredstva" OJSC. In June 2012, "Pharmstandard-Leksredstva" OJSC purchased 765,000 ordinary shares of the Company representing about 2.02% of the Company's authorized share capital for a total cash consideration of RR 1,079,415. In August 2012, "Pharmstandard-Leksredstva" OJSC purchased 600,000 ordinary shares of the Company representing about 1.59% of the Company's authorized share capital for a total cash consideration of RR 897,000.

The difference between the face value of all purchased ordinary shares and consideration paid for those ordinary shares was debited directly to retained earnings.

After these transactions, "Pharmstandard-Leksredstva" holds 8.44% of issued shares of the Company as treasury shares.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

8. 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 "TZMOI" OJSC, as production subsidiary, and by equipment department of OJSC "Pharmstandard", as managing and logistics division. Since 3rd quarter 2011, staff of equipment department of OJSC "Pharmstandard" was transferred to "Pharmstandard-Medtechnika" LLC (Note 6.2), the joint venture representing management, distribution and logistics company specialized in trading 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 segments' 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 2012 and 2011. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Capital expenditure comprises additions to property, plant and equipment.

There were no significant intercompany transactions between these operating segments.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

8. Segment information (continued)

The following tables present revenue and profit information regarding the Group's operating segments:

Year ended 31 December 2012	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Group
Sales to external customers	50,061,256	1,330,219	51,391,475
Total revenue	50,061,256	1,330,219	51,391,475
Gross profit	18,443,154	460,076	18,903,230
Segment result	12,238,893	240,397	12,479,290
Financial income, net			91,119
Profit before income tax			12,570,409
Income tax expense			(2,606,403)
Profit for the year			9,964,006
Segment assets	52,072,897	1,274,772	53,347,669
Total assets	52,072,897	1,274,772	53,347,669
Segment liabilities	12,597,351	261,787	12,859,138
Unallocated liabilities			1,270,759
Total liabilities			14,129,897
Acquisition of property, plant and equipment (Note 10)	1,462,550	37,871	1,500,421
Depreciation and amortisation	955,680	32,569	988,249
Reversal of impairment charge of property, plant and equipment (Note 10)	8,073	12,862	20,935
Reversal of impairment of intangible assets (Note 11)	25,000	-	25,000

As at 31 December 2012 the unallocated liabilities of RUR 1,270,759 consist of income tax payable of RR 495,776 and deferred tax liability of 774,983.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

8. Segment information (continued)

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 10)	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 10)	13,794	31,942	45,736

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.

Revenues from certain customers in the pharmaceutical products segment approximated or exceeded 10% of total Group's segment revenue.

The table below shows the revenue from these customers:

Customer	2012	2011
The Ministry of Health of Russian Federation (federal state open auctions)	13,042,525	13,289,821
Customer 1 (only third party products, Note 22)	7,147,055	3,615,047
Customer 2	5,408,139	4,008,796
Customer 3	4,904,393	3,547,568

The Group's sales to the Ministry of Health represent about 25% of the total Group's revenue for 2012 (2011: 30%).

In 2012 and 2011, the Group purchased Velcade® in-bulk form from the Customer 1, packed it on production facilities of "Pharmstandard-Ufavita" OJSC and sold back to the Customer 1 for RR 7,147,055 (2011: RR 3,596,447). 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.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

9. 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 2012 and 2011 are detailed below.

Balances with related parties

2012	Short-term financial assets – (a)	Cash and short- term deposits – (a) Note 15	Short-term and long-term loans and borrowings – (b)	Trade and other receivables – (a) Note 13	Trade payables, other payables and accruals – (c) Note 19
Other related parties ¹	3,063,711	5,158,196	81,650	87,017	684,666
Total	3,063,711	5,158,196	81,650	87,017	684,666
2011	Short-term financial assets – (a)	Cash and short- term deposits – (a) Note 15	Short-term loans and borrowings – (b)	Trade and other receivables – (a) Note 13	Trade payables, other payables and accruals – (c) Note 19
Other related parties	200,000	5,285,895	32,900	20,922	1,391,371
Total	200,000	5,285,895	32,900	20,922	1,391,371

- (a) These balances primarily represented (i) cash, short-term bank deposits, issued promissory notes and interest receivable at a bank controlled by a related party (Notes 13, 15 and 16), (ii) short-term loans provided to a majority shareholder (refer to sub-section "Loans provided to majority shareholder" below and Note 16), (iii) short-term loan provided to other related party (refer to sub-section "Loan provided to other related party" below and Note 16) and (iv) immaterial trade receivables for agency fee from sales of certain products of the related party.
- (b) This balance primarily represented (i) non-interest bearing loan received by "NauchTechStroy Plus" LLC from another participant of this joint-venture (Note 17); since July 2011, this participant is a member of the Board of Directors of the Company; and (ii) other interest bearing loan received by "NauchTechStroy Plus" LLC from a related party.
- (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.

¹ 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)

9. Balances and transactions with related parties (continued)

Cash balances with the related bank carry no interest. Short-term financial assets at 31 December 2012 and 2011 include cash deposits in the related bank and carry 3.5% interest p.a. for deposits denominated in US\$ (2011: 6.5%-7.0% interest p.a. for deposits denominated in Russian Roubles). For more details see Notes 15 and 16.

Significant transactions with related parties

Statement of comprehensive income caption	Relationship	2012	2011
Revenue	Other related parties	51,227	4,620
Interest income from deposits placed in a related bank (included in financial income)	Other related parties	15,489	23,349
License fee (included in distribution costs) (A)	Other related parties	(11,314)	(30,470)
Warehouse rental expenses (included in distribution costs) (B)	Other related parties	(91,987)	(86,816)
Office rental expenses (included in general and administrative expenses) (B)	Other related parties	(55,368)	(48,277)
Cost of sales (C)	Other related parties	(1,663,570)	(1,827,287)
Agency fee income (included in other income) (D)	Other related parties	295,526	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	34,541	-

(A) License fee

License fee is paid for use of several trademarks 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) Cost of sales

The Group holds a purchase contracts for supply of third-party product Koagil VII manufactured by a related party. The presented amount includes the cost of this product in the amount of RR 1,417,570 (2011: RR 1,608,196) sold by the Group primarily through open state auctions (Notes 22 and 23). As of 31 December 2012 the Group had RR 8,384 unsold inventory balances of Koagil VII. The remaining amount of RR 246,000 (2011: RR 219,091 included in the cost of sales line primarily represents the cost of raw materials purchased from a related party.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

9. Balances and transactions with related parties (continued)

Significant transactions with related parties (continued)

(D) Agency fee income

The Company holds an agency contract with the related party for distribution and sales of certain products owned by a related party.

Loans 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 Group provided unsecured US\$ denominated short-term loans to Augment with the initial maturity date of 28 February 2013 and fixed interest rate of 3.5% p.a. by two tranches:

- in April 2012, of US\$ 27,500 thousand (RR 835,249 at the exchange rate as of 31 December 2012); and
- in June 2012, of US\$ 20,000 thousand (RR 607,454 at the exchange rate as of 31 December 2012).

In February 2013 the Group postponed maturity dates for the both loans to 31 August 2013.

Loan provided to other related party

In December 2012, the Company provided an unsecured short-term loan to other related party of RR 72,000 with maturity date of 27 December 2013 and fixed interest rate of 12% p.a. This loan provided for the purpose of financing the current business activity of that related party.

Loan received from a related party

In December 2012, the Company's joint-venture "NauchTechStroy Plus" LLC received an interest bearing long-term loans of RR 130,000 from other related party (for more details see Note 17). The loan bears interest at 12% p.a. In accordance with the Group's accounting policies the Group recognized RR 48,750 of the total amount of these loans as a proportional part of the Group's liabilities in this joint-venture.

Compensation to key management personnel

Total compensation to key management personnel, amounted to RR 42,432 for the year ended 31 December 2012 (2011: RR 56,514). Such compensation represents the payroll and bonuses included in general and administrative expenses.

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Notes to the consolidated financial statements (continued)

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

10. Property, plant and equipment

Property, plant and equipment consist of the following:

31 December 2012	Land	Buildings	Plant and machinery	Equipment, motor vehicles and other	Assets under construction	Total
Cost						
Balance at 31 December 2011	46,153	2,976,431	3,156,272	510,718	1,453,656	8,143,230
Additions	628	276	62,790	94,813	1,341,914	1,500,421
Transfers	-	595,905	519,681	18,584	(1,134,170)	-
Disposals	-	(4,045)	(31,198)	(27,401)	(6,132)	(68,776)
Acquisition through business combinations (Note 5)	409,794	879,739	334,361	9,498	25,203	1,658,595
Transfers to non-current assets classified as held for sale	-	-	-	-	(7,251)	(7,251)
Foreign exchange differences	-	(8,845)	(8,489)	(693)	(5,657)	(23,684)
Balance at 31 December 2012	456,575	4,439,461	4,033,417	605,519	1,667,563	11,202,535
Accumulated depreciation and impairment						
Balance at 31 December 2011	-	428,273	1,856,028	264,534	50,703	2,599,538
Depreciation charge	-	115,243	422,627	91,335	-	629,205
Disposals	-	(32)	(12,506)	(23,605)	(134)	(36,277)
Impairment and reversal of impairment (a)	-	(5,201)	(6,463)	18	(9,289)	(20,935)
Foreign exchange differences	-	(615)	(1,577)	(211)	(1,079)	(3,482)
Balance at 31 December 2012	-	537,668	2,258,109	332,071	40,201	3,168,049
Net book value						
Balance at 31 December 2011	46,153	2,548,158	1,300,244	246,184	1,402,953	5,543,692
Balance at 31 December 2012	456,575	3,901,793	1,775,308	273,448	1,627,362	8,034,486

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

10. Property, plant and equipment (continued)

31 December 2011	Land	Buildings	Plant and machinery	Equipment, motor vehicles and other	Assets under construction	Total
Cost						
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	-	(52,297)	(6,042)	(614)	(6,249)	(65,202)
Effect from change of Group's share in joint-venture (b)	(4,461)	(2,622)	(4,591)	(523)	(41,148)	(53,345)
Foreign exchange differences	-	7,937	7,460	603	4,709	20,709
Balance at 31 December 2011	46,153	2,976,431	3,156,272	510,718	1,453,656	8,143,230
Accumulated depreciation and impairment						
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	-	(26,943)	(3,104)	(588)	-	(30,635)
Effect from change of Group's share in joint-venture (b)	-	(56)	(112)	(35)	-	(203)
Foreign exchange differences	-	597	1,520	208	207	2,532
Balance at 31 December 2011	-	428,273	1,856,028	264,534	50,703	2,599,538
Net book value						
Balance at 31 December 2010	33,912	1,903,389	1,217,746	201,845	811,187	4,168,079
Balance at 31 December 2011	46,153	2,548,158	1,300,244	246,184	1,402,953	5,543,692

(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 closing of production line of medical disposables. The impairment charge equals to the carrying value of those equipment and assets under construction. In 2012, the Group started to use some items of property, plant and equipment and reversed impairment previously recorded in relation to these items.

(b) In 2011 the Group's interest in the joint venture "NauchTechStroy Plus" LLC decreased from 50% to 37.5%.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

10. Property, plant and equipment (continued)

In 2012 and 2011, the Group did not borrow money for capital construction and there were no new qualifying assets, therefore no borrowing costs were capitalized.

The Group assets include only an insignificant 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 2012 was RR 8,214 (2011: RR 9,833). Such payments are reassessed by the state authorities on an annual basis. No such reassessment has been completed for 2013 and beyond as of the date of approval of these consolidated financial statements for issue.

11. Intangible assets

	Goodwill	Trademarks and patents	Development costs	Total
Cost				
Balance at 31 December 2011	1,561,361	6,730,141	-	8,291,502
Acquisition through business combinations (Note 5)	1,046,381	456,057	151,600	1,654,038
Additions	-	-	28,760	28,760
Foreign exchange differences	(23,440)	-	-	(23,440)
Balance at 31 December 2012	<u>2,584,302</u>	<u>7,186,198</u>	<u>180,360</u>	<u>9,950,860</u>
Accumulated amortisation and impairment				
Balance at 31 December 2011	-	1,573,878	-	1,573,878
Amortisation expense	-	359,044	-	359,044
Reversal of impairment (a) - Note 26	-	(25,000)	-	(25,000)
Balance at 31 December 2012	<u>-</u>	<u>1,907,922</u>	<u>-</u>	<u>1,907,922</u>
Net book value				
Balance at 31 December 2011	<u>1,561,361</u>	<u>5,156,263</u>	<u>-</u>	<u>6,717,624</u>
Balance at 31 December 2012	<u>2,584,302</u>	<u>5,278,276</u>	<u>180,360</u>	<u>8,042,938</u>

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

11. Intangible assets (continued)

	Goodwill	Trademarks and patents	Total
Cost			
Balance at 31 December 2010	1,180,469	6,730,141	7,910,610
Additions through business combinations (Note 5)	359,531	-	359,531
Foreign exchange differences	21,361	-	21,361
Balance at 31 December 2011	1,561,361	6,730,141	8,291,502
Accumulated amortisation and impairment			
Balance at 31 December 2010	-	1,224,400	1,224,400
Amortisation expense	-	349,478	349,478
Balance at 31 December 2011	-	1,573,878	1,573,878
Net book value			
Balance at 31 December 2010	1,180,469	5,505,741	6,686,210
Balance at 31 December 2011	1,561,361	5,156,263	6,717,624

- (a) The reversal of impairment mainly relates to increase in consumption of certain pharmaceutical Group's products in 2012. The recoverable amount was 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 mid-term average growth rate for pharmaceuticals market. The discount rate applied to cash flow projections is 14.8%.

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

Name	Carrying amount		Remaining amortization period (years)	
	2012	2011	2012	2011
Afobazol®	1,642,942	1,747,256	16	17
Arbidol®	1,404,960	1,508,393	13	14
Acipol®	680,649	734,385	13	14
Flucostat®	546,549	586,786	13	14

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	
	2012	2011	2012	2011	2012	2011
Carrying amount of goodwill	2,365,448	1,342,507	218,854	218,854	2,584,302	1,561,361

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

11. Intangible assets (continued)

Impairment testing of goodwill (continued)

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 (2011: 5%). The discount rate applied to cash flow projections is 14.8% (2011: 14.3%).

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.

Sensitivity to changes in assumptions

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

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

12. Inventories

Inventories consist of the following:

	2012	2011
Raw materials - at cost	3,158,610	3,369,275
Work in progress - at cost	347,898	211,645
Finished goods - at net realisable value (a)	5,023,455	3,564,371
	<u>8,529,963</u>	<u>7,145,291</u>

- (a) On 31 December 2012, finished goods balance included third party products in the amount of RR 1,463,239 (2011: 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:

	2012	2011
Balance at 1 January	58,919	41,164
Additional write-downs	246,032	53,453
Unused amounts reversed	(1,278)	(675)
Utilised during the year	(68,975)	(34,959)
Foreign exchange differences	(309)	(64)
Balance at 31 December	<u>234,389</u>	<u>58,919</u>

13. Trade and other receivables

	2012	2011
Trade receivables (net of allowance for impairment of receivables of RR 107,410 (2011: RR 135,600))	14,905,394	13,973,032
Interest receivable - third parties	56,178	145,744
Interest receivable - related parties (Note 9)	15,490	8,450
Other receivables (a)	-	120,195
	<u>14,977,062</u>	<u>14,247,421</u>

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

At 31 December 2012 RR 193,979 of trade receivables were denominated in currencies other than Russian Roubles, primarily in US\$ (RR: 114,632) and Ukrainian Hryvnia (RR: 79,146). At 31 December 2011 RR 287,216 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)

13. Trade and other receivables (continued)

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

	2012	2011
Balance at 1 January	135,600	48,781
Additional allowance	21,649	94,046
Unused amounts reversed	(45,915)	(7,440)
Utilised during the year	(2,782)	(819)
Translation differences	(1,142)	1,032
Balance at 31 December	<u>107,410</u>	<u>135,600</u>

14. Prepayments

	2012	2011
Trade prepayments for services and materials	280,448	245,734
Trade prepayments for third parties products	-	500,000
	<u>280,448</u>	<u>745,734</u>

15. Cash and short-term deposits

Cash and short-term deposits consist of the following:

	2012	2011
Cash in bank – Russian Roubles	2,841,147	5,273,076
Cash in bank – Ukrainian Hryvnia	13,944	7,072
Cash in bank – US\$ and Euro	2,360,240	41,614
Short-term bank deposits with original maturity less than 90 days – Russian Roubles (a)	3,262,000	-
Short-term bank deposits with original maturity less than 90 days – Ukrainian Hryvnia (a)	82,698	30,042
Short-term bank deposits with original maturity less than 90 days placed in related bank – Russian Roubles (b)	28,327	-
Cash deposits on state open auctions – Russian Roubles (c)	75,627	31,268
	<u>8,663,983</u>	<u>5,383,072</u>

- (a) Short-term bank deposits bear an interest rate of 5.59%-7.55% p.a. for deposits denominated in Russian Roubles and 20.3%-24.0% p.a. for deposits denominated in Ukrainian Hryvnia (2011: 10.5% p.a. for deposits denominated in Ukrainian Hryvnia).
- (b) This item represents cash deposits 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. These cash deposits have a 2.2%-3.0% p.a. and released within 30 days from the date of deposit.
- (c) This item represents cash deposits restricted for use and placed to secure participation in state open auctions announced by the Government of the Russian Federation. These cash deposits are interest free, payable on demand, and are usually released within 30 days from the date of placing the deposit.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

16. Short-term financial assets

	2012	2011
<i>Accounted for as loans and receivables:</i>		
Promissory notes – Russian Roubles	990,790	586,820
Promissory notes issued by a related bank – US\$ – Note 9	607,454	-
Short-term bank deposits – Russian Roubles	400,000	2,300,000
Short-term bank deposits placed in related bank – Russian Roubles – Note 9	-	200,000
Short-term bank deposits – US\$	-	321,961
Short-term bank deposits placed in related bank – US\$ – Note 9	941,554	-
Short-term loans (a)	-	25,000
Short-term loan provided to other related party – Russian Roubles – Note 9	72,000	-
Short-term loans provided to majority shareholder – US\$ – Note 9	1,442,703	-
<i>Accounted for as available for sale:</i>		
Securities	13,513	9,340
Other	1,858	2,920
	<u>4,469,872</u>	<u>3,446,041</u>

(a) In 2012, the Group recognized an impairment loss of RR 25,000 (2011: 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 denominated in Russian Roubles as of 31 December 2012 earn interest at a rate of 8.5% p.a. (2011: 8.0%-8.5% p.a.). The short-term bank deposits placed in related bank and denominated in US\$ earn interest at a rate of 3.5% p.a.

17. Borrowings and loans

	2012	2011
Long-term borrowings and loans		
Loans from a related party – Russian Roubles (Note 9)	48,750	-
	<u>48,750</u>	<u>-</u>

Long-term debt is repayable as follows:

	2012	2011
1 to 2 years (a)	15,000	
2 to 2 years (a)	33,750	-
	<u>48,750</u>	<u>-</u>

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

17. Borrowings and loans (continued)

	2012	2011
Short-term borrowings and loans		
Short-term loan – Russian Roubles (b)	-	700,000
Loan from related party – Russian Roubles (Note 9)	32,250	32,250
Other loans – Note 9	1,300	1,300
	33,550	733,550

- (a) The unsecured loan in amount RR 33,750 was raised in October 2012. The unsecured loan in amount RR 15,000 was raised in December 2012. These loans bore a fixed interest rate of 12% p.a. The loan in amount RR 33,750 has maturity date 19 October 2015, the loan in amount RR 15,000 has maturity date 30 December 2014.
- (b) 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.

18. Other taxes payable

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

	2012	2011
Value-added tax	971,561	512,696
Social taxes	60,857	31,936
Property tax	17,488	14,101
Other taxes	40,719	40,552
	1,090,625	599,285

19. Trade and other payables and accruals, and advances received

	2012	2011
Trade payables	1,913,063	1,412,990
Payables for products procurement – third parties (a)	7,751,941	7,346,166
Payables for products procurement and other payables – related parties (Note 9, a)	684,666	1,391,371
Advances received	143,579	103,359
Issued promissory notes – US\$ and Euro (b)	240,514	277,030
Other payables and accruals	863,530	704,072
	11,597,293	11,234,988

- (a) These balances represent payables for branded third parties products manufactured by other pharmaceutical companies.
- (b) 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 "Pharmstandard-Biolik". These promissory notes are payable on demand (Note 5).

At 31 December 2012 RR 2,052,699 of total payables were denominated in currencies other than Russian Rouble, primarily in US\$ (2011: RR 1,597,538).

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

20. Other non-current liabilities

	2012	2011
Deferred income (a)	75,000	-
Other	13,920	9,265
	<u>88,920</u>	<u>9,265</u>

- (a) The newly acquired subsidiaries of the Group "Pharmapark" LLC and "Biomed named after I.I. Mechnikov" OJSC (Note 5) receive government grants to finance certain development costs. This amount represents cash proceeds from government grants and it will be credited to profit or loss over useful life of the intangible asset recognised upon completion of the development stage (see Notes 3.7, 3.19 and 11).

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 2012 and 2011 except for the acquisition of Company's treasury shares by "Pharmstandard-Leksredstva" OJSC as described in Note 7.

As of 31 December 2012 and 2011 54.32% 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 2011 and 2012, approximately 8.44% of the Company's shares were acquired by the Company's subsidiary "Pharmstandard-Leksredstva" OJSC and were recognized as treasury shares (for more details see Note 7).

After these transactions, "Pharmstandard-Leksredstva" OJSC holds 8.44% of issued shares as treasury shares, Augment holds 54.32% of share capital and 37.24% 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 27,363,676 (unaudited) of undistributed and unreserved earnings as of 31 December 2012 (2011: RR 20,559,281- unaudited). In addition, the Company's share in the undistributed and unreserved earnings of the subsidiaries and joint ventures was approximately RR 19,017,643 (unaudited) as at 31 December 2012 (2011: RR 14,883,682 - unaudited).

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

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)

Earnings per share

Earnings per share are as follows:

	2012	2011
Weighted average number of ordinary shares outstanding (Note 7)	35,385,353	36,271,978
Profit for the year attributable to the shareholders	9,790,915	8,780,520
Basic and diluted earnings per share, Russian Roubles	276.69	242.07

22. Revenue

Revenue breakdown by product groups comprised the following:

	2012	2011
Pharmaceutical products		
Over the Counter ("OTC")		
Branded	12,461,582	13,270,489
Non-branded	2,823,266	2,226,822
	<u>15,284,848</u>	<u>15,497,311</u>
Prescription		
Branded	4,957,477	3,509,433
Non-branded	938,200	769,996
	<u>5,895,677</u>	<u>4,279,429</u>
Third parties products (a)	28,279,120	21,725,971
Other – substances and APIs	601,611	387,569
Total pharmaceutical products	<u>50,061,256</u>	<u>41,890,280</u>
Medical equipment	<u>1,330,219</u>	<u>763,607</u>
	<u>51,391,475</u>	<u>42,653,887</u>

(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®, Pulmozyme® and Reduxin manufactured by other pharmaceutical companies.

23. Cost of sales

The components of cost of sales were as follows:

	2012	2011
Materials and components	6,819,221	6,137,034
Third parties products	22,944,229	18,323,186
Production overheads	1,504,435	1,170,378
Depreciation and amortisation	847,094	792,840
Direct labour costs	373,266	304,981
	<u>32,488,245</u>	<u>26,728,419</u>

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:

	2012	2011
Advertising	2,753,636	1,692,558
Labour costs	1,366,104	1,092,143
Freight, communication and insurance of goods in transit	202,805	207,107
Trainings and other services	73,748	78,100
Certification expenses	98,774	87,620
Rent	93,229	88,034
Commission and license fee	132,110	78,987
Materials, maintenance and utilities	121,170	128,909
Travel and entertainment	141,760	92,295
Depreciation	79,343	59,860
Other expenses	42,461	36,502
	<u>5,105,140</u>	<u>3,642,115</u>

25. General and administrative expenses

General and administrative expenses were as follows:

	2012	2011
Labour costs	955,032	769,209
Services, legal, audit and consulting expense	104,701	97,698
Travel and entertainment	37,985	27,584
Taxes other than income tax	24,659	21,300
Property and other insurance	20,976	18,403
Freight and communication	30,870	28,169
Depreciation	61,812	36,159
Rent	83,107	58,928
Materials, maintenance and utilities	145,924	104,317
Other	41,538	34,382
	<u>1,506,604</u>	<u>1,196,149</u>

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:

	2012	2011
Foreign exchange gain, net	-	9,370
Gain from disposal of property, plant and equipment	-	22,619
Agency fee (a)	340,882	144,413
Income from non-core operations (b)	55,919	21,834
Cash rebates	-	63,478
Reversal of impairment – property, plant and equipment (Note 10)	23,087	7,333
Reversal of impairment – intangible assets (Note 11)	25,000	-
Other income	4,807	25,646
	<u>449,695</u>	<u>294,693</u>

- (a) Agency fee was earned by the Company in respect of sale of certain third-parties products, including products manufactured by related parties.
- (b) Income from non-core operations primarily includes (i) income from sale of materials and other assets not included in other categories (ii) income from tolling operation (iii) income from other non-core services such as manufacturing production and utilities.

Other expenses comprised the following:

	2012	2011
Foreign exchange loss	36,061	-
Loss from disposal of property, plant and equipment	3,436	-
Expense related to the joint venture	-	53,142
Charity	6,029	30,062
Bank charges (b)	28,463	32,878
Other taxes and penalties	81,044	60,128
Impairment of property, plant and equipment (Note 10)	2,152	53,069
Impairment of short-term financial assets (c)	25,000	25,000
Loss recognized on non-current assets classified as held for sale	-	16,537
Other	79,706	61,780
	<u>261,891</u>	<u>332,596</u>

- (a) In May 2011 the Group's share in "NauchTechStroy Plus" LLC 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.
- (b) Bank charges includes (i) commission for daily banking operations, and (ii) commission for certain bank guarantees obtained by the Group.
- (c) In 2012 and 2011, the Group recognized an impairment loss in the amount of RR 25,000 per each year for the loan provided by the Company in 2009 (Note 16).

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:

	2012	2011
Interest income:		
Income from changes in fair value of Interest Rate Swap (a)	-	11,249
Interest income from loans and deposits	125,306	220,270
Other	1,461	-
	<u>126,767</u>	<u>231,519</u>
Interest expense:		
Loss from Interest Rate Swap (a)	-	10,453
Interest expense on borrowings and loans	35,648	30,139
Other	-	2,643
	<u>35,648</u>	<u>43,235</u>

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

28. Income tax

	2012	2011
Income tax expense - current	2,758,284	2,484,941
Deferred tax benefit- origination and reversal of temporary differences	(151,881)	(79,993)
Income tax expense	<u>2,606,403</u>	<u>2,404,948</u>

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

	2012	2011
Profit before income tax	<u>12,570,409</u>	<u>11,237,585</u>
Theoretical tax charge at Russian statutory rate of 20%	2,514,082	2,247,517
Effect of the difference in tax rates in countries other than the Russia	1,529	701
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	<u>90,792</u>	<u>156,730</u>
Income tax expense	<u>2,606,403</u>	<u>2,404,948</u>

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 2010	Temporary differences recognition and reversal in profit and loss	Effect of business combination in 2011 (Note 5)	31 December 2011	Temporary differences recognition and reversal in profit and loss	Effect of business combinations in 2012 (Note 5)	31 December 2012
Tax effects of deductible temporary differences – asset (liability):							
Property, plant and equipment (Note 10)	(285,957)	15,713	(15,241)	(285,485)	(2,140)	(277,414)	(565,039)
Intangible assets (Note 11)	(484,497)	30,540	-	(453,957)	24,277	(86,165)	(515,845)
Trade and other receivables	23,971	(29,723)	3,389	(2,363)	26,973	7,622	32,232
Inventories	91,857	51,060	(11,036)	131,881	88,582	(15,531)	204,932
Trade and other payables	4,896	13,224	1,992	20,112	14,044	3,331	37,487
Financial Instruments	2,250	2,963	45	5,258	(2,816)	-	2,442
Other	5,146	(3,784)	1,402	2,764	2,961	23,083	28,808
Total net deferred tax liability	<u>(642,334)</u>	<u>79,993</u>	<u>(19,449)</u>	<u>(581,790)</u>	<u>151,881</u>	<u>(345,074)</u>	<u>(774,983)</u>

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 trademarks in excess of the amortisation for tax purposes; and
- deemed cost adjustments upon conversion to IFRS.

The aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognised was approximately RR 11,552,934 as at 31 December 2012 (2011: RR 10,534,712).

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 2012, 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.

The second largest market the Group operates is Ukraine. The Ukrainian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world and while deemed to be of market status continues to display certain characteristics consistent with that of an economy in transition. These characteristics include, but are not limited to, low levels of liquidity in the capital markets, high inflation and the existence of currency controls which cause the national currency to be illiquid outside of Ukraine. The stability of the Ukrainian economy will be significantly impacted by the Government's policies and actions with regard to administrative, legal, and economic reforms. As a result, operations in Ukraine involve risks that are not typical for developed markets.

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 and Ukrainian 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 2012 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 and Ukrainian 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 2012. 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 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 (in Russia 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.

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)

Russian transfer pricing legislation

The new Russian transfer pricing legislation, which came into force on 1 January 2012, allows the tax Russian authority to apply transfer pricing adjustments and impose additional profits tax liabilities in respect of all "controlled" transactions if the transaction price differs from the market level of prices. The list of "controlled" transactions includes transactions performed with related parties and certain types of cross-border transactions. For domestic transactions the transfer pricing rules apply only if the amount of all transaction with related party exceeds RUR 3 billion in 2012. In cases where the domestic transaction resulted in an accrual of additional tax liabilities for one party, another party could correspondingly adjust its profit tax liabilities according to the special notification issued by the authorized body in due course.

The current Russian transfer pricing rules have considerably increased the compliance burden for the taxpayers compared to the transfer pricing rules which were in effect before 2012 due to, inter alia, shifting the burden of proof from the Russian tax authorities to the taxpayers. These rules are applicable not only to the transactions taking place in 2012 but also to the prior transactions with related parties if related income and expenses were recognized in 2012. Special transfer pricing rules apply to transactions with securities and derivatives.

In 2012, the Group determined its tax liabilities arising from "controlled" transactions using actual transaction prices.

Due to the uncertainty and absence of current practice of application of the current Russian transfer pricing legislation the Russian tax authorities may challenge the level of prices applied by the Group under the "controlled" transactions and assess additional tax liabilities unless the Group is able to demonstrate the use of market prices with respect to the "controlled" transactions, and that there has been proper reporting to the Russian tax authorities, supported by appropriate available transfer pricing documentation.

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.

Operating lease agreements

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

Commitment liabilities

In 2012, the Group provided certain unsecured guaranties in the total amount of RR 111,645 with maturity period from two years to three years for related parties to provide some state contracts signed by these related parties. 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 2012.

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)

Statutory inspection of "Biolik"

In December 2012, the Ukrainian authorities performed an extraordinary inspection of Biolik compliance with the applicable production quality standards. The inspection revealed certain formal deficiencies in the controls over production quality resulting in suspension in Biolik production process until resolution of those deficiencies. Those deficiencies were primarily due to the reconstruction of production and maintenance work to improve the quality of Biolik's products. Management believes that the deficiencies will be resolved soon and Biolik production process will be renewed in the near future. In addition, management believes that the discussed circumstances will not have material adverse effects on the Group.

Significant litigations

The Company is involved in on-going litigation initiated by the Federal Anti-monopoly Service of Russia regarding breach by the Company of anti-monopoly legislation at the state open tender in 2009.

While there is uncertainty as to ultimate outcome of this litigation, the Group has reasonable grounds to conclude that the associated risks of imposing the applicable administrative fines up to RR 201,000 are not probable. Therefore, no provision for this contingent liability was recorded in these consolidated financial statements. Management estimates that the litigation will be finalized in 2013.

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 2012.

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.

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)

31 December 2012:

	Total	Level 1	Level 2	Level 3
Assets measured at fair value				
Financial assets				
Securities (Note 16)	13,513	9,842	-	3,671

31 December 2011:

	Total	Level 1	Level 2	Level 3
Assets measured at fair value				
Financial assets				
Securities (Note 16)	9,340	8,380	-	960

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.

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

Management believes that the Group does not have significant interest rate risk as of 31 December 2012. The Group has certain short-term financial investments (loans and bank deposits, see Notes 15 and 16) at fixed interest rates based on current market rates and has no borrowings and loans except for loans from related parties as described in Note 9. Therefore, the Group has no risk to interest rates changes due to possible changes in market interest rates.

Foreign exchange risk

The Group has certain US dollar denominated cash and cash equivalents, short-term bank deposits, promissory notes, trade payables, issued promissory notes and other payables (Note 19), trade receivables (Note 13) 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.

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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)

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
As at 31 December 2012		
US\$/Roubles exchange rate	+10%	406,227
US\$/Roubles exchange rate	-10%	(406,227)
As at 31 December 2011		
US\$/Roubles exchange rate	+10%	(51,621)
US\$/Roubles exchange rate	-10%	51,621

Foreign exchange risk (continued)

	Increase/decrease in US\$ rate	Effect on profit before tax
As at 31 December 2012		
US\$/Ukrainian Hryvnia exchange rate	+7%	(13,570)
US\$/Ukrainian Hryvnia exchange rate	-7%	13,570
As at 31 December 2011		
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.

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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)

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 four months.

	Total	Less than 3 months	3 to 6 months	6 to 12 months	More than 12 months
As at 31 December 2012					
Borrowings and loans (Note 9 and 17)	82,300	-	-	33,550	48,750
Other current liabilities	25,159	25,159	-	-	-
Other non-current liabilities	5,225	-	-	-	5,225
Total	112,684	25,159	-	33,550	53,975
	Total	Less than 3 months	3 to 6 months	6 to 12 months	
As at 31 December 2011					
Guarantee payment for Biolik acquisition (Note 5)	10,625	10,625	-	-	-
Borrowings and loans (Note 9 and 17)	735,828	702,278	-	33,550	-
Other current liabilities	26,669	26,669	-	-	-
Total	773,122	739,572	-	33,550	-

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 appropriate internal control procedures.

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

Cash and deposits are mainly held in related bank, so the Group assessed the credit risk as low.

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
31 December 2012	14,977,062	14,222,302	516,441	168,713	39,735	21,879	7,992
31 December 2011	14,247,421	12,055,149	1,948,540	165,888	23,543	7,964	46,337

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)

Sales concentration to a small group of customers

The Group works with six distributors that together represent more than 50% of the Group's revenue² for 2012 (seven distributors in 2011). 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.

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.

	2012	2011
Borrowings and loans	82,300	733,550
Trade and other payables	11,453,714	11,131,629
Less: cash and short-term deposits	(8,663,983)	(5,383,072)
Net debt	2,872,031	6,482,107
Equity	37,566,634	29,778,979
Capital and net debt	40,438,665	36,261,086
Gearing ratio	7%	18%

31. Events after the reporting period

Treasury shares purchase

On 15 February 2013, the management of the Group announced a plan to purchase the Company's ordinary shares at Russian stock exchanges and/or at London stock exchange in the form of Global Depositary Receipts by the Company's subsidiary "Pharmstandard-Leksredstva" OJSC. The total amount of funds allocated for the treasury shares purchase is limited to RR 8,000,000 and the plan should be fulfilled by 31 December 2013.

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