

OJSC “Pharmstandard”

Consolidated financial statements

For the year ended 31 December 2009

OJSC “Pharmstandard”

Consolidated financial statements

For the year ended 31 December 2009

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Independent Auditors' Report

To the Shareholders and Management of OJSC "Pharmstandard"

We have audited the accompanying consolidated financial statements of OJSC "Pharmstandard" and its subsidiaries ("the Group"), which comprise the consolidated statement of financial position as at 31 December 2009, and the consolidated statement of comprehensive income, consolidated cash flow statement and consolidated statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory 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 2009, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.



12 April 2010

OJSC "Pharmstandard"

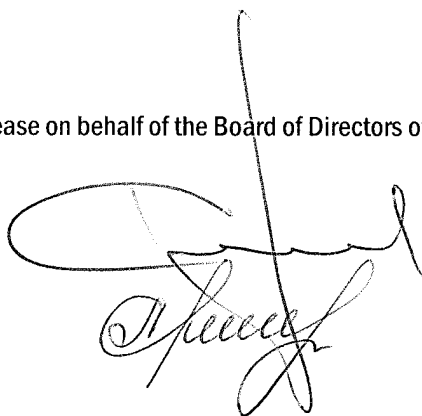
Consolidated statement of financial position as at 31 December 2009

(in thousands of Russian Roubles)

	Notes	2009	2008
Assets			
Non-current assets			
Property, plant and equipment	9	3,685,845	3,917,109
Intangible assets	10	6,162,135	6,347,141
		<u>9,847,980</u>	<u>10,264,250</u>
Current assets			
Inventories	11	2,758,691	2,484,910
Trade and other receivables	12	9,289,082	4,761,359
VAT recoverable		258,932	326,208
Prepayments		136,729	73,544
Short-term financial assets	14	1,133,287	113,995
Cash and short term deposits	13	2,798,160	186,066
		<u>16,374,881</u>	<u>7,946,082</u>
Total assets		<u><u>26,222,861</u></u>	<u><u>18,210,332</u></u>
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	18	37,793	37,793
Treasury shares		(6)	-
Retained earnings		19,243,766	12,413,396
		<u>19,281,553</u>	<u>12,451,189</u>
Non-controlling interest	5	413,961	163,203
Total equity		<u>19,695,514</u>	<u>12,614,392</u>
Non-current liabilities			
Long-term borrowings and loans	15	391,511	760,512
Deferred tax liability	25	807,062	739,186
Derivative financial instruments	15,27	34,751	89,087
Other non-current liabilities		24,197	34,048
		<u>1,257,521</u>	<u>1,622,833</u>
Current liabilities			
Trade and other payables and accruals	17	3,905,979	1,707,544
Current portion of long-term borrowings	15	391,360	1,582,722
Income tax payable		403,961	144,292
Other taxes payable	16	568,526	339,307
Bank overdraft		-	199,242
		<u>5,269,826</u>	<u>3,973,107</u>
Total liabilities		<u>6,527,347</u>	<u>5,595,940</u>
Total equity and liabilities		<u><u>26,222,861</u></u>	<u><u>18,210,332</u></u>

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

Chief Executive Officer



I.K. Krylov

Chief Financial Officer

E.V. Arkhangelskaya

12 April 2010

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

OJSC "Pharmstandard"

Consolidated statement of comprehensive income

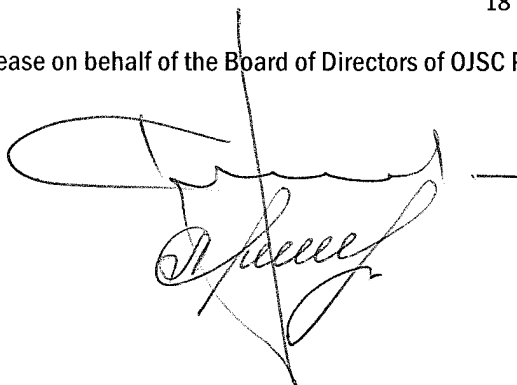
For the year ended 31 December 2009

(in thousands of Russian Roubles)

	Notes	2009	2008
Revenue	19	24,095,393	14,335,867
Cost of sales	20	(12,367,935)	(5,577,468)
Gross profit		11,727,458	8,758,399
Selling and distribution costs	21	(2,463,128)	(2,466,841)
General and administrative expenses	22	(711,245)	(656,248)
Other income	23	505,860	149,762
Other expenses	23	(400,603)	(864,963)
Financial income	24	132,878	22,569
Financial expense	24	(145,969)	(255,189)
Profit before income tax		8,645,251	4,687,489
Income tax expense	25	(1,792,810)	(1,184,381)
Profit for the year		6,852,441	3,503,108
Other comprehensive income			
Effect from change in profit tax rate	25	-	34,937
Other comprehensive income for the year, net of tax		-	34,937
Total comprehensive income for the year, net of tax		6,852,441	3,538,045
Profit for the year			
Attributable to:			
Equity holders of the Parent		6,836,430	3,504,046
Non-controlling interest		16,011	(938)
		6,852,441	3,503,108
Total comprehensive income for the year, net of tax			
Attributable to:			
Equity holders of the Parent		6,836,430	3,538,983
Non-controlling interest		16,011	(938)
		6,852,441	3,538,045
Earnings per share (in Russian roubles)			
- basic and diluted, for profit of the period attributable to equity holders of the parent	18	180.89	92.72

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

Chief Executive Officer



I.K. Krylov

Chief Financial Officer

E.V. Arkhangelskaya

12 April 2010

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

OJSC “Pharmstandard”

Consolidated cash flow statement

For the year ended 31 December 2009

(in thousands of Russian Roubles)

	Notes	2009	2008
Cash flows from operating activities:			
Profit before income tax		8,645,251	4,687,489
Adjustments for:			
Depreciation and amortisation	9,10	752,058	604,204
Change in allowance for impairment of financial assets	12,23	(472,301)	427,259
Write-down of inventories to net realizable value	11	6,447	-
(Gain) loss recognised on sale of non-current assets classified as held for sale		(13,627)	13,891
Impairment charge – intangible assets	10, 23	62,696	140,563
(Reversal of impairment) impairment charge – property, plant and equipment	23	(13,374)	59,186
Loss (gain) from disposal of property, plant and equipment	23	7,578	(18,996)
Foreign exchange loss	23	138,589	524,842
Gain from disposal of financial assets	14	-	(23,546)
Financial income	24	(132,878)	(22,569)
Financial expense	24	170,563	255,189
Operating cash flows before working capital changes		9,151,002	6,647,512
Increase in trade receivables	12	(4,062,775)	(1,047,408)
Increase in inventories	11	(280,229)	(718,039)
Decrease in VAT recoverable		67,276	32,559
(Increase) decrease in prepayments		(63,185)	56,936
Increase in trade payables, other payables and accruals	17	2,586,467	273,368
Increase in taxes payable other than income tax		229,219	126,501
Cash generated from operations		7,627,775	5,371,429
Income tax paid	25	(1,465,261)	(1,351,703)
Interest paid		(146,256)	(195,680)
Interest received		54,959	12,815
Net cash from operating activities		6,071,217	3,836,861
Cash flows from investing activities:			
Purchase of property, plant and equipment	9	(361,270)	(661,068)
Purchase of intangible assets	10	(167,801)	(1,993,637)
Cash received from sale of long-term financial assets		-	268,944
Cash paid for acquisition of non-controlling interests		(25,103)	(501,740)
Cash received from sale property, plant and equipment	9	10,487	51,573
Cash received from sale of short-term financial assets	14	106,105	84,220
Cash paid for short-term financial assets	14	(1,073,562)	(104,300)
Cash received from sale of non-current assets classified as held for sale		-	141,086
Loans provided	14	(50,000)	-
Loans repaid by related parties	8	-	5,121
Net cash used in investing activities		(1,561,144)	(2,709,801)
Cash flows from financing activities:			
Proceeds from loans and borrowings	15	-	4,407
Cash paid for treasury shares	6	(5,916)	-
Repayment of loans and borrowings	15	(1,692,821)	(1,337,232)
Net cash used in financing activities		(1,698,737)	(1,332,825)
Net increase (decrease) in cash and cash equivalents, net of bank overdraft		2,811,336	(205,765)
Cash and cash equivalents at the beginning of the year, net of bank overdraft	13	(13,176)	192,589
Cash and cash equivalents at the end of the year, net of bank overdraft	13	2,798,160	(13,176)

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

OJSC "Pharmstandard"

Consolidated statement of changes in equity

For the year ended 31 December 2009

(in thousands of Russian Roubles)

	Equity attributable to equity holders of the parent			Non-controlling interest	Total equity
	Share capital	Treasury shares	Retained earnings		
Balance at 31 December 2007	37,793	-	9,004,021	560,879	9,602,693
Profit for the year	-	-	3,504,046	(938)	3,503,108
Other comprehensive income for the year	-	-	34,937	-	34,937
Total comprehensive income for the year	-	-	3,538,983	(938)	3,538,045
Effect of de-recognition of non-controlling interests (Note 5)	-	-	(493)	(24,113)	(24,606)
Effect of acquisition of non-controlling interests (Note 5)	-	-	(129,115)	(372,625)	(501,740)
Balance at 31 December 2008	37,793	-	12,413,396	163,203	12,614,392
Profit for the year	-	-	6,836,430	16,011	6,852,441
Total comprehensive income for the year	-	-	6,836,430	16,011	6,852,441
Acquisition of treasury shares (Note 6)	-	(6)	(5,910)	-	(5,916)
Effect of sale of non-controlling interests in subsidiary interests (Note 5)	-	-	(150)	234,730	234,580
Recognition of non-controlling interest in MDR Pharmaceuticals	-	-	-	17	17
Balance at 31 December 2009	37,793	(6)	19,243,766	413,961	19,695,514

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

OJSC “Pharmstandard”

Notes to the consolidated financial statements

For the year ended 31 December 2009

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

1. Corporate information

OJSC “Pharmstandard” (“the Company”) and its subsidiaries (“the Group”) principal activities are production and wholesale distribution of pharmaceutical and medical products. The Company is incorporated in the Russian Federation. Since May 2007, the Company’s shares are publicly traded (Note 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 2009 and 2008, respectively:

Entity	Country of incorporation	Activity	2009 % share	2008 % share
1. “Pharmstandard” LLC	Russian Federation	Central procurement	100	100
2. “Pharmstandard-Leksredstva” OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
3. “Pharmstandard-Tomskhimpharm” OJSC	Russian Federation	Manufacturing of pharmaceutical products	91	91
4. “Pharmstandard-Ufavita” OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
5. “Pharmstandard-Octyabr” OJSC	Russian Federation	Manufacturing of pharmaceutical products	-	100
6. “Pharmstandard-Phitofarm-NN” LLC	Russian Federation	Manufacturing of pharmaceutical products	99	99
7. “TZMOI” OJSC	Russian Federation	Manufacturing of medical equipment	100	100
8. “Masterlek” CJSC	Russian Federation	Manufacturing pharmaceutical products	-	100
9. “Black Bird Investment Enterprises Corp”	British Virgin Islands	Finance and holding Company*	-	100
10. Donelle Company Limited	Cyprus	Finance and holding Company*	89	100
11. Aphopharm CJSC	Russian Federation	Finance and holding Company*	89	100
12. MDR Pharmaceuticals	Cyprus	Finance and holding company*	50.05	-

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

For changes in the shareholding of subsidiaries, please refer to Note 5 and 6.

These consolidated financial statements were authorised for issue by the Board of Directors of OJSC “Pharmstandard” on 12 April 2010.

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 2009.

- Amendments to IFRS 2 *Share-based Payments* - Vesting Conditions and Cancellations;
- IFRS 7 *Financial Instruments: Disclosures* - Fair Value Measurement and Liquidity Risk;
- IFRS 8 *Operating segments*;
- IAS 1 Revised *Presentation of Financial Statements*;
- IAS 23 (amended 2007) *Borrowing costs*;
- Amendments to IAS 32 and IAS 1 *Puttable Financial Instruments and Obligations Arising on Liquidation*;
- IFRIC 9 *Reassessment of Embedded derivatives* and IAS 39 *Financial Instruments: Recognition and Measurement*;
- 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 18 *Transfers of Assets from Customers* effective 1 July 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 (continued)

- "Improvements to IFRSs-2008" - a first 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:

<i>IFRS (amended in 2008)</i>	Subject of amendment
<i>IFRS 5 Non-current Assets Held for Sale and Discontinued Operations</i>	Plan to sell the controlling interest in a subsidiary
<i>IFRS 7 Financial Instruments: Disclosures</i>	Removal of the reference to "total interest income" as a component of finance costs
<i>IAS 1 Presentation of Financial Statements</i>	Current/non-current classification of derivatives
<i>IAS 8 Accounting Policies, Change in Accounting Estimates and Errors</i>	Clarification that only implementation guidance that is an integral part of an IFRS is mandatory when selecting accounting policies
<i>IAS 10 Events after the Reporting Period</i>	Clarification that dividends declared after the end of the reporting period are not obligations
<i>IAS 16 Property, Plant and Equipment</i>	Recoverable amount Sale of assets held for rental
<i>IAS 18 Revenue</i>	Replacement of the term "direct costs" with "transaction costs" as defined in IAS 39
<i>IAS 19 Employee Benefits</i>	Curtailments and negative past service cost Plan administration costs Replacement of term 'fall due' Guidance on contingent liabilities
<i>IAS 20 Accounting for Government Grants and Disclosure of Government Assistance</i>	Government loans with a below-market rate of interest
<i>IAS 23 Borrowing Costs</i>	Components of borrowing costs
<i>IAS 27 Consolidated and Separate Financial Statements</i>	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
<i>IAS 28 Investments in Associates</i>	Required disclosures when investments in associates are accounted for at fair value through profit or loss Impairment of investment in associate
<i>IAS 34 Interim Financial Reporting</i>	Earnings per share is disclosed in interim financial reports if an entity is within the scope of IAS 33
<i>IAS 31 Interests in Joint Ventures</i>	Required disclosures when interests in jointly controlled entities are accounted for at fair value through profit or loss
<i>IAS 29 Financial Reporting in Hyperinflationary Economies</i>	Description of measurement basis in financial statements

OJSC “Pharmstandard”

Notes to the consolidated financial statements (continued)

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

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

IFRS <i>(amended in 2008)</i>	Subject of amendment
IAS 36 <i>Impairment of Assets</i>	Disclosure of estimates used to determine recoverable amount
IAS 38 <i>Intangible Assets</i>	Advertising and promotional activities Units of production method of amortisation
IAS 39 <i>Financial Instruments: Recognition and Measurement</i>	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 <i>Investment Property</i>	Property under construction or development for future use as investment property
IAS 41 <i>Agriculture</i>	Discount rate for fair value calculations Additional biological transformation

Amendment to IFRS 2 *Share-based Payments* clarifies the definition of vesting conditions and prescribed the treatment for an award that is cancelled.

The amended standard IFRS 7 *Financial Instruments: Disclosures* requires additional disclosures about fair value measurements and liquidity risk. Fair value measurements related to items recorded at fair value are to be disclosed by source of inputs using a three level fair value hierarchy, by class, for all financial instruments recognised at fair value. In addition, reconciliation between the beginning and ending balance for level 3 fair value measurements is now required, as well as significant transfers between levels in the fair value hierarchy. The amendments also clarify the requirements for liquidity risk disclosures with respect to derivative transactions and assets used for liquidity management.

IFRS 8 *Operating Segments* replaced IAS 14 *Segment Reporting* upon its effective date. The Group concluded that the operating segments determined in accordance with IFRS 8 are the same as the business segments previously identified under IAS 14.

The revised IAS 1 *Presentation of Financial Statements* separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented in a reconciliation of each component of equity. In addition, the standard introduces the statement of comprehensive income: it presents all items of recognised income and expense, either in one single statement, or in two linked statements. The Group has elected to present single statement.

The revised IAS 23 *Borrowing costs* requires capitalisation of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

IAS 32 *Financial Instruments: Presentation* and IAS 1 *Puttable Financial Instruments and Obligations Arising on Liquidation* have been amended to allow a limited scope exception for puttable financial instruments to be classified as equity if they fulfil a number of specified criteria.

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 IFRIC 9 *Reassessment of Embedded Derivatives* and IAS 39 *Financial Instruments: Recognition and Measurement* require an entity to assess whether an embedded derivative must be separated from a host contract when the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category. This assessment is to be made based on circumstances that existed on the later of the date the entity first became a party to the contract and the date of any contract amendments that significantly change the cash flows of the contract. IAS 39 now states that if an embedded derivative cannot be reliably measured, the entire hybrid instrument must remain classified as at fair value through profit or loss.

IFRIC 13 *Customer Loyalty Programmes* requires customer loyalty credits to be accounted for as a separate component of the sales transaction in which they are granted. A portion of the fair value of the consideration received is allocated to the award credits and deferred. This is then recognised as revenue over the period that the award credits are redeemed.

IFRIC 15 *Agreements for the Construction of Real Estate* standardises accounting practice across jurisdictions for the recognition of revenue among real estate developers for sales of units, such as apartments or houses, ‘off plan’, i.e. before construction is complete.

IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* provides guidance on the accounting for a hedge of a net investment. As such it provides guidance on identifying the foreign currency risks that qualify for hedge accounting in the hedge of a net investment, where within the group the hedging instruments can be held in the hedge of a net investment and how an entity should determine the amount of foreign currency gain or loss, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment.

There were no significant effects of these changes in accounting policies on these consolidated financial statements excepting to IFRS 8 and revised IAS 1. The adoption of IFRS 8 *Operating segments* affects the disclosures relating to business segments as presented in the notes to these consolidated financial statements. IAS 1 Revised *Presentation of Financial Statements* separates owner and non-owner changes in equity.

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:

- Amendments to IFRS 2 *Share-based Payments* – Group Cash-settled Share-based Payment Transactions;
- IFRIC 17 *Distributions of Non-cash Assets to Owners*;
- IFRIC 18 *Transfers of Assets from Customers*;
- IAS 39 *Financial Instruments: Recognition and Measurement* - Eligible Hedged Items;
- IFRS 3R *Business Combinations* and IAS 27R *Consolidated and Separate Financial Statements*;
- Amendments to IFRS 1 and IAS 27 *Determining the cost of an investment in the separate financial statements*;
- Amendments to IAS 24 *Related Party Disclosures*;

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)

- Amendment to IAS 32 *Financial Instruments: Presentation* – Classification of rights issues denominated in a foreign currency;
- IFRS 9 *Financial Instruments*;
- IFRIC 19 *Extinguishing Financial Liabilities with Equity Instruments*;
- Amendment to IFRIC 14 *IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and Their Interaction* – Prepayment of a minimum funding requirement;
- “Improvements to IFRSs-2009” – 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 (amended in 2009)	Subject of amendment
IFRS 2 <i>Share-based Payment</i>	Scope of IFRS 2 and revised IFRS 3 <i>Business Combinations</i>
IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i>	Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations
IFRS 8 <i>Operating Segments</i>	Disclosure of information about segment assets
IAS 1 <i>Presentation of Financial Statements</i>	Current/noncurrent classification of convertible instruments
IAS 7 <i>Statement of Cash Flows</i>	Classification of expenditures on unrecognised assets
IAS 17 <i>Leases</i>	Classification of leases of land and buildings
IAS 18 <i>Revenue</i>	Determining whether an entity is acting as a principal or as an agent
IAS 36 <i>Impairments of Assets</i>	Unit of accounting for goodwill impairment test
IAS 38 <i>Intangible Assets</i>	Additional consequential amendments arising from revised IFRS 3 Measuring the fair value of an intangible asset acquired in a business combination
IAS 39 <i>Financial Instruments: Recognition and Measurement</i>	Treating loan prepayment penalties as closely related embedded derivatives Scope exemption for business combination contracts Cash flow hedge accounting
IFRIC 9 <i>Reassessment of Embedded Derivatives</i>	Scope of IFRIC 9 and revised IFRS 3
IFRIC 16 <i>Hedges of a Net Investment in a Foreign Operation</i>	Amendment to the restriction on the entity that can hold hedging instruments

The Group expects that the adoption of the pronouncements listed above will have no significant impact on the Group's results of operations and financial position 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.

Non-controlling interest is the interest in subsidiaries with equity not held by the Group. Non-controlling interest at the reporting 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. Non-controlling 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 non-controlling 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 profit or loss.

Losses allocated to non-controlling interest do not exceed the non-controlling 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 additional interests in existing 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 short-term deposits

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

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

3.3 Value added tax

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

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

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

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:

	Number of years
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 depreciation methods are reviewed, and adjusted as appropriate, at each financial year end. Land is not depreciated.

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

3.7 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 profit or loss 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 profit or loss when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial investments

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

OJSC “Pharmstandard”

Notes to the consolidated financial statements (continued)

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

3. Summary of Significant Accounting Policies (continued)

3.9 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 reporting date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; discounted cash flow analysis or other valuation models.

Amortised cost

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

Impairment of financial assets

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

Assets carried at amortised cost

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

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 profit or loss, is transferred from other comprehensive income to profit or loss. Reversals in respect of equity instruments classified as available-for-sale are not recognised in profit or loss. Reversals of impairment losses on debt instruments are reversed through the profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

3. 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 reporting date.

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

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

The effect from a change in tax rates is recognised in profit or loss except to the extent that it relates to items previously charged or credited to other comprehensive income. In particular, this policy is applicable to deferred taxes recorded to other comprehensive income 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 profit or loss 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 profit or loss.

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

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

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 excluding discounts and rebates.

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 265,015 during the year ended 31 December 2009 (2008: RR 270,277) 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 reporting date. All resulting differences are taken to profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

The functional currency of the foreign operations is the United States dollar (US\$). As at the reporting date, the assets and liabilities of those subsidiaries are translated into the presentation currency of the Group (the Russian Rouble) at the rate of exchange ruling at the reporting date and its statement of comprehensive income is translated at the weighted average exchange rate for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. In 2009 and 2008, the foreign subsidiaries did not perform any significant operations and held minor assets and liabilities, therefore its translation into the presentation currency had no significant 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 reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Useful life of property, plant and equipment and intangible assets

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

Impairment of non-financial assets

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

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 2009 and 2008 was RR 1,180,469. More details are provided in Note 10.

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 2009, allowances for doubtful accounts amounted to RR 94,910 (2008: RR 568,676). More details are provided in Note 12.

Allowance for write-down of inventories to net realizable value

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

Fair value of derivatives

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

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

4. Significant accounting judgements and estimates (continued)

Current taxes

Russian tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group's entities may be assessed additional taxes, penalties and interest, which can be significant. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As of 31 December 2009 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.

Leases

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

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

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

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

5. Transactions with non-controlling interests

Disposal of Donelle shares

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. Therefore acquisition of Donelle was accounted for as an acquisition of a single-asset entity.

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 non-controlling interests (continued)

Disposal of Donelle shares (continued)

As at 31 December 2008 a total of RR 235 million was still payable to the former shareholders of Donelle. 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 million (Note 17). This transaction was recorded in 2009 as an increase in non-controlling interest with the corresponding decrease in other accounts payable.

Acquisition of non-controlling interests in the Group production entities

In the 1st quarter of 2008, the Company's management approved a plan to acquire non-controlling interest 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 non-controlling interest was RR 501,740. The difference of RR 129,115 between the total consideration and the carrying amount of the non-controlling interest acquired of RR 372,625 was debited directly to equity.

De-recognition of non-controlling interest in OJSC "Pharmstandard-Octyabr"

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 non-controlling interest, the Group derecognised the remaining non-controlling interest of 3% in OJSC "Pharmstandard-Octyabr". At the time of derecognition, the carrying value of the non-controlling 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 non-controlling interest derecognised was debited directly to equity.

6. Reorganization of Group's structure and sale of subsidiary

Reorganization of Group's structure

In July 2009, the management approved a plan to reorganise the legal structure of some of the Group's subsidiaries. This plan included a legal merger of OJSC "Pharmstandard-Octyabr" and CJSC "Masterlek" with OJSC "Pharmstandard". In November 2009, OJSC "Pharmstandard-Octyabr" and CJSC "Masterlek" were merged into OJSC "Pharmstandard".

OJSC "Pharmstandard-Octyabr" and CJSC "Masterlek" did not conduct any operating activities during 2009. These subsidiaries had only minor assets and liabilities. The reorganization will improve the structure of Group's assets and liabilities and will improve the Group business efficiency.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

6. Reorganization of Group's structure and sale of subsidiary (continued)

Reorganization of Group's structure

In accordance with Russian legislation, shareholders have the right to unconditionally offer their shares for redemption by the Company, in the event of reorganization. In 2009, certain shareholders executed this right and the Company acquired 6,000 treasury shares with par value 1 (one) Russian Ruble. These shares comprise less than 0.02% of the authorized share capital. The difference between the nominal value of the treasury shares and consideration paid was debited directly to equity.

Sale of subsidiary

In 2009 the management approved a plan to dispose of "Black Bird Investment Enterprises Corp". This subsidiary did not conduct any business activities and had a loan balance payable and receivable. This subsidiary was sold during the 4th quarter of 2009 to a related party (Note 8). This arrangement resulted in a gain amounting to RR 13,627 that was recognised in other income (Note 23).

7. Segment information

For the management purposes, the Group is organised into two main reportable operating segments: (1) production and wholesale of pharmaceutical products and (2) production and wholesale of medical equipment and disposables. The medical equipment segment is primarily represented by OJSC "TZMOI", as production subsidiary, and by equipment department of OJSC "Pharmstandard", as managing and logistics division.

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

Management monitors the sales, cost of sales, operating expenses and other operating results and budgets of these business segments separately for the purpose of making decisions about resource allocation and performance assessment. For the management purposes, budgets of income and expense are planned, made and analyzed for each of operating segments separately.

Segment result is segment revenue less segment expenses. Segment expenses consist of cost of sales, selling and distribution costs, general and administrative expenses and other income and expenses that can be directly attributed to the segment on a reasonable basis.

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, financial assets, receivables and operating cash. There were no assets unallocated to segments as of 31 December 2009 and 2008. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Capital expenditure comprises additions to property, plant and equipment.

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

OJSC “Pharmstandard”

Notes to the consolidated financial statements (continued)

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

7. Segment information (continued)

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

Year ended 31 December 2009	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Eliminations	Group
Sales to external customers	23,406,685	688,708	-	24,095,393
Total revenue	23,406,685	688,708	-	24,095,393
Gross profit	11,533,284	194,174	-	11,727,458
Segment result	8,550,210	108,132	-	8,658,342
Financial expense, net				(13,091)
Profit before income tax				8,645,251
Income tax expense				(1,792,810)
Profit for the year				6,852,441
Segment assets	25,215,141	1,007,720	-	26,222,861
Total assets	25,215,141	1,007,720	-	26,222,861
Segment liabilities	4,466,577	32,125	-	4,498,702
Unallocated liabilities				2,028,645
Total liabilities				6,527,347
Acquisition of property, plant and equipment (Note 9)	224,294	11,079	-	235,373
Intangible assets acquisition (Note 10)	167,801	-	-	167,801
Depreciation and amortisation	695,683	56,375	-	752,058
Impairment charge	62,696	-	-	62,696

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

7. Segment information (continued)

Year ended 31 December 2008	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Eliminations and reconciliations	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
Acquisition of property, plant and equipment (Note 9)	672,172	40,248	-	712,420
Intangible assets acquisition (Note 10)	2,228,620	-	-	2,228,620
Depreciation and amortisation	553,693	50,511	-	604,204
Impairment charge	174,022	25,727	-	199,749

Revenues from some customers in pharmaceutical products segment exceeded 10% of total Group revenue for each of them.

The table below shows the revenue from these customers:

Customer	2009	2008
The Ministry of health and social department (state tenders)	3,905,778	23,562
Customer 1	3,289,494	2,433,550
Customer 2	3,169,648	1,796,009
Customer 3	2,663,604	1,814,600

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

8. 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 2009 and 2008 are detailed below.

Balances with related parties:

2009	Short-term financial assets (a)	Cash and cash equivalents Note 13 (a)	Trade payables, other payables and accruals - (b) Note 17
Other related parties ¹	440,000	2,475,900	12,004
Total	440,000	2,475,900	12,004

2008	Short-term financial assets (a)	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

(a) This balance represented cash and short-term bank deposits 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.

Cash balances with the related bank carry no interest. Short-term financial assets at 31 December 2009 include cash deposits in the related bank and carry 12.5% interest p.a. (for more details see Notes 13 and 14).

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)

8. Balances and transactions with related parties

Significant transactions with related parties included in the profit or loss:

Statement of comprehensive income caption	Relationship	2009	2008
License fee (included in distribution costs) (A)	Other related parties ¹	(30,401)	(23,231)
Warehouse rental expenses (included in distribution costs) (B)	Other related parties ¹	(53,801)	(32,108)
Office rental expenses (included in general and administrative expenses) (B)	Other related parties ¹	(15,654)	(19,188)
Agency fee income (included in other income) (C)	Other related parties ¹	4,779	-
Gain from disposal of subsidiary (D)	Other related parties ¹	13,627	-

(A) License fee

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

(B) Rental expenses

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

(C) Agency fee income

In 2009 the Company signed an agency contract with the related party for purchasing of certain equipment on behalf of that party.

(D) Gain from disposal of subsidiary

This line includes a gain received from disposal of subsidiary sold to a related party (for more information see Note 6).

Acquisition of intangible assets

In 2009, the Group acquired an intangible asset (trade mark) for RR 90,050 from the related party.

Compensation to key management personnel

Key management personnel comprise 3 persons as at 31 December 2009 and 2008. Total compensation to key management personnel, amounted to RR 39,310 for the year ended 31 December 2009 (2008: RR 35,224). Such compensation represented the following short-term employee benefits: payroll and bonuses included in general and administrative expenses.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

9. Property, plant and equipment

Property, plant and equipment consist of the following:

1 December 2009	Land	Buildings	Plant and machinery	Equipment and motor vehicles	Assets under construction	Total
Cost						
Balance at 31 December 2008	32,986	1,959,337	2,322,910	282,368	464,589	5,062,190
Additions	-	7,815	60,613	14,578	152,367	235,373
Transfers	-	238,754	165,850	2,531	(407,135)	-
Disposals	-	(1,905)	(31,314)	(17,102)	(4,309)	(54,630)
Balance at 31 December 2009	32,986	2,204,001	2,518,059	282,375	205,512	5,242,933
Accumulated Depreciation and Impairment						
Balance at 31 December 2008	-	213,249	794,702	103,671	33,459	1,145,081
Depreciation charge	-	64,367	336,824	60,756	-	461,947
Disposals	-	(1,054)	(23,651)	(11,861)	-	(36,566)
Reversal of impairment (a)	-	-	(13,374)	-	-	(13,374)
Balance at 31 December 2009	-	276,562	1,094,501	152,566	33,459	1,557,088
Net Book Value						
Balance at 31 December 2008	32,986	1,746,088	1,528,208	178,697	431,130	3,917,109
Balance at 31 December 2009	32,986	1,927,439	1,423,558	129,809	172,053	3,685,845

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

9. Property, plant and equipment (continued)

1 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 and Impairment						
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 (b)	-	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

- (a) Due to changes in the market situation for medical devices during 2009 the Company resumed the production of syringes. As a result the previous impairment of the related equipment has been reversed.
- (b) 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, including syringes, removed from active use due to decline in customer demand. The impairment charge equals to the carrying value of those building and equipment.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

9. Property, plant and equipment (continued)

The Group did not use borrowings to finance capital expenditures, thus no interest expense was capitalized in 2009 and 2008.

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 2009 was RR 8,187 (2008: RR 8,397). Such payments are reassessed by the state authorities on an annual basis. No such reassessment has been completed for 2010 and beyond.

10. Intangible assets

	Goodwill	Trademarks and patents	Total
Cost			
Balance at 31 December 2008	1,180,469	5,756,308	6,936,777
Additions (a)	-	167,801	167,801
Balance at 31 December 2009	1,180,469	5,924,109	7,104,578
Accumulated Amortisation			
Balance at 31 December 2008	-	589,636	589,636
Impairment (b)	-	62,696	62,696
Amortisation expense	-	290,111	290,111
Balance at 31 December 2009	-	942,443	942,443
Net Book Value			
Balance at 31 December 2008	1,180,469	5,166,672	6,347,141
Balance at 31 December 2009	1,180,469	4,981,666	6,162,135
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 (c)	-	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)

10. Intangible assets (continued)

- (a) Additions during 2009 represented acquisition of some trade mark (see Note 8) and some patents (know-how). Additions during 2008 represented acquisition of the Afobazol trade mark (see Note 5).
- (b) The impairment mainly relates to the decrease in customer demand due to the recent financial crisis. The recoverable amount was 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 5% growth rate (2008: 15%) that is the mid-term average growth rate for pharmaceuticals market. The discount rate applied to cash flow projections is 16.4% (2008: 18.1%).
- (c) 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 in 2008.

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

Name	Carrying amount		Remaining amortization period (years)	
	2009	2008	2009	2008
Afobazol	1,955,884	2,060,199	19	20
Arbidol	1,715,258	1,818,691	16	17
Flucostat	667,259	707,496	16	17

Impairment testing of goodwill

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

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

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

	Pharmaceuticals		Equipment		Total	
	2009	2008	2009	2008	2009	2008
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)

10. 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 5% growth rate that is the same as the mid-term average growth rate for pharmaceuticals and medical equipment market (2008: 24% for pharmaceuticals and 5% for medical equipment market). The discount rate applied to cash flow projections is 16.4% (2008: 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 reporting date.

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.

11. Inventories

Inventories consist of the following:

	2009	2008
Raw materials - at cost	1,448,918	1,113,174
Work in progress - at cost	330,508	179,319
Finished goods (cost or net realizable value):		
- at cost	999,267	1,216,896
- at net realisable value	979,265	1,192,417
	<u>2,758,691</u>	<u>2,484,910</u>

OJSC “Pharmstandard”

Notes to the consolidated financial statements (continued)

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

11. Inventories (continued)

Movements in allowance for write-down of inventories to net realizable value consist of the following:

	2009	2008
Balance at 1 January	24,479	67,114
Additional allowance	7,434	-
Unused amounts reversed	(987)	(6,674)
Utilised during the year	(10,924)	(35,961)
Balance at 31 December	<u>20,002</u>	<u>24,479</u>

12. Trade and other receivables

	2009	2008
Trade receivables (net of allowance for impairment of receivables of RR 94,910 (2008: RR 568,676)) (a)	9,012,168	4,761,359
Other receivables (b)	276,914	-
	<u>9,289,082</u>	<u>4,761,359</u>

(a) In the 4th quarter of 2009 in the Russian Federation the epidemiological situation on a flu was critical. This fact has demanded to increase in volumes of antiviral and anti-cold pharmaceutical products on the Russian market. As a result, the Group has considerably increased production and sales of these products, such as Arbidol, Amixin and other.

(b) Other receivables represented cash rebates on procurement.

At 31 December 2009 RR 52,584 of trade receivables were denominated in currencies other than Russian Roubles, primarily in US\$ (2008: RR 172,870).

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

	2009	2008
Balance at 1 January	568,676	167,933
Additional allowance	4,979	484,194
Unused amounts reversed	(477,279)	(53,977)
Utilised during the year	(1,466)	(29,474)
Balance at 31 December	<u>94,910</u>	<u>568,676</u>

The additional allowance for impairment in 2008 includes RR 476,131 in relation to the bankruptcy of one of the Group’s distributor, CJSC “Genesis” (Note 21). In 2009, a successor of the distributor, agreed to pay almost the entire balance receivable that had been previously provided for. The reversal of the allowance for accounts receivable, included in “Unused amount reversed” line, amounted to RR 447,671 and recognised in profit or loss (Note 23).

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

13. Cash and short-term deposits

Cash and short-term deposits consist of the following:

	2009	2008
Cash in bank – Russian Roubles	1,604,760	183,688
Cash in bank – US\$ and Euro	617,176	2,378
Cash deposits on tenders (a):		
- transferred to the Ministry of Health	156,224	-
- placed in the related bank	420,000	-
	2,798,160	186,066

- (a) This item represents cash deposits restricted for use placed to secure participation in tenders announced by the Government of the Russian Federation. Cash deposit transferred to the Ministry of Health is interest free.

Cash deposits placed in the related bank carried an interest rate of 12.5% per annum.

14. Short-term financial assets

	2009	2008
<i>Accounted for as loans and receivables:</i>		
Promissory notes	331,120	104,300
Short-term bank deposits – Russian Roubles (Note 8)	440,000	-
Short-term bank deposits – US\$	302,442	-
Short-term loans	45,500	-
<i>Accounted for as available for sale: Securities and other</i>	14,225	9,695
	1,133,287	113,995

15. Borrowings and loans

	2009	2008
Long-term borrowings and loans		
(a) Syndicated borrowing organised by Citibank ("Citibank loan")	782,871	2,328,985
(b) Other loans	-	14,249
Less: Current portion of long-term borrowings and loans	(391,360)	(1,582,722)
	391,511	760,512

Long-term debt is repayable as follows:

	2009	2008
1 to 2 years	391,511	380,182
2 to 3 years	-	380,330
	391,511	760,512

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Notes to the consolidated financial statements (continued)

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

15. Borrowings and loans (continued)

As at 31 December 2009 and 2008 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 (on 18 December 2009 this facility was repaid); and
- Facility B in the total amount of US\$ 55 million with maturity period of 5 years.

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.

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 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 2009, the Group repaid US\$ 53,385 thousand (RR 1,688,150) of the Citibank loan (2008: US\$ 53,384 thousand (RR 1,337,232)).

16. Other taxes payable

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

	2009	2008
Value-added tax	520,305	292,064
Property and other taxes	48,221	47,243
	568,526	339,307

17. Trade and other payables and accruals

	2009	2008
Trade payables	2,043,178	1,193,029
Payables for Velcade procurement (Notes 19 and 20)	1,502,796	-
Payable for Afobazol trade mark acquisition (Note 5)	-	235,000
Payable for non-controlling interest acquisitions	-	24,606
Other payables – related party (Note 8)	12,004	6,495
Other payables and accruals	348,001	248,414
	3,905,979	1,707,544

At 31 December 2009 RR 1,253,586 of trade payables were denominated in currencies other than Russian Rouble, primarily in US\$ (2008: RR 527,018).

OJSC “Pharmstandard”

Notes to the consolidated financial statements (continued)

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

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 Rouble. All authorised shares are issued and fully paid. There were no other transactions with own shares during 2009 except the redemption of a minor part of own shares as described in Note 6.

As at 31 December 2009 and 2008 more than half of voting shares of OJSC “Pharmstandard” were held by “Augment Investments Limited” (“Augment”), a company registered under the laws of Cyprus and controlled by Victor Kharitonin, a Russian citizen.

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 2008 and 2009, 969,815 ordinary shares representing 2.56% of share capital of the Company were sold by Augment and were offered at LSE. Also, in 2009 Augment reacquired 55,000 ordinary shares representing a minor part of share capital. After these transactions, 45.7% of share capital was publicly listed of which 27.6% is on the LSE.

In accordance with Russian legislation, dividends may only be declared from accumulated undistributed and unreserved earnings as shown in Russian statutory financial statements. The Company had approximately RR 8,911,487 (unaudited) of undistributed and unreserved earnings as at 31 December 2009 (2008: RR 6,152,441- unaudited). In addition, the Company's share in the undistributed and unreserved earnings of the subsidiaries was approximately RR 9,307,037 (unaudited) as at 31 December 2009 (2008: RR 9,826,453- unaudited). For more details see Note 6.

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:

	2009	2008
Weighted average number of ordinary shares outstanding	37,792,603	37,792,603
Profit for the year attributable to the shareholders	6,836,430	3,504,046
Basic and diluted earnings per share, Russian Roubles	180.89	92.72

OJSC “Pharmstandard”

Notes to the consolidated financial statements (continued)

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

19. Revenue

Sales breakdown by product groups comprised the following:

Product group	2009	2008 (b)
Pharmaceutical products		
OTC		
Branded	12,709,906	8,852,923
Non-branded	2,130,766	1,527,884
	14,840,672	10,380,807
Prescription		
Branded	2,022,368	1,190,629
Non-branded	315,741	171,271
	2,338,109	1,361,900
Third parties products (a)	6,156,359	1,446,635
Other	71,545	70,872
	23,406,685	13,260,214
Total pharmaceutical products (c)		
Medical equipment and disposables	688,708	1,075,653
	24,095,393	14,335,867

- (a) Third parties products include sales of branded pharmaceutical products manufactured by other pharmaceutical companies such as Midronat (produced by Grindex). Furthermore, this category includes RR 3,661,922 sales through government tenders under federal reimbursement programs such as the prescription drug Velcade (produced by Janssen-Cilag).
- (b) 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 and 2009 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.
- (c) In the 4th quarter of 2009 in the Russian Federation the epidemiological situation on a flu was critical. This fact has demanded to increase in volumes of antiviral and anti-cold pharmaceutical products on the Russian market. As a result, the Group has considerably increased production and sales of its products, such as Arbidol, Amixin and other (Note 12).

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

20. Cost of sales

The components of cost of sales were as follows:

	2009	2008
Materials and components	5,618,032	2,833,105
Third parties products (see 19b)	4,973,093	1,269,143
Production overheads	817,656	734,949
Depreciation and amortisation	684,802	535,583
Direct labour costs	274,352	204,688
	12,367,935	5,577,468

21. Selling and distribution costs

Selling and distribution costs were as follows:

	2009	2008
Advertising	1,365,491	1,061,815
Labour costs	585,997	476,985
Freight, communication and insurance of goods in transit	150,738	122,246
Trainings and other services	29,436	47,009
Certification expenses	38,763	29,996
Rent	53,920	35,873
Commission and license fee	51,495	36,886
Materials, maintenance and utilities	54,211	42,834
Travel and entertainment	58,976	56,148
Depreciation	50,066	45,201
Allowances for impairment of receivables (see Note 12)	-	476,131
Other expenses	24,035	35,717
	2,463,128	2,466,841

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 2010 compared to 2009.

OJSC "Pharmstandard"

Notes to the consolidated financial statements (continued)

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

22. General and administrative expenses

General and administrative expenses were as follows:

	2009	2008
Labour costs	436,082	403,121
Utilities and services	78,585	63,002
Travel and entertainment	16,315	15,494
Taxes other than income tax	15,347	15,213
Property insurance	13,981	14,756
Freight and communication	25,134	26,171
Depreciation	17,190	23,420
Rent	27,359	26,520
Materials and maintenance	38,227	24,777
Other	43,025	43,774
	711,245	656,248

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 2010 compared to 2009.

23. Other Income and other expenses

Other income comprised the following:

	2009	2008
Income from non-core operations (a)	31,188	107,220
Reversal of impairment – property, plant and equipment (Note 9)	13,374	-
Reversal of impairment of receivables (Note 12)	447,671	-
Gain from disposal of property, plant and equipment	-	18,996
Gain from disposal of long-term financial assets	-	23,546
Gain from sale of subsidiary (Note 6)	13,627	-
	505,860	149,762

(a) Income from non-core operations includes agency fee (2009) and reimbursement of marketing and promotional expenses incurred in respect of certain products (2008).

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Notes to the consolidated financial statements (continued)

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

23. Other Income and other expenses (continued)

Other expenses comprised the following:

	2009	2008
Foreign exchange loss, net	226,329	524,842
Impairment of property, plant and equipment (Note 9)	-	59,186
Loss from disposal of property, plant and equipment	7,578	-
Impairment of intangible assets (Note 10)	62,696	140,563
Charity	13,992	1,959
Other taxes	53,959	93,784
Fees for factoring	24,594	-
Impairment of other short-term financial assets	-	3,715
Loss recognised on non-current assets classified as held for sale	-	13,891
Other	11,455	27,023
	<u>400,603</u>	<u>864,963</u>

24. Financial Income and expense

Financial income and expense comprised the following:

	2009	2008
Interest income:		
Income from changes of fair value of financial assets recognised in profit or loss	6,336	-
Income from changes in fair value of Interest Rate Swap (Notes 15 and 27)	54,337	-
Interest income from loans and deposits	72,205	22,569
	<u>132,878</u>	<u>22,569</u>
Interest expense:		
Loss from changes of fair value of financial assets recognised in profit or loss	-	8,457
Loss from Interest Rate Swap (Notes 15 and 27)	74,074	43,608
Expense from changes in fair value of the Interest Rate Swap (Notes 15 and 27)	-	44,490
Interest expense on borrowings and loans	71,895	158,634
	<u>145,969</u>	<u>255,189</u>

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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

	2009	2008
Income tax expense – current	1,724,934	1,458,057
Deferred tax credit – effect from change in profit tax rate (a)	-	(116,374)
Deferred tax expense (benefit) – origination and reversal of temporary differences	67,876	(157,302)
Income tax expense	1,792,810	1,184,381

- (a) 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.

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

	2009	2008
Profit before income tax	8,645,251	4,687,489
Theoretical tax charge at statutory rate of 20% (24% in 2008)	1,729,050	1,124,997
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	63,760	87,199
Other items	-	88,559
Income tax expense	1,792,810	1,184,381

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Notes to the consolidated financial statements (continued)

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25. Income tax (continued)

Movements in deferred tax balances were as follows:

	31 December 2007	Effect from change in profit tax rate recognised in other comprehen-sive income	Effect from change in profit tax rate recognised in profit or loss	Temporary differences recognition and reversal	31 December 2008	Temporary differences recognition and reversal	31 December 2009
Tax effects of deductible temporary differences - asset (liability):							
Property, plant and equipment (Note 9)	(360,359)	34,937	23,286	11,020	(291,116)	(16,746)	(307,862)
Intangible assets (Note 10)	(697,026)	-	110,792	31,801	(554,433)	40,110	(514,323)
Trade and other receivables	4,399	-	(24,248)	141,090	121,241	(153,617)	(32,376)
Inventories	(18,278)	-	(4,222)	43,613	21,113	(8,782)	12,331
Trade and other payables and other taxes	19,656	-	11,025	(85,805)	(55,124)	71,482	16,358
Financial instruments	-	-	-	17,817	17,817	(10,867)	6,950
Other	3,809	-	(259)	(2,234)	1,316	10,544	11,860
Total net deferred tax liability	(1,047,799)	34,937	116,374	157,302	(739,186)	(67,876)	(807,062)

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 5,839,675 as at 31 December 2009 (2008: RR 8,679,758).

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Notes to the consolidated financial statements (continued)

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

26. Contingencies, commitments and operating risks

Operating environment of the group

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in a decline in the gross domestic product, 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 to 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.

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

Taxation

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

As at 31 December 2009 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 2009. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Should the Russian tax authorities decide to issue a claim and prove successful in the court, they would be entitled to recover the amount claimed, together with fines amounting to 20% of such amount and interest at the rate of 1/300 of the Central Bank of the Russian Federation rate for each day of delay for late payment of such amount. Management believes that it is not probable that the ultimate outcome of such matters would result in a liability. Therefore, no provision for these contingencies was recorded in these consolidated financial statements.

26. Contingencies, commitments and operating risks (continued)

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.

27. Financial Instruments and financial risk management objectives and policies

Fair values

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Notes to the consolidated financial statements (continued)

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

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.

	2009		2008	
	Fair value	Net carrying value	Fair value	Net carrying value
Financial assets				
Cash and cash equivalents (Note 13)	2,798,160	2,798,160	186,066	186,066
Short-term loans (Note 14)	45,500	45,500	-	-
Promissory notes (Note 14)	331,120	331,120	104,300	104,300
Short-term deposits (Note 14)	742,442	742,442	-	-
Other short-term investments (Note 14)	14,225	14,225	9,695	9,695
Financial liabilities				
Overdraft	-	-	199,242	199,242
Borrowings and loans (Note 15)	782,871	782,871	2,343,234	2,343,234
Derivative financial instruments	34,751	34,751	89,087	89,087
Other non-current liabilities	24,197	24,197	34,048	34,048

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 values of promissory notes, short-term deposits and other items above approximate their carrying amounts due to their short maturity.

Fair value hierarchy

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

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

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

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

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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)

The table below shows the assets measured at fair value as at 31 December 2009:

	Total	Level 1	Level 2	Level 3
Assets measured at fair value				
Financial assets				
Securities (Note 14)	9,595	8,774	-	821
Liabilities measured at fair value				
Interest rate swap	34,751	-	34,751	-

Financial risk management objectives and policies

The Group's principal financial instruments comprise bank loans, short-term bank deposits and cash and cash equivalents. The main 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.

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 profit or loss (interest expense)	Effect on profit or loss (due to fair value change)
As at 31 December 2009	100	(7,829)	6,429
	(25)	1,957	(1,711)
As at 31 December 2008	200	(46,567)	36,842
	(100)	23,298	(20,918)

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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)

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 2009		
US\$/Roubles exchange rate	+10%	(104,057)
US\$/Roubles exchange rate	-10%	104,057
As at 31 December 2008		
US\$/Roubles exchange rate	+25%	(688,074)
US\$/Roubles exchange rate	+10%	(275,230)

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.

		Less than 3 months	3 to 6 months	6 to 12 months	1 to 5 years
As at 31 December 2009					
	Total				
Borrowings (a)	804,921	102,039	102,039	204,078	396,765
Other non-current liabilities	67,018	-	-		67,018
Total	871,939	102,039	102,039	204,078	463,783
As at 31 December 2008					
	Total				
Borrowings (a)	2,489,338	418,926	418,926	852,102	799,384
Payable for trade mark	235,000	235,000	-	-	-
Other non-current liabilities	80,810	-	-		80,810
Total	2,805,148	653,926	418,926	852,102	880,194

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

- (a) The Citibank loan received in 2006 (see Note 15 for details) is including contractual principal amount of a debt and interest rate calculated in accordance with corresponding terms of the loan agreement at 31 December 2009 and 2008.

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Notes to the consolidated financial statements (continued)

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

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.

Cash is placed in the related bank (Note 8), which is considered to have minimal risk of default.

The table below summarises the Group’s trade receivables aging.

	Total	Neither impaired nor past due	Not impaired but past due				
			less 1 month	1-2 months	2-3 months	3 to 6 months	> 6 months (a)
31 December 2009	9,289,082	8,455,737	612,742	19,995	10,657	14,175	175,776
31 December 2008	4,761,359	3,890,073	793,465	54,283	6,013	14,734	2,791

- (a) At 31 December 2009 these receivables primarily represent the amount of restructured receivable of CJSC “Genesis”. In 2009, the Group reversed impairment against the receivable from CJSC “Genesis”, which was recorded in 2008. They were collected in January-March 2010 (for more details see Note 12).

Sales concentration to a small group of customers

The Group works with five distributors that together represent more than 50% of the Group’s revenue for 2009 and 2008. 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.

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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)

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.

	2009	2008
Borrowings and loans	782,871	2,343,234
Trade and other payables	3,905,979	1,707,544
Bank overdraft	-	199,242
Less: cash and cash equivalents	(2,798,160)	(186,066)
Net debt	1,890,690	4,063,954
Equity	19,281,553	12,451,189
Capital and net debt	21,172,243	16,515,143
Gearing ratio	9%	25%

28. Post balance sheet events

Foundation of the joint venture organization

In the 4th quarter of 2009 the management of the Group approved the plan for the foundation of a new joint venture. In February 2010 the “NauchTechStroy+” LLC (“NTS+”) was registered in the Russian Federation. The joint venture was formed by two participants. The Group's equity participation in the share capital of this company is 50% and amounted to RR 150,004. There were no transactions with the “NTS+” before the date of approval of these consolidated financial statements for issue.