

OJSC "Pharmstandard"

Consolidated Financial Statements

For the year ended 31 December 2008

OJSC "Pharmstandard"
Consolidated Financial Statements
For the Year Ended 31 December 2008

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Independent Auditors' Report

To the Shareholders and Management of OJSC "Pharmstandard"

We have audited the accompanying consolidated financial statements of OJSC "Pharmstandard" and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2008, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young LLC

15 April 2009

OJSC "Pharmstandard"
Consolidated Balance Sheet at 31 December 2008
(in thousands of Russian Roubles)

Assets	Notes	2008	2007
Non-current assets			
Property, plant and equipment	8	3,917,109	3,691,266
Intangible assets	9	6,347,141	4,468,477
Long-term financial assets at fair value through profit or loss	14	-	245,398
		<u>10,264,250</u>	<u>8,405,141</u>
Current assets			
Inventories	11	2,484,910	1,760,195
Trade receivables	12	4,761,359	4,176,200
VAT recoverable		326,208	358,767
Prepayments		73,544	130,479
Short-term financial assets at fair value through profit or loss	14	113,995	111,899
Cash and cash equivalents	13	186,066	192,589
		<u>7,946,082</u>	<u>6,730,129</u>
Non-current assets classified as held for sale	10	-	158,855
Total assets		<u>18,210,332</u>	<u>15,294,125</u>
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	18	37,793	37,793
Retained earnings		<u>12,413,396</u>	<u>9,004,021</u>
		<u>12,451,189</u>	<u>9,041,814</u>
Minority interest		<u>163,203</u>	<u>560,879</u>
Total equity		<u>12,614,392</u>	<u>9,602,693</u>
Non-current liabilities			
Long-term borrowings and loans	15	760,512	1,954,576
Deferred tax liability	25	739,186	1,047,799
Derivative financial instruments	15,27	89,087	44,598
Other non-current liabilities		<u>34,048</u>	<u>36,826</u>
		<u>1,622,833</u>	<u>3,083,799</u>
Current liabilities			
Trade and other payables and accruals	17	1,707,544	1,046,520
Current portion of long-term borrowings	15	1,582,722	1,310,374
Income tax payable		144,292	37,934
Other taxes payable	16	339,307	212,806
Bank overdraft	13	199,242	-
		<u>3,973,107</u>	<u>2,607,633</u>
Total liabilities		<u>5,595,940</u>	<u>5,691,432</u>
Total equity and liabilities		<u>18,210,332</u>	<u>15,294,125</u>

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

General Director

I.K. Krylov

Chief Financial Officer

E.V. Arkhangelskaya

15 April 2009

The accompanying notes on pages 7-45 are an integral part of these consolidated financial statements.

OJSC "Pharmstandard"
 Consolidated Income Statement
 For the Year Ended 31 December 2008
 (in thousands of Russian Roubles)

	Notes	2008	2007
Revenue	19	14,335,867	11,371,345
Cost of sales	20	(5,577,468)	(4,519,749)
Gross profit		8,758,399	6,851,596
Selling and distribution costs	21	(2,466,841)	(1,626,041)
General and administrative expenses	22	(656,248)	(570,519)
Other income	23	149,762	274,142
Other expenses	23	(864,963)	(315,591)
Financial income	24	22,569	28,729
Financial expense	24	(255,189)	(320,367)
Profit before income tax		4,687,489	4,321,949
Income tax expense	25	(1,184,381)	(1,058,709)
Profit for the year		3,503,108	3,263,240
Attributable to:			
Equity holders of the Parent		3,504,046	3,227,895
Minority interests		(938)	35,345
		3,503,108	3,263,240
Earnings per share (in Russian roubles) - basic and diluted, for profit of the year attributable to equity holders of the parent	18	92.72	85.41

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

General Director

I.K. Krylov

Chief Financial Officer

E.V. Arkhangelskaya

15 April 2009

The accompanying notes on pages 7-45 are an integral part of these consolidated financial statements.

OJSC "Pharmstandard"
Consolidated Cash Flow Statement
For the Year Ended 31 December 2008
(in thousands of Russian Roubles)

	Notes	2008	2007
Cash flows from operating activities:			
Profit before income tax		4,687,489	4,321,949
Adjustments for:			
Depreciation and amortisation	8,9	604,204	527,600
Allowances for impairment of inventories and financial assets	11,12,23	427,259	152,364
Loss recognised on sale of non-current assets classified as held for sale	23	13,891	24,101
Impairment charge - property, plant and equipment and intangible assets	8,9, 23	199,749	42,403
Gain from disposal of property, plant and equipment and investments property and non-current assets classified as held for sale	23	(18,996)	(15,044)
Foreign exchange loss (gain)	23	524,842	(259,098)
Gain from disposal of long-term financial assets	14	(23,546)	-
Financial income	24	(22,569)	(28,729)
Financial expense	24	255,189	320,367
Operating cash flows before working capital changes		6,647,512	5,085,913
Increase in trade receivables	12	(1,047,408)	(892,491)
Increase in inventories	11	(718,039)	(385,398)
Decrease (increase) in VAT recoverable		32,559	(136,091)
Decrease in prepayments		56,936	38,753
Increase (decrease) in trade payables, other payables and accruals and advances received	17	273,368	(184,189)
Increase in taxes payable other than income tax		126,501	64,346
Cash generated from operations		5,371,429	3,590,843
Income tax paid	25	(1,351,703)	(1,237,928)
Interest paid		(195,680)	(282,917)
Interest received		12,815	11,361
Net cash from operating activities		3,836,861	2,081,359
Cash flows from investing activities:			
Purchase of property, plant and equipment	8	(661,068)	(521,582)
Purchase of intangible assets	9	(1,993,637)	(165,220)
Cash received from sale of long-term financial assets	14	268,944	-
Cash paid for long-term financial assets	14	-	(245,398)
Cash paid for acquisition of minority interests		(501,740)	(910)
Cash paid to settle the obligation for OJSC "TZMOI" shares acquired in 2005	7	-	(824,723)
Cash received from sale of investment property and property, plant and equipment	8	51,573	17,574
Cash received from sale of short-term financial assets	14	84,220	32,513
Cash paid for short-term financial assets	14	(104,300)	(81,300)
Cash received from sale of non-current assets classified as held for sale	10	141,086	34,133
Loans repaid by related parties	7	5,121	25,153
Net cash used in investing activities		(2,709,801)	(1,729,760)
Cash flows from financing activities:			
Proceeds from loans and borrowings	15	4,407	-
Repayment of loans and borrowings	15	(1,337,232)	(351,976)
Net cash used in financing activities		(1,332,825)	(351,976)
Net decrease in cash and cash equivalents overdraft		(205,765)	(377)
Cash and cash equivalents at the beginning of the year	13	192,589	192,966
Cash and cash equivalents at the end of the year, net of bank overdraft	13	(13,176)	192,589

The accompanying notes on pages 7-45 are an integral part of these consolidated financial statements.

OJSC "Pharmstandard"

Consolidated Statement of Changes in Equity

For the Year Ended 31 December 2008

(in thousands of Russian Roubles)

	Equity attributable to equity holders of the parent			
	Share capital	Retained earnings	Total	Minority interests
				Total equity
Balance at 31 December 2006	37,793	5,838,906	5,876,699	463,664
Profit for the year	-	3,227,895	3,227,895	35,345
Disposal of part of an ownership interests in subsidiaries	-	(66,476)	(66,476)	66,476
Effect of acquisition of minority interests	-	3,696	3,696	(4,606)
				(910)
Balance at 31 December 2007	37,793	9,004,021	9,041,814	560,879
Effect from change in profit tax rate (Note 25)	-	34,937	34,937	-
Net income for the year recognized directly in equity	-	34,937	34,937	-
Profit for the year	-	3,504,046	3,504,046	(938)
Total income and expense for the year	-	3,538,983	3,538,983	(938)
Effect of de-recognition of minority interests (Note 5.2)	-	(493)	(493)	(24,113)
Effect of acquisition of minority interests (Note 5.2)	-	(129,115)	(129,115)	(372,625)
				(501,740)
Balance at 31 December 2008	37,793	12,413,396	12,451,189	163,203
				12,614,392

The accompanying notes on pages 7-45 are an integral part of these consolidated financial statements.

OJSC "Pharmstandard"
Notes to the Consolidated Financial Statements
For the Year Ended 31 December 2008

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

1. Corporate Information

OJSC "Pharmstandard" ("the Company") and its subsidiaries ("the Group") principal activities are production and wholesale distribution of pharmaceutical and medical products. The Company is incorporated in the Russian Federation. Prior to 5 May 2006, the Company was registered as a limited liability company under the name of "Biovit". In May 2006, the Company was renamed as "Pharmstandard" and reorganised into an open joint stock company. Since May 2007, the Company's shares are publicly traded (Note 18). The Group's corporate office is in Dolgoprudny, Likhachevsky proezd, 5B, Moscow region, Russian Federation and its manufacturing facilities are based in Kursk, Tomsk, Ufa, Nizhny Novgorod and Tyumen. The Company held shares of voting interests in the following major subsidiaries consolidated within the Group as at 31 December 2008 and 2007, respectively:

Entity	Country of incorporation	Activity	2008 % share	2007 % share
1. "Pharmstandard" LLC	Russian Federation	Central procurement	100	100
2. "Pharmstandard-Leksredstva" OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	99
3. "Pharmstandard-Tomskhimpharm" OJSC	Russian Federation	Manufacturing of pharmaceutical products	91	91
4. "Pharmstandard-Ufavita" OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	94
5. "Pharmstandard-Octyabr" OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	93
6. "Pharmstandard-Phitofarm-NN" LLC	Russian Federation	Manufacturing of pharmaceutical products	99	99
7. "TZMOI" OJSC	Russian Federation	Manufacturing of medical equipment	100	89
8. "TMK" LLC*	Russian Federation	Manufacturing of medical equipment	-	100
9. "Masterlek" CJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
10. "Black Bird Investment Enterprises Corp"	British Virgin Islands	Finance and holding Company**	100	100
11. Donelle Company Limited	Cyprus	Finance and holding Company**	100	-
12. Aphopharm CJSC	Russian Federation	Finance and holding Company**	100	-

*TMK LLC was sold during the first quarter of 2008 (Note 10).

** - Finance and holding companies do not conduct any business activities.

These consolidated financial statements were authorised for issue by the Board of Directors of OJSC "Pharmstandard" on 15 April 2009.

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

2. Basis of Preparation of the Financial Statements

Statement of compliance

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

Basis of accounting

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

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

Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial period except that the Group has adopted the following new and amended IFRS and IFRIC interpretations as of 1 January 2008.

- IFRIC 11 "IFRS 2 - Group and Treasury Share Transactions";
- IFRIC 12 "Service Concession Arrangements";
- IFRIC 14 IAS 19 "The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction";
- Amendments to IAS 39 and IFRS 7 "Reclassification of Financial Assets";

IFRIC 11 "IFRS 2 - Group and Treasury Share Transactions" requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme, even if the entity buys the instruments from another party, or the shareholders provide the equity instruments needed.

IFRIC 12 "Service Concession Arrangements" applies to service concession operators and explain how to account for the obligations undertaken and rights received in service concession arrangements.

IFRIC 14 "The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" provides guidance on how to access the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 1 Employee Benefits.

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)

Amendments to IAS 39 and IFRS 7 "Reclassification of Financial Assets" are the latest in a series of steps that the IASB has undertaken to respond to the credit crisis. These amendments permit the reclassification of some financial instruments

There were no significant effects of these changes in accounting policies on these consolidated financial statements.

IFRSs and IFRIC interpretations not yet effective

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

- IFRIC 13 "Customer Loyalty Programmes";
- IFRIC 15 "Agreements for the Construction of Real Estate";
- IFRIC 16 "Hedges of a Net Investment in a Foreign Operation";
- IFRIC 17 "Distributions of Non-cash Assets to Owners";
- IFRIC 18 "Transfers of Assets from Customers";
- IFRS 8 "Operating segments";
- IAS 23 (amended 2007) "Borrowing costs";
- IAS 39 "Financial Instruments: Recognition and Measurement" - Eligible Hedged Items;
- IFRS 2 "Share-based Payments" - Vesting Conditions and Cancellations;
- IFRS 3R "Business Combinations" and IAS 27R "Consolidated and Separate Financial Statements";
- IAS 1 Revised "Presentation of Financial Statements";
- Amendments to IAS 32 and IAS 1 "Puttable Financial Instruments";
- Amendments to IFRS 1 and IAS 27 "Determining the cost of an investment in the separate financial statements";
- "Improvements to IFRSs" – a collection of amendments to IFRSs that will not be included as part of another major project. The following table shows the list of IFRSs where amendments have been made that can result in accounting changes for presentation, recognition or measurement purposes and the topics addressed by these amendments:

IFRS	Subject of amendment
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations	Plan to sell the controlling interest in a Subsidiary
IFRS 7 Financial Instruments: Disclosures	Removal of the reference to "total interest income" as a component of finance costs
IAS 8 Accounting Policies, Change in Accounting Estimates and Errors	Clarification that only implementation guidance that is an integral part of an IFRS is mandatory when selecting accounting policies
IAS 10 Events after the Reporting Period	Clarification that dividends declared after the end of the reporting period are not obligations

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)

IFRS	Subject of amendment
IAS 16 Property, Plant and Equipment	Recoverable amount Sale of assets held for rental
IAS 18 Revenue	Replacement of the term "direct costs" with "transaction costs" as defined in IAS 39
IAS 19 Employee Benefits	Curtailments and negative past service cost Plan administration costs Replacement of term 'fall due' Guidance on contingent liabilities
IAS 20 Accounting for Government Grants and Disclosure of Government Assistance	Government loans with a below-market rate of interest
IAS 27 Consolidated and Separate Financial Statements	When a parent entity accounts for a subsidiary at fair value in accordance with IAS 39 in its separate financial statements, this treatment continues when the subsidiary is subsequently classified as held for sale
IAS 28 Investments in Associates	Required disclosures when investments in associates are accounted for at fair value through profit or loss Impairment of investment in associate
IAS 34 Interim Financial Reporting	Earnings per share is disclosed in interim financial reports if an entity is within the scope of IAS 33
IAS 31 Interests in Joint Ventures	Required disclosures when interests in jointly controlled entities are accounted for at fair value through profit or loss
IAS 29 Financial Reporting in Hyperinflationary Economies	Description of measurement basis in financial statements
IAS 36 Impairment of Assets	Disclosure of estimates used to determine recoverable amount
IAS 38 Intangible Assets	Advertising and promotional activities Units of production method of amortisation
IAS 39 Financial Instruments: Recognition and Measurement	Reclassification of derivatives into or out of the classification of at fair value through profit or loss Designating and documenting hedges at the segment level Applicable effective interest rate on cessation of fair value hedge accounting
IAS 40 Investment Property	Property under construction or development for future use as investment property
IAS 41 Agriculture	Discount rate for fair value calculations Additional biological transformation

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

Subsidiaries

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

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

Business combinations

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

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

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. The excess, and any further losses applicable to the minority, are allocated against the Group interest.

Increases in ownership interests in subsidiaries

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

Acquisition of productive assets (single asset entities)

Acquisition of a subsidiary that does not constitute a business but a group of productive assets is not considered a business combination and the cost of such acquisition is allocated to the identifiable assets and liabilities in the group based on their relative fair values at the date of acquisition.

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.2 Cash and Cash Equivalents

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

For the purpose of the consolidated cash flow statements 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 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 balance sheet date, is deducted from the amount of VAT payable.

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

3.4 Inventories

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

3.5 Non-current Assets Held for Sale

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

3.6 Property, Plant and Equipment

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

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.6 Property, Plant and Equipment (continued)

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

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

3.7 Goodwill

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

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

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

3.8 Other Intangible Assets

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.9 Investments and Other Financial Assets

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

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

Financial assets at fair value through profit or loss

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

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

Loans and receivables

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

Available-for-sale financial investments

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.9 Investments and Other Financial Assets (continued)

Fair value

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

Amortised cost

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

Impairment of financial assets

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

Assets carried at amortised cost

If there is objective evidence that an impairment loss on assets carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss shall be recognised in the income statement. 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 income statement. For more information in relation to trade receivables see Note 3.3.

Available-for-sale financial investments

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.10 Borrowings

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

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

3.11 Income Taxes

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

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

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

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

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

The effect from a change in tax rates is recognized in income statement except to the extent that it relates to items previously charged or credited to equity. In particular, this policy is applicable to deferred taxes recorded to equity at the date of transition to IFRS for deemed cost of property, plant and equipment.

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.12 Leases

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

3.13 Derecognition of Financial Assets and Liabilities

Financial assets

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

Financial liabilities

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

3.14 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 the income statement. 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.

3.15 Equity

Share capital

Ordinary shares are classified as equity.

Dividends

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.16 Revenue Recognition

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

3.17 Employee Benefits

Under provision of the Russian legislation, social contributions are made through a unified social tax ("UST") calculated by the Group by the application of a regressive rate (from 26% to 2%) to the annual gross remuneration of each employee. The Group allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund varies from 20% to 2% depending on the annual gross salary of each employee. The Group's contributions relating to UST are expensed in the year to which they relate. Total contributions for UST amounted to RR 270,770 during the year ended 31 December 2008 (2007: RR 244,179) and they were classified as labour costs in these consolidated financial statements.

3.18 Foreign Currency Transactions

The consolidated financial statements are presented in the national currency of the Russian Federation, Russian Rouble (RR), which is the functional currency of the Company and its Russian subsidiaries. Transactions in foreign currencies are initially recorded in the functional currency at the exchange rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the income statement. 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.

The functional currency of the foreign operations is the United States dollar (US\$). As at the reporting date, the assets and liabilities of that subsidiary are translated into the presentation currency of the Group (the Russian Rouble) at the rate of exchange ruling at the balance sheet date and its income statement is translated at the weighted average exchange rate for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. In 2008 and 2007, the foreign subsidiaries did not perform any operations and held minor assets and liabilities, therefore its translation into the presentation currency had no effect on these consolidated financial statements.

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.19 Impairment of Non-Financial Assets

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

4. Significant Accounting Judgements and Estimates

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

Useful life of property, plant and equipment 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 the income statement.

Impairment of non-financial assets

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

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)

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

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

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 2008 and 2007 was RR 1,180,469. More details are provided in Note 9.

Allowance for doubtful accounts

The Group maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected. As at 31 December 2008, allowances for doubtful accounts have been created in the amount of RR 568,676 (2007: RR 167,933). More details are provided in Note 12.

Allowance for obsolete and slow moving inventory

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

Fair value of derivatives

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

4. Significant Accounting Judgements and Estimates (continued)

Current taxes

Russian tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group's entities may be assessed additional taxes, penalties and interest, which can be significant. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As of 31 December 2008 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. More details are provided in Note 26.

5. Acquisitions and de-recognition of minority interests and other acquisitions

5.1. Acquisition of Afobazol Trade Mark

In August 2008, the Company signed contracts with shareholders of Donelle Company Limited (Cyprus) - "Donelle" with the purpose of acquiring the Afobazol trade mark through the purchase of all outstanding Donelle shares. On 10 October 2008 all shares of Donelle were transferred to the Company.

Donelle is the sole shareholder of CJSC Aphopharm - "Aphopharm". Aphopharm is a holder of the Afobazol trade mark being its only asset. The acquisition was accounted for as an acquisition of a productive assets (see note 3.1) and the consideration payable amounting to RR 2,228,620 was allocated fully to the trade mark (see Note 9).

As at 31 December 2008 a total of RR 235,000 was still payable to the former shareholders of Donelle. An addendum to the original contract with the former shareholders of Donelle was concluded on 12 March 2009 (Note 28).

5.2 Acquisitions and De-recognition of Minority Interests

In 1st quarter 2008, the Company's management approved a plan to acquire minority interests in several subsidiaries. As a result, the Company acquired a further 6% interest in OJSC "Pharmstandard-Ufavita", 4% interest in OJSC "Pharmstandard-Octyabr", 1% interest in OJSC "Pharmstandard-Leksredstva" and 11% interest in OJSC "TZMOI", resulting in an increase in the Company's interests in OJSC "Pharmstandard-Ufavita", OJSC "Pharmstandard-Octyabr", OJSC "Pharmstandard-Leksredstva" and OJSC "TZMOI" to 100%, 97%, 100% and 100%, respectively. Total consideration paid in cash for the acquired minority interests was RR 501,740. The difference of RR 129,115 between the total consideration and the carrying amount of the minority interests acquired of RR 372,625 was debited directly to equity.

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

5. Acquisitions and de-recognition of minority interests and other acquisitions

5.2 Acquisitions and De-recognition of Minority Interests (continued)

In accordance with Russian regulations in respect of joint stock companies with a controlling shareholder interest of more than 95% and in accordance with the approved plan on acquisition of minority interests, the Group derecognised the remaining minority interest of 3% in OJSC "Pharmstandard-Octyabr". At the time of derecognition, the carrying value of the minority interest amounted to RR 24,113 and the liability to minority shareholders amounted to RR 24,606 (Note 17). This liability was measured based on the unconditional shares purchase value offered by the Company to the minority shareholders in accordance with the regulations. The difference of RR 493 between the total unconditional shares purchase value offered to the minority shareholders and the carrying amount of the minority interests derecognised was debited directly to equity.

6. Segment Information

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

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, receivables and operating cash. There were no assets unallocated to segments as of 31 December 2008 and 2007. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Segment result is segment revenue less segment expenses. Segment expenses consist of cost of sales, selling and distribution costs, general and administrative expenses and other income and expenses that can be directly attributed to the segment on a reasonable basis. Capital expenditure comprises additions to property, plant and equipment. Impairment loss and provisions relate only to those charges made against allocated assets.

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

6. Segment Information (continued)

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

Year ended 31 December 2008	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Eliminations	Group
Sales to external customers	13,260,214	1,075,653	-	14,335,867
Total revenue	13,260,214	1,075,653	-	14,335,867
Gross profit	8,405,364	353,035	-	8,758,399
Segment result	4,694,120	225,989	-	4,920,109
Financial expense, net				(232,620)
Profit before income tax				4,687,489
Income tax expense				(1,184,381)
Profit for the year				3,503,108
Segment assets	17,018,798	1,191,534	-	18,210,332
Total assets	17,018,798	1,191,534	-	18,210,332
Segment liabilities	1,983,319	87,224	-	2,070,543
Unallocated liabilities				3,525,397
Total liabilities				5,595,940
Capital expenditure (Note 8)	672,172	40,248	-	712,420
Intangible assets acquisition (Note 9)	2,228,620	-	-	2,228,620
Depreciation and amortisation	553,693	50,511	-	604,204
Impairment loss	174,022	25,727		199,749

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

6. Segment Information (continued)

Year ended 31 December 2007	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Eliminations	Group
Sales to external customers	9,762,637	1,608,708	-	11,371,345
Total revenue	9,762,637	1,608,708	-	11,371,345
Gross profit	6,127,524	724,072	-	6,851,596
Segment result	4,163,254	450,333	-	4,613,587
Financial expense, net				(291,638)
Profit before income tax				4,321,949
Income tax expense				(1,058,709)
Profit for the year				3,263,240
Segment assets	13,711,609	1,582,516	-	15,294,125
Total assets	13,711,609	1,582,516	-	15,294,125
Segment liabilities	1,208,628	96,362	-	1,304,990
Unallocated liabilities				4,386,442
Total liabilities				5,691,432
Capital expenditure (Note 8)	446,758	37,375	-	484,133
Intangible assets acquisition (Note 9)	165,220	-	-	165,220
Depreciation and amortisation	466,755	60,845	-	527,600
Impairment loss		42,403		42,403

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

7. Balances and Transactions with Related Parties

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 2008 and 2007 are detailed below.

Balances with related parties:

2008	Short-term financial assets Note 14	Cash and cash equivalents Note 13 (a)	Trade payables, other payables and accruals - (b) Note 17
Other related parties ¹	-	92,930	6,495
Total	-	92,930	6,495

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

(a) This balance represented cash at a bank controlled by a related party.

(b) This balance represented obligation for the license fee, described in section "Transactions with related parties" below.

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

Caption	Interest rate %		Maturity period	
	2008	2007	2008	2007
Current loans to related parties	-	2%	-	3 months

Cash balances with the related bank carry no interest. Cash equivalents at 31 December 2008 were represented by deposits with the related bank and carry 9% interest p.a.

¹ Other related parties represent entities under control of the Company's shareholders having significant influence over the Company.

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

7. Balances and Transactions with Related Parties (continued)

Transactions with related parties included in the income statement:

Income Statement caption	Relationship	2008	2007
License fee (included in distribution costs) (A)	Other related parties ¹	23,231	24,522
Warehouse rental expenses (included in distribution costs) (B)	Other related parties ¹	32,108	30,532
Office rental expenses (included in general and administrative expenses) (B)	Other related parties ¹	19,188	14,473

(A) License fee

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

(B) Rental expenses

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

Acquisition of intangible assets

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

Compensation to key management personnel

Key management personnel comprise 3 persons as at 31 December 2008 and 2007. Total compensation to key management personnel, amounted to RR 35,224 for the year ended 31 December 2008 (2007: RR 82,257). Such compensation represented the following short-term employee benefits: (i) payroll and bonuses included in general and administrative expenses and (ii) for the year ended 31 December 2007 one-off remuneration for achievement of the IPO-related targets (Notes 18 and 23) included in other expenses in the income statement.

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

8. Property, Plant and Equipment

Property, plant and equipment consist of the following:

31 December 2008	Land	Buildings	Plant and machinery	Equipment and motor vehicles	Assets under construction	Total
Cost						
Balance at 31 December 2007	32,982	1,810,835	1,939,827	206,696	430,861	4,421,201
Additions	4	147	107,641	89,701	514,927	712,420
Transfers	-	157,210	305,242	3323	(465,775)	-
Disposals	-	(8,855)	(29,800)	(17,352)	(15,424)	(71,431)
Balance at 31 December 2008	32,986	1,959,337	2,322,910	282,368	464,589	5,062,190
Accumulated Depreciation						
Balance at 31 December 2007	-	158,579	515,168	56,188	-	729,935
Depreciation charge	-	56,423	279,846	58,542	-	394,811
Disposals	-	(3,250)	(24,513)	(11,088)	-	(38,851)
Impairment charge (a)	-	1,497	24,201	29	33,459	59,186
Balance at 31 December 2008	-	213,249	794,702	103,671	33,459	1,145,081
Net Book Value						
Balance at 31 December 2007	32,982	1,652,256	1,424,659	150,508	430,861	3,691,266
Balance at 31 December 2008	32,986	1,746,088	1,528,208	178,697	431,130	3,917,109

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

8. Property, Plant and Equipment (continued)

- (a) Impaired assets represented (i) a workshop building which construction was started several years ago but then management decided to continue with the existing premises and (ii) equipment for production of medical devices removed from active use due to decline in customer demand. The impairment charge equals to the carrying value of those building and equipment.
- (b) Impaired assets represented property and equipment for production of needles for syringes which was terminated by the Group due to low profitability. The impairment charge equals to the carrying value of that equipment.

The Group did not use borrowings to finance capital expenditures, thus no interest expense was capitalized in 2008 and 2007.

The Group assets include only a minor portion of the land on which the Group's factories and buildings, comprising the Group's principal manufacturing facilities, are located, whilst the major portion of the land is held under operating lease agreements with the state municipal bodies. The lease agreements specify lease terms between 10 and 50 years with an option to prolong the lease term for another 10 years. In addition, the lease agreements include a purchase option after termination of the lease. Purchase price will be determined based on fair value of the land as determined by the municipal authorities. The total amount of rental payments for the use of the land during 2008 was RR 8,397 (2007: RR 8,382). Such payments are reassessed by the state authorities on an annual basis. No such reassessment has been completed for 2009.

In 2008, several social objects (buildings of a former kindergarden unused for several years) with zero carrying value were sold to municipality for a cash consideration of RR 34,107 and the respective gain was recognised in the income statement.

9. Intangible Assets

	Goodwill	Trademarks	Total
Cost			
Balance at 31 December 2007	1,180,469	3,527,688	4,708,157
Additions (a)	-	2,228,620	2,228,620
Balance at 31 December 2008	1,180,469	5,756,308	6,936,777
Accumulated Amortisation			
Balance at 31 December 2007	-	239,680	239,680
Impairment (b)	-	140,563	140,563
Amortisation expense	-	209,393	209,393
Balance at 31 December 2008	-	589,636	589,636
Net Book Value			
Balance at 31 December 2007	1,180,469	3,288,008	4,468,477
Balance at 31 December 2008	1,180,469	5,166,672	6,347,141

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

9. Intangible Assets (continued)

	Goodwill	Trademarks	Total
Cost			
Balance at 31 December 2006	1,180,469	3,362,468	4,542,937
Additions (Note 7)	-	165,220	165,220
Balance at 31 December 2007	1,180,469	3,527,688	4,708,157
Accumulated Amortisation			
Balance at 31 December 2006	-	69,298	69,298
Amortisation expense	-	170,382	170,382
Balance at 31 December 2007	-	239,680	239,680
Net Book Value			
Balance at 31 December 2006	1,180,469	3,293,170	4,473,639
Balance at 31 December 2007	1,180,469	3,288,008	4,468,477

- (a) Additions during 2008 represented acquisition of Afobazol trade mark (see note 5.1).
 (b) The impairment mainly relates to the effect of higher discount rates used in the value in use calculations of trademarks that were tested for impairment. The increase in discount rates from 13% to 18.1% for the first 10 years and declining thereafter, mainly relates to the effect of the current financial crisis.

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

Name	Carrying amount		Remaining amortization period (years)	
	2008	2007	2008	2007
Afobazol	2,060,199	-	20	-
Arbidol	1,818,691	1,922,123	17	18
Flucostat	707,496	747,733	17	18

Impairment testing of goodwill

Goodwill acquired through business combinations before 2008 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	
	2008	2007	2008	2007	2008	2007
Carrying amount of goodwill	961,615	961,615	218,854	218,854	1,180,469	1,180,469

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

9. Intangible Assets (continued)

The recoverable amount of the cash-generating units has been determined based on a value in use calculation using cash flow projections based on financial budgets approved by management covering a five-year period and cash flows beyond the five-year period are extrapolated using a 24% and 5% growth rate that is the same as the mid-term average growth rate for Pharmaceuticals and Equipment groups of cash-generating units, respectively. The discount rate applied to cash flow projections is 18.1%.

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 group of units. This is the benchmark used by management to assess operating performance and to evaluate future investment proposals. In determining appropriate discount rates for each group of units, regard has been given to the Capital Assets Pricing Model calculation at the beginning of the budgeted year.

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

Currency exchange rates changes - estimated values based on current market values.

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.

10. Non-Current Assets Classified as Held for Sale

Sale of non-current assets classified as held for sale

"TMK" LLC (Note 1) was sold during the first quarter of 2008 for a cash consideration of RR 122,169. This arrangement resulted in a loss amounting to RR 13,953 that was recognised in the income statement (Note 23).

The remainder of the non-current Assets Classified as Held for Sale in the balance sheet as at 31 December 2007 amounted to RR 18,855 and represented some non-current assets located in St.Petersburg. These assets were sold in the first quarter of 2008 for a cash consideration of RR 18,917 (Note 23).

Part of the cash consideration for "TMK" LLC and other non-current Assets Classified as Held for Sale, totalling RR 17,831, was collected in advance in 2006 and 2007.

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Notes to the Consolidated Financial Statements (continued)

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

11. Inventories

Inventories consist of the following:

	2008	2007
Raw materials - at cost	1,113,174	841,703
Work in progress - at cost	179,319	134,554
Finished goods:		
- at cost	1,216,896	851,052
- at net realisable value	1,192,417	783,938
	2,484,910	1,760,195

Movements in allowance for impairment of inventories consist of the following:

	2008	2007
Balance at 1 January	67,114	35,607
Additional allowance	-	43,224
Unused amounts reversed	(6,675)	-
Utilised during the year	(35,961)	(11,717)
Balance at 31 December	24,479	67,114

12. Trade Receivables

	2008	2007
Trade receivables (net of allowance for impairment of receivables of RR 568,676 (2007: RR 167,933))	4,761,359	4,176,200
	4,761,359	4,176,200

At 31 December 2008 RR 172,870 of trade receivables were denominated in currencies other than Russian Roubles, primarily in US\$ (2007: RR 129,304).

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

	2008	2007
Balance at 1 January	167,933	79,308
Additional allowance	484,194	95,483
Unused amounts reversed	(53,977)	-
Utilised during the year	(29,474)	(6,858)
Balance at 31 December	568,676	167,933

The additional allowance for impairment in 2008 includes RR 476,131 in relation to the bankruptcy of one of the Group's distributors CJSC "Genesis" (Note 21).

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

13. Cash and Cash Equivalents and Bank Overdraft

Cash and cash equivalents consist of the following:

	2008	2007
Cash in bank - Russian Roubles	183,688	119,126
Cash in bank - US\$ and Euro	2,378	13,463
Short-term bank deposits with original maturity less than 90 days - Russian Roubles	-	60,000
	<u>186,066</u>	<u>192,589</u>

On 3 December 2007 the Company entered into an overdraft facility agreement with Citibank ZAO for RR 40,000 with an interest of 14% per annum. The overdraft and related interest accrued is payable monthly. Citibank retains the right to immediately demand full repayment of the outstanding overdraft amount and interest accrued. On 8 February 2008 the amount of overdraft was increased to RR 200,000 and on 25 December 2008 the interest was increased from 14% to 18% per annum.

14. Financial Assets

Short-term financial assets at fair value through profit or loss

	2008	2007
Promissory notes	104,300	81,300
Loans to related parties (Note 7)	-	5,111
Trading securities and other	9,695	25,488
	<u>113,995</u>	<u>111,899</u>

Long-term financial assets at fair value through profit or loss

	2008	2007
Non-listed shares	-	245,398
	<u>-</u>	<u>245,398</u>

In December 2007, the Group acquired 19.88% of "Dipaka Trading Limited", a company registered under the laws of Cyprus, for a cash consideration of US\$10 million (RR 245,398). The investment in Dipaka Trading Limited was sold in the fourth quarter of 2008 for RR 268,944. A gain on disposal amounting to RR 23,546 was recognised in the income statement.

15. Borrowings and Loans

	2008	2007
Long-term borrowings and loans		
(a) Syndicated borrowing organised by Citibank ("Citibank loan")	2,328,985	3,256,151
(b) Other loans	14,249	8,799
Less: Current portion of long-term borrowings and loans	(1,582,722)	(1,310,374)
	<u>760,512</u>	<u>1,954,576</u>

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

15. Borrowings and Loans (continued)

Long-term debt is repayable as follows:

	<u>2008</u>
1 to 2 years	380,182
2 to 3 years	<u>380,330</u>
	<u>760,512</u>

As at 31 December 2008 and 2007 all the borrowings are US\$ denominated. The foreign exchange risk in this respect is not covered by any derivative instruments.

(a) The Citibank loan was provided in December 2006 in two credit facilities:

- Facility A in the total amount of US\$ 91 million with maturity period of 3 years; and
- Facility B in the total amount of US\$ 55 million with maturity period of 5 years.

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

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

On 18 December 2008 several banks, representing 52.27% of the syndicate in the Citibank loan, declared that a market disruption event occurred in relation to their loan balances. In accordance with the Citibank loan agreement the interest rate quoted by those banks for the next interest period was determined based on the actual cost of funding for each individual bank (which was higher than LIBOR and was ranging from 2.46% p.a. to 5% p.a.) plus the standard margin of 1.50% p.a. for facility A and 1.90% p.a. for facility B. This change was effective only for the interest period ending 18 March 2009 and since that date interest rate for the both facilities is determined based on the initial conditions, i.e. 3 month LIBOR plus the standard margin per facility.

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

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

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

In 2008, the Group repaid US\$ 53,384 thousand (RR 1,337,232) of the Citibank loan (2007: US\$ 13,346 thousand (RR 329,726)).

(b) Other loans mature in September 2009 and bear fixed interest rate 5-7% per annum.

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Notes to the Consolidated Financial Statements (continued)

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

16. Other Taxes Payable

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

	2008	2007
Value-added tax	292,064	157,585
Property and other taxes	47,243	55,221
	<u>339,307</u>	<u>212,806</u>

17. Trade and Other Payables and Accruals

	2008	2007
Trade payables	1,193,029	766,007
Payable for Afobazol trade mark acquisition (Notes 5.1 and 28)	235,000	-
Payable for minority interests acquisitions (Note 5.2)	24,606	-
Other payables - related party (Note 7)	6,495	6,990
Other payables and accruals	248,414	273,523
	<u>1,707,544</u>	<u>1,046,520</u>

At 31 December 2008 RR 527,018 of trade payables were denominated in currencies other than Russian Rouble, primarily in US\$ (2007: RR 274,167).

18. Share Capital

In accordance with its charter documents the share capital of the Company is RR 37,793. The authorised number of ordinary shares is 37,792,603 with par value of 1 (one) Russian Ruble. All authorised shares are issued and fully paid. There were no transactions with own shares during 2008.

As at 31 December 2008 and 2007 more than half of voting shares of OJSC "Pharmstandard" were held by "Augment Investments Limited" ("Augment"), a company registered under the laws of Cyprus. On 26 March 2008, Victor Kharitonin, a Russian citizen, obtained control over more than a half of voting shares of the Company. He became the Group's ultimate controlling party since that date.

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

In addition, in May 2008, 944,815 ordinary shares representing 2.5% of share capital of the Company were sold by Augment and were offered at LSE. After this transaction, 45.8% of share capital was publicly listed of which 27.5% on LSE.

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Notes to the Consolidated Financial Statements (continued)

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

18. Share Capital (continued)

In accordance with 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 6,152,441 of undistributed and unreserved earnings as at 31 December 2008 (2007: RR 3,779,003). In addition, the Company's share in the undistributed and unreserved earnings of the subsidiaries was approximately RR 9,826,453 as at 31 December 2008 (2007: RR 7,698,340).

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

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

Earnings per Share

Earnings per share are as follows:

	2008	2007
Weighted average number of ordinary shares outstanding	37,792,603	37,792,603
Profit for the year attributable to the shareholders	3,504,046	3,227,895
Basic and diluted earnings per share, Russian Roubles	92.72	85.41

19. Revenue

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

Sales breakdown by product groups comprised the following:

Product group	2008	2007
Pharmaceutical products		
OTC		
Branded	9,087,126	7,427,511
Non-branded	1,466,262	1,092,351
	10,553,388	8,519,862
Prescription		
Branded	2,349,202	937,999
Non-branded	288,355	250,201
	2,637,557	1,188,200
Other	69,269	54,575
Total pharmaceutical products (a)	13,260,214	9,762,637
Medical equipment and disposables	1,075,653	1,608,708
	14,335,867	11,371,345

(a) In Russia, classification of pharmaceuticals as prescription products (Rx) or non-prescription over-the-counter products (OTC) is regulated by the government and is periodically re-visited. The recent re-visiting of OTC and Rx products classification introduced in 2008 had a significant influence of the Group's product portfolio structure. For the purpose of comparative analysis, the prior year figures were restated accordingly. The above changes in the Group portfolio structure do not affect the sales results.

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Notes to the Consolidated Financial Statements (continued)

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

20. Cost of Sales

The components of cost of sales were as follows:

	2008	2007
Materials and components	4,102,248	2,997,475
Production overheads	734,949	815,557
Depreciation and amortisation	535,583	481,309
Direct labour costs	204,688	225,408
	5,577,468	4,519,749

21. Selling and Distribution Costs

Selling and distribution costs were as follows:

	2008	2007
Advertising	1,061,815	753,580
Labour costs	476,985	397,082
Freight, communication and insurance of goods in transit	122,246	126,817
Trainings and other services	47,009	26,492
Certification expenses	29,996	29,092
Rent	35,873	35,211
Commission and license fee	36,886	105,681
Materials, maintenance and utilities	42,834	43,969
Travel and entertainment	56,148	43,986
Depreciation	45,201	27,920
Allowances for impairment of receivables (see Note 12)	476,131	-
Other expenses	35,717	36,211
	2,466,841	1,626,041

The Group entered into a number of operating lease agreements for warehouses. Rental agreements are revised on an annual basis. Future minimum operating lease payments classified as selling and distribution costs will not substantially change in 2009 compared to 2008.

22. General and Administrative Expenses

General and administrative expenses were as follows:

	2008	2007
Labour costs	403,121	356,500
Utilities and services	63,002	48,050
Travel and entertainment	15,494	10,783
Taxes other than income tax	15,213	17,589
Property insurance	14,756	13,481
Freight and communication	26,171	20,142
Depreciation	23,420	18,371
Rent	26,520	34,286
Materials and maintenance	24,777	19,745
Other	43,774	31,572
	656,248	570,519

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Notes to the Consolidated Financial Statements (continued)

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

22. General and Administrative Expenses (continued)

The Group entered into a number of operating lease agreements for office premises. Rental agreements are revised on an annual basis. Future minimum operating lease payments classified as are general and administrative expense will not substantially change in 2009 compared to 2008.

23. Other Income and Other Expenses

Other income comprised the following:

	2008	2007
Income from non-core operations (a)	107,220	-
Gain from disposal of property, plant and equipment and investments property	18,996	3,556
Gain from disposal of long-term financial assets	23,546	-
Gain from sale of non-current assets classified as held for sale (Note 10)	-	11,478
Foreign exchange gain, net	-	259,098
	149,762	274,142

(a) Income from non-core operations includes agency fee and reimbursement of marketing and promotional expenses incurred in respect of certain products.

Other expenses comprised the following:

	2008	2007
Foreign exchange loss, net	524,842	-
Impairment of property, plant and equipment (Note 8)	59,186	42,403
Impairment of intangible assets (Note 9)	140,563	-
Legal, audit, one-off management remuneration (Note 7) and other non-recurring expenses incurred in connection with the IPO (Note 18)	-	110,016
Charity	1,959	4,114
Other taxes	93,784	56,381
Impairment of other short-term financial assets	3,715	13,657
Loss recognised on non-current assets classified as held for sale (Note 10)	13,891	24,101
Other	27,023	64,919
	864,963	315,591

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Notes to the Consolidated Financial Statements (continued)

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

24. Financial Income and Expense

Financial income and expense comprised the following:

	2008	2007
Interest income:		
Income from changes of fair value of financial assets recognised in the income statement	-	10,578
Income from Interest Rate Swap (Notes 15 and 27)	-	6,790
Interest income from loans and deposits	22,569	11,361
	22,569	28,729
Interest expense:		
Loss from changes of fair value of financial assets recognised in the income statement	8,457	-
Loss from Interest Rate Swap (Notes 15 and 27)	43,608	-
Expense from changes in fair value of the Interest Rate Swap (Notes 15 and 27)	44,490	44,598
Interest expense on borrowings and loans	158,634	275,769
	255,189	320,367

25. Income Tax

	2008	2007
Income tax expense - current	1,458,057	1,106,218
Correction of prior periods after reconciliation with tax authorities (a)	-	(14,480)
Deferred tax credit - effect from change in profit tax rate (b)	(116,374)	-
Deferred tax credit - origination and reversal of temporary differences	(157,302)	(33,029)
Income tax expense	1,184,381	1,058,709

- (a) The Group identified overpayment of income tax in prior periods as a result of routine reconciliation with tax authorities. As a result, the respective receivable from the budget was recognised as at 31 December 2007.
- (b) On 20 November 2008, the Russian Government enacted a law which reduced the statutory income tax rate from 24% to 20% effective from 1 January 2009. This reduction in the statutory income tax rate is reflected in the deferred tax balances as at 31 December 2008.

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Notes to the Consolidated Financial Statements (continued)

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

25. Income Tax (continued)

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

	2008	2007
Profit before income tax	4,687,489	4,321,949
Theoretical tax charge at statutory rate of 24%	1,124,997	1,037,268
Correction of prior periods after reconciliation with tax authorities	-	(14,480)
Effect from change in profit tax rate	(116,374)	-
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	87,199	113,788
Other items	88,559	(77,867)
Income tax expense	1,184,381	1,058,709

Movements in deferred tax balances were as follows:

	31 December 2006	Differences recognition and reversal	31 December 2007	Effect from change in profit tax rate recognised in equity	Effect from change in profit tax rate recognised in income statement	Differences and reversal	31 December 2008
Tax effects of deductible temporary differences - asset (liability):							
Property, plant and equipment (Note 8)	(340,988)	(19,371)	(360,359)	34,937	23,286	11,020	(291,116)
Intangible assets (Note 9)	(721,766)	24,740	(697,026)	-	110,792	31,801	(554,433)
Trade and other receivables	(44,957)	49,356	4,399	-	(24,248)	141,090	121,241
Inventories	205	(18,483)	(18,278)	-	(4,222)	43,613	21,113
Trade and other payables and other taxes	21,524	(1,868)	19,656	-	11,025	(85,805)	(55,124)
Financial instruments	-	-	-	-	-	17,817	17,817
Other	5,154	(1,345)	3,809	-	(259)	(2,234)	1,316
Total net deferred tax liability	(1,080,828)	33,029	(1,047,799)	34,937	116,374	157,302	(739,186)

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;
- allowances to write inventory down to net realizable value;
- amortisation of trade marks in excess of the amortisation for tax purposes; and
- deemed cost adjustments upon conversion to IFRS.

The aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognised was approximately RR 10,204,820 as at 31 December 2008 (2007: RR 7,698,340).

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Notes to the Consolidated Financial Statements (continued)

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26. Contingencies, Commitments and Operating Risks

Operating environment of the group

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The ongoing global financial crisis has resulted in capital markets instability, significant deterioration of liquidity in the banking sector, and tighter credit conditions within Russia. While the Russian Government has introduced a range of stabilization measures aimed at providing liquidity and supporting debt refinancing for Russian banks and companies, there continues to be uncertainty regarding the access to capital and cost of capital for the Group and its counterparties, which could affect the Group's financial position, results of operations and business prospects.

Taxation

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

As at 31 December 2008 management believes that its interpretation of the relevant legislation is appropriate and that the Group's tax, currency and customs positions will be sustained.

Because of the uncertainties associated with the Russian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as of 31 December 2008. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Should the Russian tax authorities decide to issue a claim and prove successful in the court, they would be entitled to recover the amount claimed, together with fines amounting to 20% of such amount and interest at the rate of 1/300 of the Central Bank of Russian Federation rate for each day of delay for late payment of such amount. Management believes that it is not probable that the ultimate outcome of such matters would result in a liability. Therefore, no provision for these contingencies was recorded in these consolidated financial statements.

Insurance policies

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

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Notes to the Consolidated Financial Statements (continued)

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

27. Financial Instruments and Financial Risk Management Objectives and Policies

Fair values

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

	2008		2007	
	Fair value	Net carrying value	Fair value	Net carrying value
Financial assets				
Cash and cash equivalents (Note 13)	186,066	186,066	192,589	192,589
Short-term loans to related parties (Note 7)	-	-	5,111	5,111
Promissory notes (Note 14)	104,300	104,300	81,300	81,300
Other short-term investments (Note 14)	9,695	9,695	25,488	25,488
Long-term investment in non-listed shares (Note 14)	-	-	245,398	245,398
Financial liabilities				
Overdraft	199,242	199,242	-	-
Borrowings and loans (Note 15)	2,343,234	2,343,234	3,264,950	3,264,950
Derivative financial instruments	89,087	89,087	44,598	44,598
Other non-current liabilities	34,048	34,048	36,826	36,826

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

Financial risk management objectives and policies

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

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

OJSC "Pharmstandard"

Notes to the Consolidated Financial Statements (continued)

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

Interest rate risk

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

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

	Increase/decrease in basis points	Effect on the income statement (Interest expense)	Effect on the income statement (due to fair value change)
As at 31 December 2008			
	200	(46,567)	36,842
	(100)	23,298	(20,918)
As at 31 December 2007			
	200	(65,131)	51,383
	(200)	65,131	(80,720)

Foreign exchange risk

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

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

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

	Increase/decrease in US\$ rate	Effect on profit before tax
As at 31 December 2008		
US\$/Roubles exchange rate	+25%	(688,074)
US\$/Roubles exchange rate	+10%	(275,230)
As at 31 December 2007		
US\$/Roubles exchange rate	+7%	(233,902)
US\$/Roubles exchange rate	-7%	233,902

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Notes to the Consolidated Financial Statements (continued)

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

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

Liquidity risk

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

The table below summarises the maturity profile of the Group's non-derivative financial liabilities based on contractual undiscounted payments including interest except for payables which normally have maturity periods shorter than 4 months.

As at 31 December 2008	Total	Less than 3 months	3 to 6 months	6 to 12 months	1 to 5 years
Borrowings (a)	2,489,338	418,926	418,926	852,102	799,384
Payable for trade mark (Note 28)	235,000	235,000	-	-	-
Other non-current liabilities	80,810	-	-	16,875	63,935
Total	2,805,148	653,926	418,926	868,977	863,319
As at 31 December 2007	Total	Less than 3 months	3 to 6 months	6 to 12 months	1 to 5 years
Borrowings (a)	3,709,520	379,335	379,335	758,669	2,192,181
Other non-current liabilities	79,825	-	-	12,347	67,418
Total	3,789,345	379,335	379,335	771,016	2,259,599

(a) The Citibank loan received in 2006 (see Note 15 for details) is including contractual principal amount of a debt and interest rate calculated in according with corresponding terms of the loan agreement at 31 December 2008 and 2007 (Notes 15 and 28).

Credit risk

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

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

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Notes to the Consolidated Financial Statements (continued)

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

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

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

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

	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 2008	4,761,359	3,890,073	793,465	54,283	6,013	14,734	2,791
31 December 2007	4,176,200	3,240,772	792,664	66,548	49,989	22,335	3,892

Sales concentration to a small group of customers

The Group works with five distributors that together represent about 50% of the Group's revenue for 2008 and 2007. Given the Russian market structure limited number of large distributors is not unusual. The Group has no other significant concentrations of credit risk but is exposed to general risk of the global credit crisis and its effects on the Group's 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 (while taking into consideration terms and conditions set by the Citibank Loan Agreement, Note 15).

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

	2008	2007
Borrowings and loans	2,343,234	3,264,950
Trade and other payables	1,707,544	1,046,520
Bank overdraft	199,242	-
Less: cash and cash equivalents	(186,066)	(192,589)
Net debt	4,063,954	4,118,881
Equity	12,451,189	9,041,814
Capital and net debt	16,515,143	13,160,695
Gearing ratio	25%	31%

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

28. Post Balance Sheet Events

Addendum to purchase contract for Donelle Company Limited

On 12 March 2009 the Company signed an addendum to the contract with the sellers of Donelle Company Limited in relation to the Afobazol trade mark. Parties agreed that the Company will return back 10.93% of the shares in Donelle Company Limited to the sellers in lieu of paying the remaining balance of RR 235,000 (see Notes 5.1 and 17). This transaction will be recorded in 2009 as an increase in minority interest with the corresponding decrease in other accounts payable.

Withdrawal of some series of defective Mildronat in ampoules from the market

Since February 2008, the Group has an agreement with Grindeks (Latvia) on exclusive rights to promotion and distribution on the Russian market of products under Mildronat trade mark held by Grindeks. Under this agreement Mildronat products are partially imported by Pharmstandard and partially purchased from the local manufacturer licensed by Grindeks and unrelated to the Group. On 24 March 2009, Russian Medical Supervisory Authority issued an order for withdrawal from the market of certain series of Mildronat in ampoules produced in 2008 by the local manufacturer due to a production error identified in February 2009. Total sales of the defective Mildronat series were RR 218,383 in 2008 and about RR 25,000 in 2009.

As a result, management expects distributors will return unsold defective series of Mildronat in ampoules which, together with the Group's defective series of Mildronat in stock, will be returned to Grindeks in accordance with the agreement.

These Mildronat returns were booked consistently with the accounting policy for other defective stock returns, i.e. as reversal of the respective sales and cost of sales in the consolidated income statement. Based on the contract the Group has an unconditional right to recover the full amount of defective stock from the vendor and as a result the total amount recoverable from Grindeks of RR 379,460 was offset against the outstanding payable to that vendor as of 31 December 2008.