

Consolidated financial statements  
**OJSC "Pharmstandard" and its subsidiaries**  
for the year ended 31 December 2013

*with independent auditor's report*

**Consolidated financial statements -  
OJSC "Pharmstandard" and its subsidiaries**

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## **Independent auditor's report**

To the Shareholders and Management of OJSC "Pharmstandard"

We have audited the accompanying consolidated financial statements of OJSC "Pharmstandard" and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2013, and the consolidated statement of comprehensive income, consolidated cash flow statement and consolidated statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

### ***Audited entity's responsibility for the consolidated financial statements***

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

### ***Auditor's responsibility***

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

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

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

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

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OJSC "Pharmstandard" and its subsidiaries as at 31 December 2013, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.



A.B. Khorovitch  
Partner  
Ernst & Young LLC

25 April 2014

### **Details of the audited entity**

Name: OJSC "Pharmstandard"  
Record made in the State Register of Legal Entities on 5 May 2006, State Registration Number 02N<sup>o</sup>005162109.  
Address: 141701, Russia, Moscow region, Dolgoprudny, Likhachevsky drive, 5 "b".

### **Details of the auditor**

Name: Ernst & Young LLC  
Record made in the State Register of Legal Entities on 5 December 2002, State Registration Number 1027739707203.  
Address: Russia 115035, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.  
Ernst & Young LLC is a member of Non Profit partnership "Russian Audit Chamber" ("NP APR"). Ernst & Young LLC is registered in the register of auditors and audit organizations of NP APR, number 3028, and also included in the control copy of the register of auditors and audit organizations, main registration number 10201017420.

**OJSC "Pharmstandard"**  
**Consolidated statement of financial position**  
**as at 31 December 2013**  
*(in thousands of Russian Roubles)*

	Notes	2013	2012 Restated (Note 8)	As at 1 January 2012 Restated (Note 8)
<b>Assets</b>				
<b>Non-current assets</b>				
Property, plant and equipment	14	8,403,238	7,614,707	5,210,016
Intangible assets	15	3,202,517	8,042,938	6,717,624
Long-term financial assets	20	537,458	-	-
Investment in an associate	9	1,163,949	-	-
Investments in joint ventures	8	314,612	436,781	408,041
		<b>13,621,774</b>	<b>16,094,426</b>	<b>12,335,681</b>
<b>Current assets</b>				
Inventories	16	7,486,754	8,439,344	7,043,697
Trade and other receivables	17	23,969,063	15,036,360	14,165,839
VAT recoverable		337,772	333,451	337,160
Prepayments		373,745	274,021	727,867
Short-term financial assets	19	1,453,322	4,469,872	3,446,041
Cash and short term deposits	18	15,364,875	8,462,982	5,307,079
		<b>48,985,531</b>	<b>37,016,030</b>	<b>31,027,683</b>
Non-current assets classified as held for sale		-	5,348	18,030
<b>Total assets</b>		<b>62,607,305</b>	<b>53,115,804</b>	<b>43,381,394</b>
<b>Equity and liabilities</b>				
<b>Equity attributable to equity holders of the parent</b>				
Share capital	25	37,793	37,793	37,793
Treasury shares	10	(1,437)	(3,190)	(1,825)
Foreign currency translation reserve		24,846	(1,922)	24,923
Retained earnings		27,567,243	37,533,953	29,718,088
		<b>27,628,445</b>	<b>37,566,634</b>	<b>29,778,979</b>
Non-controlling interests	35	1,445,848	1,651,138	514,968
<b>Total equity</b>		<b>29,074,293</b>	<b>39,217,772</b>	<b>30,293,947</b>
<b>Non-current liabilities</b>				
Deferred tax liability	32	186,095	782,668	583,286
Other non-current liabilities	24	150,762	88,920	9,265
		<b>336,857</b>	<b>871,588</b>	<b>592,551</b>
<b>Current liabilities</b>				
Trade and other payables	23	24,931,724	11,452,654	11,038,159
Short-term borrowings and loans	21	7,024,080	1,300	701,300
Income tax payable		332,068	489,992	158,925
Taxes payable other than income tax	22	908,283	1,082,498	596,512
		<b>33,196,155</b>	<b>13,026,444</b>	<b>12,494,896</b>
<b>Total liabilities</b>		<b>33,533,012</b>	<b>13,898,032</b>	<b>13,087,447</b>
<b>Total equity and liabilities</b>		<b>62,607,305</b>	<b>53,115,804</b>	<b>43,381,394</b>

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

Chief Executive Officer

I.K. Krylov

Chief Financial Officer

M.A. Markova

25 April 2014

*The accompanying notes on pages 9-60 are an integral part of these consolidated financial statements.*

**OJSC "Pharmstandard"**  
**Consolidated statement of comprehensive income**  
**For the year ended 31 December 2013**  
*(in thousands of Russian Roubles)*

	Notes	2013	2012 Restated (Note 8)
Revenue	26	55,907,597	50,783,517
Cost of sales	27	(32,509,838)	(32,024,139)
<b>Gross profit</b>		<b>23,397,759</b>	<b>18,759,378</b>
Selling and distribution costs	28	(6,193,581)	(5,072,313)
General and administrative expenses	29	(1,930,313)	(1,425,224)
Other income	30	1,508,995	429,931
Other expenses	31	(986,044)	(252,002)
Interest income		290,074	126,768
Interest expense		(126,632)	(33,992)
Share in (loss)/profit of equity accounted investments	8, 9	(97,728)	28,740
<b>Profit before income tax</b>		<b>15,862,530</b>	<b>12,561,286</b>
Income tax expense	32	(3,942,091)	(2,597,280)
<b>Profit for the year</b>		<b>11,920,439</b>	<b>9,964,006</b>
<b>Other comprehensive income to be reclassified to profit or loss in subsequent periods</b>			
Exchange differences on translation of foreign operations		30,247	(31,227)
<b>Other comprehensive income/(loss) for the year to be reclassified to profit or loss in subsequent periods</b>		<b>30,247</b>	<b>(31,227)</b>
<b>Total comprehensive income for the year</b>		<b>11,950,686</b>	<b>9,932,779</b>
<b>Profit for the year</b>			
Attributable to:			
Equity holders of the parent		11,805,787	9,790,915
Non-controlling interests		114,652	173,091
		<b>11,920,439</b>	<b>9,964,006</b>
<b>Total comprehensive income for the year</b>			
Attributable to:			
Equity holders of the parent		11,835,761	9,764,070
Non-controlling interests		114,925	168,709
		<b>11,950,686</b>	<b>9,932,779</b>
Earnings per share (in Russian roubles)			
- basic and diluted, based on profit for the year attributable to equity holders of the parent	25	340.92	276.69

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Chief Executive Officer



I.K. Krylov

Chief Financial Officer

M.A. Markova

25 April 2014

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**OJSC "Pharmstandard"**  
**Consolidated cash flow statement**  
**For the year ended 31 December 2013**  
*(in thousands of Russian Roubles)*

	Notes	2013	2012 Restated (Note 8)
<b>Cash flows from operating activities:</b>			
Profit before income tax		15,862,530	12,561,286
<i>Adjustments for:</i>			
Depreciation and amortisation	14, 15	953,836	978,822
Loss from impairment of trade and other receivables, net	17	136,928	441
Write-down of inventories to net realizable value, net	16	187,701	244,754
Impairment charge/(reversal of impairment) - property, plant and equipment, net	14, 30, 31	457	(11,656)
Write-off of cash restricted in Cyprus bank	31	9,269	-
Impairment charge/(reversal of impairment) - intangible assets	5, 30, 31	100,000	(25,000)
(Gain)/loss from disposal of property, plant and equipment	30, 31	(47,912)	4,766
Share in net loss/(profit) of joint ventures and associate	8, 9	97,728	(28,740)
Foreign exchange (gain)/loss		(157,827)	102,450
Interest income		(290,074)	(126,768)
Interest expense		126,632	33,992
<b>Operating cash flows before working capital changes</b>		<b>16,979,268</b>	<b>13,734,347</b>
Increase in trade and other receivables	17	(9,157,513)	(607,656)
Decrease/(increase) in inventories	16	858,269	(1,298,986)
(Increase)/decrease in VAT recoverable		(4,254)	13,727
(Increase)/decrease in prepayments		(97,493)	464,595
Increase in trade payables and other payables	23	8,997,619	287,751
(Decrease)/increase in taxes payable other than income tax	22	(177,736)	447,077
<b>Cash generated from operations</b>		<b>17,398,160</b>	<b>13,040,855</b>
Income tax paid	32	(4,086,713)	(2,423,662)
Interest paid		(111,784)	(34,907)
Interest received		329,084	207,035
<b>Net cash from operating activities</b>		<b>13,528,747</b>	<b>10,789,321</b>
<b>Cash flows from investing activities:</b>			
Purchase of property, plant and equipment	14	(1,475,004)	(1,368,112)
Payments for development expenditures	15	(98,740)	(28,760)
Cash paid for acquisition of share in associate	9	(1,206,457)	-
Acquisition of intangible assets	6, 15	(2,409,854)	-
Net cash used in acquisition of subsidiaries, net of cash acquired	7	-	(2,495,317)
Cash in new subsidiary (joint venture prior to 1 January 2013)	8.2	259,125	-
Proceeds from government grants	24	64,100	38,665
Cash received from sale property, plant and equipment		64,148	32,437
Cash received from sale of non-current assets held for sale		-	17,850
Cash paid for long-term bank deposit	20	(400,000)	-
Cash paid for other financial investment	20	(65,458)	-
Cash received from return of short-term financial assets	19	2,951,958	3,126,872
Cash paid for short-term financial assets	19	(675,257)	(2,645,728)
Loans provided to related parties	13, 19, 20	(1,945,978)	(1,537,945)
Loans repaid by related parties		2,751,469	-
<b>Net cash used in investing activities</b>		<b>(2,185,948)</b>	<b>(4,860,038)</b>
<b>Cash flows from financing activities:</b>			
Proceeds from loans and borrowings	21	7,721,700	3,000,000
Repayment of loans and borrowings	21	(700,000)	(3,793,189)
Cash paid for acquisition of non-controlling interests	11	(360,730)	-
Cash paid for acquisition of treasury shares	10	(11,076,520)	(1,976,415)
Dividends paid by a subsidiary to non-controlling shareholders	35	(23,498)	-
<b>Net cash used in financing activities</b>		<b>(4,439,048)</b>	<b>(2,769,604)</b>
<b>Net increase in cash and cash equivalents</b>		<b>6,903,751</b>	<b>3,159,679</b>
<b>Net foreign exchange differences</b>		<b>(1,858)</b>	<b>(3,776)</b>
<b>Cash and cash equivalents at the beginning of the year</b>	18	<b>8,462,982</b>	<b>5,307,079</b>
<b>Cash and cash equivalents at the end of the year</b>	18	<b>15,364,875</b>	<b>8,462,982</b>

*The accompanying notes on pages 9-60 are an integral part of these consolidated financial statements.*

**OJSC "Pharmstandard"**  
**Consolidated statement of changes in equity**  
**For the year ended 31 December 2013**  
*(in thousands of Russian Roubles)*

	Equity attributable to equity holders of the parent						Total equity
	Share capital	Treasury shares	Foreign currency translation reserve	Retained earnings	Total	Non-controlling Interests	
<b>Balance at 1 January 2012</b>	<b>37,793</b>	<b>(1,825)</b>	<b>24,923</b>	<b>29,718,088</b>	<b>29,778,979</b>	<b>514,968</b>	<b>30,293,947</b>
Profit for the year	-	-	-	9,790,915	9,790,915	173,091	9,964,006
Other comprehensive income for the year	-	-	(26,845)	-	(26,845)	(4,382)	(31,227)
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>-</b>	<b>(26,845)</b>	<b>9,790,915</b>	<b>9,764,070</b>	<b>168,709</b>	<b>9,932,779</b>
Acquisition of subsidiaries (Note 7)	-	-	-	-	-	967,813	967,813
Disposal of subsidiary	-	-	-	-	-	(352)	(352)
Acquisition of treasury shares (Note 10)	-	(1,365)	-	(1,975,050)	(1,976,415)	-	(1,976,415)
<b>Balance at 31 December 2012</b>	<b>37,793</b>	<b>(3,190)</b>	<b>(1,922)</b>	<b>37,533,953</b>	<b>37,566,634</b>	<b>1,651,138</b>	<b>39,217,772</b>
Profit for the year	-	-	-	11,805,787	11,805,787	114,652	11,920,439
Other comprehensive income for the year	-	-	29,974	-	29,974	273	30,247
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>-</b>	<b>29,974</b>	<b>11,805,787</b>	<b>11,835,761</b>	<b>114,925</b>	<b>11,950,686</b>
Incorporation of subsidiary (Note 1)	-	-	-	-	-	250	250
Acquisition of subsidiary (Note 8.2)	-	-	-	-	-	21,643	21,643
Acquisition of non-controlling interests (Note 11)	-	-	-	(42,120)	(42,120)	(318,610)	(360,730)
Dividends paid by a subsidiary (Note 35)	-	-	-	-	-	(23,498)	(23,498)
Effect of spin-off of OTC business (Note 5)	-	-	(3,206)	(23,005,391)	(23,008,597)	-	(23,008,597)
Acquisition of treasury shares (Note 10)	-	(5,329)	-	(11,071,191)	(11,076,520)	-	(11,076,520)
Treasury shares settlement for intangible asset (Note 6)	-	7,082	-	12,346,205	12,353,287	-	12,353,287
<b>Balance at 31 December 2013</b>	<b>37,793</b>	<b>(1,437)</b>	<b>24,846</b>	<b>27,567,243</b>	<b>27,628,445</b>	<b>1,445,848</b>	<b>29,074,293</b>

The accompanying notes on pages 9-60 are an integral part of these consolidated financial statements.



# OJSC "Pharmstandard"

## Notes to the consolidated financial statements

For the year ended 31 December 2012

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

### 1. Corporate information

The principal activity of OJSC "Pharmstandard" ("the Company") and its subsidiaries ("the Group") are production and wholesale distribution of pharmaceutical products and medical equipment. The Company was incorporated in the Russian Federation. Since May 2007, the Company's shares are publicly traded (Note 25). The Group's corporate office is in Dolgoprudny, Likhachevsky proezd, 5B, Moscow region, Russian Federation and its manufacturing facilities are based in Moscow region, Vladimir region, Kursk, Tomsk, Ufa, Tyumen (all Russian Federation) and Kharkov (Ukraine). The Company held interest in the following subsidiaries and joint ventures as at 31 December 2013 and 2012:

Entity	Country of incorporation	Activity	2013 effective share	2012 effective share
<b>Subsidiaries:</b>				
1. "Pharmstandard" LLC	Russian Federation	Central procurement	100	100
2. "Pharmstandard-Leksredstva" OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
3. "Pharmstandard-Tomskhimpharm" OJSC	Russian Federation	Manufacturing of pharmaceutical products	91	91
4. "Pharmstandard-Ufavita" OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
5. "Pharmstandard-Biolik" PJSC	Ukraine	Manufacturing of pharmaceutical products	96.93	55
6. "TZMOI" OJSC	Russian Federation	Manufacturing of medical equipment	100	100
7. Donelle Company Limited****	Cyprus	Finance and holding company	-	89
8. Aphopharm CJSC****	Russian Federation	Assets holder	-	89
9. MDR Pharmaceuticals	Cyprus	Finance and holding company	50.05	50.05
10. Vindexpharm CJSC****	Russian Federation	Assets holder	-	100
11. Bigpearl Trading Limited*	Cyprus	Intermediary holding company	50.005	50.005
12. "Pharmapark" LLC*	Russian Federation	Manufacturing of pharmaceutical products	50.005	50.005
13. "Biomed named after I.I.Mechnikov" OJSC*	Russian Federation	Manufacturing of pharmaceutical products	49.845	49.795
14. "Pharmatsevticheskiye innovatsii"*	Russian Federation	Assets holder	50.005	50.005
15. "PKB named after I.I.Mechnikov" CJSC*	Russian Federation	Assets holder	49.845	49.795
16. "EKK" OJSC*	Russian Federation	Sundry activity	35.29	35.255
17. "Lekko" CJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
18. Moldildo Trading Limited **	Cyprus	Intermediary holding company	75	-
19. "Pharmstandard-Medtehnika" LLC **	Russian Federation	Distribution of medical equipment	75	-
20. Pharmstandard International S.A.***	Luxembourg	Venture investments	100	-
21. "Sellthera Pharm" LLC *****	Russian Federation	Development and manufacturing Company	75	-
<b>Joint ventures:</b>				
21. "NauchTechStroy Plus" LLC	Russian Federation	Research and development Company	37.5	37.5
22. Moldildo Trading Limited **	Cyprus	Intermediary holding company	-	75
23. "Pharmstandard-Medtehnika" LLC **	Russian Federation	Distribution of medical equipment	-	75

\* These subsidiaries comprised "Bioprocess" group of companies acquired by the Company in July 2012. The Group exercises control over these entities through its controlling interest in Bigpearl Trading Limited (Note 7).

\*\* These entities were recognised as joint venture as at 31 December 2012. Since 1 January 2013 the Group obtained control over them (Note 8.2).

\*\*\* In April 2013 this subsidiary was acquired for a total consideration of RR 1,240 with the purpose of venture investments outside of the Russian Federation (Note 9).

\*\*\*\* On 23 December 2013, these subsidiaries were disposed due to the spin-off of the OTC-business line of the Group (Note 5).

\*\*\*\*\* In August 2013 this subsidiary was incorporated with the purpose of future organization of manufacturing of high-tech specific pharmaceutical products based on cell technologies.

These consolidated financial statements were authorised for issue by the Board of Directors of OJSC "Pharmstandard" on 25 April 2014.

## OJSC "Pharmstandard"

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

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

#### **2. Basis of preparation of the financial statements**

##### *Statement of compliance*

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board (IASB).

##### *Basis of accounting*

The Group's Russian entities maintain their accounting records in Russian Roubles ("RR") and prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation. The Group's Ukrainian subsidiary maintains its accounting records in Ukrainian Hryvnia ("UAH") and prepares its statutory financial statements in accordance with IFRS. The other Group's foreign entities located in Cyprus and Luxembourg primarily maintain their accounting records in US dollars and EURO and prepare their statutory accounting records in accordance with IFRS and the local regulation respectively. When necessary the local 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, acquisition accounting for business combinations and the resulting income tax effects, and also to consolidation of subsidiaries and equity accounting of associates and joint ventures.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below. For example, 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 at 1 January 2013.

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

- ▶ Amendment to IAS 1 *Presentation of Financial Statements - Presentation of items of OCI*;
- ▶ Amendment to IFRS 7 *Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities*;
- ▶ IFRS 10 *Consolidated Financial Statements (amended in June 2012)* and amendments to IAS 27 *Consolidated and Separate Financial Statements*;
- ▶ IFRS 11 *Joint Arrangements (amended in July 2012)* and amendments to IAS 28 *Investments in Associates and Joint Ventures*;
- ▶ IFRS 12 *Disclosure of Interests in Other Entities (amended in July 2012)*;
- ▶ IFRS 13 *Fair Value Measurement*;
- ▶ IAS 19 *Employee Benefits (revised in 2011)*;
- ▶ In May 2012, *Improvements to International Financial Reporting Standards - 2009-2011 Cycle* were issued.

## OJSC "Pharmstandard"

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

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

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

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

The table below shows the list of these narrow amendments which are applicable to the Group but had no impact on the Group's financial statements:

<b>IFRS (amended in 2012)</b>	<b>Subject of amendment</b>
IFRS 1 <i>First time adoption of IFRS - Repeated application of IFRS 1</i>	Clarifying that an entity may apply IFRS 1 more than once under certain circumstances
IAS 1 <i>Presentation of financial statements - Clarification of requirements for comparative information</i>	The amendment to IAS 1 clarifies the disclosure requirements for comparative information when an entity provides a third statement of financial position either as required by IAS 8 <i>Accounting policies, changes in accounting estimates and errors</i> , or voluntarily
IAS 16 <i>Property, plant and equipment - Classification of servicing equipment</i>	Clarifying that spare parts and servicing equipment are classified as property, plant and equipment rather than inventory when they meet the definition of property, plant and equipment
Amendment to IAS 32 <i>Financial instruments: Presentation - Tax effects of distributions to holders of equity instruments</i>	Clarifying the treatment of income tax relating to distributions and transaction costs

Amendment to IAS 1 *Presentation of Financial Statements* change the grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or 'recycled') to profit or loss at a future point in time would be presented separately from items that will never be reclassified (for example, actuarial gains and losses on defined benefit plans and revaluation of land and buildings). The amendment affects presentation only and had no impact on the Group's financial position or performance.

Amendment to IFRS 7 *Disclosures - Offsetting Financial Assets and Financial Liabilities* require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 *Financial Instruments: Presentation*. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. These amendments had no impact on the Group's financial position or performance.

IFRS 10 *Consolidated Financial Statements (amended in June 2012)* replaces the portion of IAS 27 *Consolidated and Separate Financial Statements* that addresses the accounting for consolidated financial statements. It also addresses the issues raised in SIC-12 *Consolidation - Special Purpose Entities*. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 required management to exercise significant judgement to determine which entities are controlled and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. Based on the analyses performed, IFRS 10 had impact on the currently held investments of the Group.

## OJSC "Pharmstandard"

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

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

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

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

IFRS 11 *Joint Arrangements (amended in June 2012)* - replaces IAS 31 *Interests in Joint Ventures* and SIC-13 *Jointly-controlled Entities – Non-monetary Contributions by Venturers*. IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. The standard was applied retrospectively and impacted the financial position of the Group by eliminating proportionate consolidation of the joint ventures "NauchTechStroy Plus" LLC and "Pharmstandard-Medtehnika" LLC now accounted under the equity method of accounting. Impact of the adoption of this standard is further discussed in the Note 8.1.

IFRS 12 *Disclosure of Interests in Other Entities (amended in July 2012)* sets out the requirements for disclosures related to interests in subsidiaries, joint arrangements, associates and structures entities. The requirements in IFRS 12 are more comprehensive than the previously existing disclosure requirements for subsidiaries. Impact of the adoption of this standard is further discussed in Note 35.

IFRS 13 *Fair Value Measurement* establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS. IFRS 13 defines fair value as an exit price.

Amendment to IAS 19 *Employee Benefits* is amended standard resulting from the Post-Employment Benefits and Termination Benefit projects (effective for annual periods beginning on or after 1 January 2013).

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

- ▶ IFRS 9 *Financial Instruments - Classification and Measurement* (no effective date) -the adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but will not have an impact on classification and measurement of the Group's financial liabilities.
- ▶ Amendment to IAS 32 *Offsetting Financial assets and Liabilities* - Amendments clarify the meaning of "currently has a legally enforceable right to set-off" and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting (effective for annual periods beginning on or after 1 January 2014).
- ▶ Amendment to IAS 39 *Novation of Derivatives and Continuation of Hedge Accounting* - provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria (effective for annual periods beginning on or after 1 January 2014).
- ▶ Amendments to IFRS 10, IFRS 12 and IAS 27 *Investment entities (amended in October 2012)* - provide an exception to the consolidation requirements in IFRS 10 and require investment entities to measure particular subsidiaries at fair value through profit or loss, rather than consolidate them. The amendments also set out disclosure requirements for investment entities (effective for annual periods beginning on or after 1 January 2014).
- ▶ IFRIC 21 *Levies (issued in May 2013)* - clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached (effective for annual periods beginning on or after 1 January 2014).

## OJSC "Pharmstandard"

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

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

#### **3.1 Basis of consolidation**

##### *Subsidiaries*

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. All intercompany transactions, balances and unrealised gains on transactions between Group companies are eliminated; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Where necessary, accounting policies for subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

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

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

##### *Business combinations*

The acquisition method of accounting is used to account for business combinations by the Group. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any non-controlling interest. For each business combination, the Group measures the non-controlling interest in the acquired subsidiary at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses.

The excess of purchase consideration over the fair value of the Group's share of identifiable net assets is recorded as goodwill (Note 3.6). If the cost of the acquisition is less than the fair value of the Group's share of identifiable net assets of the subsidiary acquired the difference is recognised directly in profit or loss.

##### *Investments in associates and joint ventures*

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee, but is not control or joint control over those policies.

A joint venture is a type of joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint venture. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

## OJSC "Pharmstandard"

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

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

#### **3.1 Basis of consolidation (continued)**

##### *Investments in associates and joint ventures (continued)*

The results and assets and liabilities of associates and joint ventures are included in these consolidated financial statements from the date on which the investee becomes an associate or a joint venture, using the equity method of accounting. The Group discontinues the use of the equity method from the date when the investment ceases to be an associate or a joint venture. Investments in associates and joint ventures are carried in the consolidated statement of financial position at cost and adjusted for by post-acquisition changes in the Group's share of net assets of the associate or joint venture, less any impairment in the value of individual investments. Losses of an associate or joint venture in excess of the Group's interest in that associate or joint venture (which includes any long term interests, that in substance form part of the Group's net investment in the associate or joint venture) are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of the associate recognised at the date of acquisition is recognised as goodwill. The goodwill is included within the carrying amount of the investment and is assessed for impairment as part of that investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition is recognised immediately in profit or loss in the period in which the investment is acquired

#### **3.2 Cash and short-term deposits**

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

#### **3.3 Value added tax**

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

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

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

# OJSC "Pharmstandard"

## Notes to the consolidated financial statements (continued)

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

### 3.4 Inventories

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

### 3.5 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated on a straight-line basis. The depreciation periods, which represent the estimated useful economic lives of the respective assets, are as follows:

	<u>Number of years</u>
Buildings	10 to 50
Plant and machinery	5 to 30
Equipment, motor vehicles and other	2 to 7

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

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

### 3.6 Goodwill

Goodwill on an acquisition of a subsidiary is included in intangible assets. Goodwill on an acquisition of an associate is included in investment in an associate. 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 allocated represents the lowest level within the Group at which the goodwill is monitored for internal management purposes.

## OJSC "Pharmstandard"

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

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

#### **3.6 Goodwill (continued)**

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

#### **3.7 Intangible assets other than goodwill**

Intangible assets acquired separately from business combinations are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their 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; for patents useful economic life is estimated accordingly to period which is reflected in patent, but not more than 20 years) and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in profit or loss in the expense category consistent with the function of the intangible asset.

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

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

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

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



## OJSC "Pharmstandard"

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

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

#### **3.8 Investments and other financial assets**

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

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

##### *Loans and receivables*

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

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

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any other categories. After initial measurement available-for-sale investments are measured at fair value with changes in fair value recognised in other comprehensive income. If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the profit or loss, is transferred from other comprehensive income to profit or loss. Reversals in respect of equity instruments classified as available-for-sale are not recognised in profit or loss. Reversals of impairment losses on debt instruments are reversed through 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.

##### *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.

## OJSC "Pharmstandard"

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

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

#### **3.8 Investments and other financial assets (continued)**

##### *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 profit or loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date. Any subsequent reversal of an impairment loss is recognised in profit or loss.

#### **3.9 Borrowings**

Borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, borrowings are measured at amortised cost using the effective interest method.

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalised as part of the cost of the asset. All other borrowing costs are expensed.

#### **3.10 Income taxes**

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

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

## OJSC "Pharmstandard"

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

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

#### **3.10 Income taxes (continued)**

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

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

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

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

#### **3.11 Leases**

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

#### **3.12 Derecognition of financial assets and liabilities**

##### *Financial assets*

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

##### *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 profit or loss.

## OJSC "Pharmstandard"

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

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

#### **3.13 Provisions**

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

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

#### **3.14 Equity**

##### *Share capital*

Ordinary shares are classified as equity.

##### *Dividends*

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

##### *Treasury shares*

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

#### **3.15 Revenue**

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable excluding discounts and rebates, taking into account contractually defined terms of payment and excluding taxes or duty.

#### **3.16 Employee benefits**

In 2013, under provision of the Russian legislation, social contributions are made through a social tax ("ST") calculated by the Group by the application of a ST regressive rate from 30% applicable only to the gross remuneration of individual employee not more than RR 578 p.a. to 10%. The Group's contributions relating to ST are expensed in the year to which they relate.

## OJSC "Pharmstandard"

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

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

#### **3.16 Employee benefits (continued)**

Total contributions for ST amounted to RR 887,978 during the year ended 31 December 2013 (2012: RR 689,718) and they were classified as labour costs in these consolidated financial statements.

In 2014, the threshold for application of 30% ST rate for individual employee was raised to RR 624 p.a.

#### **3.17 Foreign currency transactions**

The consolidated financial statements are presented in Russian Roubles, which is the functional currency of the Company and its Russian subsidiaries. Transactions in foreign currencies are initially recorded in the functional currency at the exchange rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the reporting date. All resulting differences are taken to profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

At 31 December 2013, the exchange rates used for translation foreign currency balances were US\$ 1 = 32.73 roubles; Euro 1 = 44.97 roubles; 1 Ukrainian Hryvnia = 3.97 roubles (2012: US\$ 1 = 30.37 roubles; Euro 1 = 40.23 roubles; 1 Ukrainian Hryvnia = 3.76 roubles).

The functional currency of the Ukrainian subsidiary is the Ukrainian Hryvnia. The functional currencies of the other foreign operations are the United States dollar (US\$) and the Euro. As at the reporting date, the assets and liabilities of those subsidiaries having functional currency different from the Russian Rouble 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 and cash flow statement are translated at the exchange rate prevailing at the date of transaction. The exchange differences arising on the translation are taken directly to a separate component of equity.

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

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

## OJSC "Pharmstandard"

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

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

#### 3.19 Government grants

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

#### 3.20 Share-based payments

For equity-settled share-based payment transactions, the Group measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the Group cannot estimate reliably the fair value of the goods or services received, the Group measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

#### 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, except for goodwill*

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

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

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

## OJSC "Pharmstandard"

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

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

#### **4. Significant accounting judgements and estimates (continued)**

##### *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 2013 is RR 1,769,556 (2012: RR 2,854,302). More details are provided in Note 15.

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

The Group maintains an allowance for doubtful accounts receivable to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts receivable, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial conditions of customers were to deteriorate, actual write-offs might be higher than expected. As at 31 December 2013, allowances for doubtful accounts receivable amounted to RR 244,764 (2012: RR 107,118). More details are provided in Note 17.

##### *Write-down of inventories to net realizable value*

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

##### *Current taxes*

Russian and Ukrainian tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group's entities may be assessed additional taxes, penalties and interest, which can be significant. In Russia and Ukraine the periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As of 31 December 2013 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 33.

##### *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.

## OJSC "Pharmstandard"

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

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

#### 5. Spin-off of Branded OTC business

On 5 July 2013, the Board of Directors of the Company approved a plan of spin-off of the Group's Branded OTC business into a newly founded separate legal entity "OTCpharm" OJSC ("OTCpharm") because operating Branded OTC business separately may be more efficient and a separate listing of OTCpharm may attract additional investor interest so that the combined value of the Group and OTCpharm may increase. The shares of OTCpharm were to be distributed to the shareholders of the Company proportionately to their existing ownership. Consequently, the assets related to Branded OTC business (primarily 27 OTC trade marks<sup>1</sup>, including the major trade marks Afobazol, Arbidol, Acipol and Flucostat) were reclassified to assets held for distribution on 5 July 2013 (or on the date of acquisition for assets acquired after 5 July 2013, e.g. Bever - Note 6) and the Group did not amortize them since those dates. At the date of reclassification the Group recognised impairment loss in the amount of RR 100,000 (Note 31). Fair value of assets classified as held for distribution did not change until the date of spin-off.

Goodwill allocated for impairment testing purposes to cash generating unit (CGU) representing reportable segment "Production and wholesale of pharmaceutical products", which included both Branded OTC business (carved out) and Prescription and Resale of third party products businesses (left in the Group) was split applying "relative value approach", i.e. the amount of goodwill associated is measured on the basis of the relative values of the business disposed of and the portion of the CGU retained. Goodwill associated with Branded OTC business measured as detailed above in the amount of RR 835,000 was also reclassified to assets held for distribution on 5 July 2013.

On 27 September 2013 the plan of spin-off of Branded OTC business was approved at the extraordinary General Meeting of shareholders of the Company and on 23 December 2013 OTCpharm was registered and its shares were proportionally distributed among the shareholders of the Company.

On 23 December 2013, the spin-off was completed and the Group distributed to OTCpharm the assets related to Branded OTC business and also recognised liability on cash distribution to OTCpharm in the amount of RR 3,500,650. Total effect from disposal of assets and liabilities due to spin-off directly recognised in equity of the Group was as follows:

	<b>Effect on equity (increase/(decrease))</b>
Intangible assets	(19,398,032)
Receivables and other current assets	19,917
<b>Total assets</b>	<b>(19,378,115)</b>
Deferred tax liability	492,449
Trade and other payables and advanced received	(745,122)
Income tax and other taxes	126,047
Liability on cash distribution*	(3,500,650)
<b>Total liabilities</b>	<b>(3,627,276)</b>
<b>Net effect on equity</b>	<b>(23,005,391)</b>

\* In January 2014, this liability was settled in full.

Although the trade marks were transferred out to OTCpharm the Group continued to use them until its re-registration to OTCpharm in accordance with the regulation in March 2014. OTCpharm plans to start its operations independently from the Group in May 2014.

<sup>1</sup> Including legal entities - holders of the respective assets: Aphopharm CJSC; Vindexpharm CJSC; Donelle Company Ltd and Bever.



## OJSC "Pharmstandard"

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

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

#### 6. Acquisition of Bever

On 8 July 2013, the Board of Directors of the Company announced a plan of potential acquisition of 100% of share capital of "Bever Pharmaceutical Pte Ltd" ("Bever") controlled by Alexander Shuster, one of the Company's Directors. Bever is a single asset entity that holds two 20 year-length contracts that provide exclusive purchase rights for unique raw materials - active pharmaceutical ingredients ("APIs") used for manufacturing of the Group's leading OTC products Arbidol and Afobazol and also sale of these API in Russia and the CIS. This acquisition was related to the plan of spin-off of Branded OTC business as described above in section "*Spin-off of OTC-branded business*" therefore Bever was presented as asset held for distribution from the date of acquisition.

The acquisition of Bever was approved on 17 August 2013 at the extraordinary General Meeting of shareholders of the Company.

On 19 August 2013, the Group signed the contract to acquire 100% of Bever shares for the total agreed consideration of US\$ 590 million, of which US\$ 48 million (RR 1,582,738 at the exchange rate as at 22 August 2013) to be settled in cash and the remaining portion to be settled by 7,082 thousand of treasury shares held by the Group (Note 10).

On 22 August 2013, all acquired shares of Bever were transferred to the Company.

The Group accounted for acquisition of Bever as acquisition of intangible asset (i.e. the exclusive favorable purchase contracts). Considering that this acquisition was partly settled in the parent company's shares it was accounted for an equity-settled share-based payment transaction. Intangible asset was measured at recognition at its fair value of US\$ 423 million (RR 13,936,025) with the effect recognised in equity of US\$ 375 million (RR 12,353,287 at the exchange rate as at 19 August 2013) related to consideration paid in shares.

The fair value of the intangible asset differs from the consideration amount referred to above because the consideration amount reflects an entity-specific measurement of the acquired asset assuming that in addition to the substantial savings from lower purchase price of the API in long-term it provides the Group with the following specific economic benefits:

- ▶ Secure long-term supply of critical API for the two flagship brands;
- ▶ Increase profitability profile of the OTC business line in view of the planned (at the time) spin-off;
- ▶ Improve cost positioning and flexibility to react to competitive market dynamics;
- ▶ Realize synergy potential of managing APIs in house (planning and managing working capital/liquidity).

On 23 December 2013, Bever was transferred to OTCpharm as a result of spin-off of the OTC-branded business (Note 5).

## OJSC "Pharmstandard"

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

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

#### 7. Business combinations

##### 7.1. Acquisition of Bioprocess

In 2012, the Group acquired 50.005% of the outstanding shares of "Bigpearl Trading Limited" ("Bigpearl").

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

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

	Fair value recognised on acquisition
Intangible assets	342,959
Property, plant and equipment	1,467,981
Trade and other receivables	252,337
Prepayments	10,798
Inventories	276,331
Cash and short-term deposits	83,819
Short-term financial assets	96,623
	<b>2,530,848</b>
Deferred tax liability	(303,572)
Other long-term liabilities	(45,077)
Trade and other payables	(139,073)
Short-term loans	(93,189)
Income tax and other taxes	(42,353)
	<b>(623,264)</b>
<b>Fair value of net assets</b>	<b>1,907,584</b>
Group's share of the fair value of net assets	939,771
Goodwill arising on acquisition	970,818
	<b>1,935,719</b>
<b>Purchase consideration</b>	<b>1,935,719</b>
Minus pre-existing relationship settlements at fair value	(25,130)
Less cash acquired with acquisition of subsidiary	(83,819)
	<b>(108,949)</b>
<b>Net cash used in acquisition, net of cash acquired</b>	<b>1,826,770</b>

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

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

## OJSC "Pharmstandard"

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

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

#### 7. Business combinations (continued)

##### 7.1. Acquisition of Bioprocess (continued)

From the date of the acquisition to 31 December 2012, Bioprocess contributed RR 351,920 to the profit before income tax of the Group and RR 739,355 to the revenue of the Group. If the acquisition had taken place at the beginning of the year, the Group's profit before income tax in 2012 would have been RR 12,913,206 (i.e. aggregate profit of the Group and Bioprocess) and revenue of the Group in 2012 would have been RR 51,247,989.

##### 7.2. "Lekko" CJSC acquisition

In 2012, the Group acquired 100% shares of "Lekko" CJSC ("Lekko").

Lekko's manufacturing facilities are based in the Vladimir region and the subsidiary is involved in the production of various pharmaceutical products.

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

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

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

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

## OJSC "Pharmstandard"

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

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

#### 7. Business combinations (continued)

##### 7.2. "Lekko" CJSC acquisition (continued)

From the date of the acquisition to 31 December 2012, Lekko contributed RR 15,325 to the profit before income tax of the Group and RR 31,844 to the revenue of the Group. If the acquisition had taken place at the beginning of the year, the Group's profit before income tax in 2012 would have been RR 12,482,329 and revenue of the Group in 2012 would have been RR 51,199,069.

#### 8. Investments in joint ventures and transition to IFRS 11

##### 8.1. Transition to IFRS 11 - restatement of comparative information

In 2012, the Group had investments in the following joint ventures: a 37.5% interest in "NauchTechStroy Plus" LLC ("NTS+"), involved in research and development and a 75% interest in "Pharmstandard-Medtechnika" LLC ("Pharmstandard-Medtechnika") that is involved in distribution of medical equipment (Note 12).

Under IAS 31 *Investment in Joint Ventures* (prior to the adoption of IFRS 11), those joint ventures were classified as jointly controlled entities and the Group's share of the assets, liabilities, revenue, income and expenses were proportionately consolidated. Upon adoption of IFRS 11, the Group has determined "NTS+" and "Pharmstandard-Medtechnika" as joint ventures to be accounted for using the equity method. The transition was applied retrospectively as required of IFRS 11 and the comparative information for the immediately preceding period (2012) was restated. The effect of the restatement on the Group's consolidated financial statements is detailed in the following:

##### Impact on the consolidated statement of comprehensive income (increase/(decrease) in profit)

	<u>2012</u>
Revenue	(607,958)
Cost of sales	464,106
Selling and distribution costs	32,827
General and administrative expenses	81,380
Other income	(19,764)
Other expenses	9,889
Financial income and expense	1,657
Share of profit of joint ventures	28,740
<b>Profit before income tax</b>	<b>(9,123)</b>
Income tax expense	9,123
<b>Net impact on profit for the year</b>	<b>-</b>

## OJSC "Pharmstandard"

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

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

#### 8. Investments in joint ventures and transition to IFRS 11 (continued)

##### 8.1. Transition to IFRS 11 - restatement of comparative information (continued)

##### Impact on equity (increase/(decrease) in equity)

	31 December 2012	1 January 2012
Property, plant and equipment	(419,779)	(333,676)
Investment in joint ventures	436,781	408,041
<b>Total non-current assets</b>	<b>17,002</b>	<b>74,365</b>
Inventories	(90,619)	(101,594)
Trade and other receivables, VAT recoverable and prepayments	50,004	(132,001)
Cash and short-term deposits	(201,001)	(75,993)
<b>Total current assets</b>	<b>(241,616)</b>	<b>(309,588)</b>
Non-current assets classified as held for sale	(7,251)	-
<b>Total assets</b>	<b>(231,865)</b>	<b>(235,223)</b>
Long-term loans	48,750	-
Deferred tax liability	(7,685)	(1,496)
<b>Total non-current liabilities</b>	<b>41,065</b>	<b>(1,496)</b>
Trade and other payables and accruals and advances received	144,639	196,829
Short-term borrowings and loans	32,250	32,250
Income tax payable and other taxes payable	13,911	7,640
<b>Total current liabilities</b>	<b>190,800</b>	<b>236,719</b>
<b>Total liabilities</b>	<b>231,865</b>	<b>235,223</b>
<b>Net impact on equity</b>	<b>-</b>	<b>-</b>

##### Impact on the cash flow statement (increase/(decrease) in cash flows)

	2012
Operating activities	(168,432)
Investing activities	92,174
Financing activities	(48,750)
<b>Net decrease in cash and cash equivalents</b>	<b>(125,008)</b>

##### 8.2. Acquisition of "Pharmstandard-Medtechnika"

On 1 January 2013, the Company and the other participant, "DGM Trading Limited" signed an amendment to the shareholders' agreement whereupon the Group obtained control over a "Moldildo Trading Limited" - holder of 100% interest in "Pharmstandard-Medtechnika". In accordance with the terms of this new agreement operational decisions are taken by simple majority. In particular, the Group received a pre-emptive right to approve key management personnel of "Pharmstandard-Medtechnika" and to control operating activity of this entity. Consequently, since 1 January 2013 the Group recognised "Pharmstandard-Medtechnika" as a subsidiary and accounted for it in accordance with the requirements of IFRS 10.

The fair value of identifiable assets and liabilities of "Pharmstandard-Medtechnika" was immaterial at the date of acquisition. From the date of acquisition to 31 December 2013, "Pharmstandard-Medtechnika" contributed RR 26,540 to the profit before income tax of the Group and RR 512,890 to the revenue of the Group.

## OJSC "Pharmstandard"

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

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

#### 8. Investments in joint ventures and transition to IFRS 11 (continued)

##### 8.2. Acquisition of "Pharmstandard-Medtechnika" (continued)

Assets and liabilities of joint venture, based on its IFRS financial statements are immaterial as at 31 December 2012. Since 1 January 2013 "Pharmstandard-Medtechnika" is recognised as a subsidiary.

Summarised statement of profit or loss of "Pharmstandard-Medtechnika" is detailed below:

	2013 (Note 8.2)	2012
Revenue	-	816,728
Cost of sales	-	(625,014)
Selling and distribution expenses	-	(118,565)
General and administrative expenses	-	(65,077)
Other income	-	77,061
<b>Profit before income tax</b>	-	85,133
Income tax expense	-	(18,575)
<b>Profit for the year</b>	-	66,558
<b>Group's share of profit for the year</b>	-	49,919

##### 8.3. Joint venture "NTS+"

Summarised financial information of this joint venture, based on its IFRS financial statements, and reconciliation with the carrying amount of the investment in consolidated financial statements are set out below:

	2013	2012
Current assets, including cash and cash equivalents RR 3,539 (2012: RR 17,752) and inventories RR 20,320 (2012: 50,155)	55,544	93,363
Non-current assets, including plant, property and equipment RR 1,009,749 (2012: RR 1,096,448) and non-current assets classified as held for sale RR 214,331 (2012: RR 19,336)	1,224,080	1,133,205
Current liabilities including short-term loans RR 70,301 (2012: 86,000)	(108,739)	(102,752)
Non-current liabilities represented by long-term loans RR 278,000 (2012:RR 132,205)	(331,920)	(132,205)
<b>Equity</b>	838,965	991,611
<b>Proportion of the Group's ownership</b>	37.5%	37.5%
<b>Carrying amount of the investment</b>	314,612	371,854

## OJSC "Pharmstandard"

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

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

#### 8. Investments in joint ventures and transition to IFRS 11 (continued)

Summarised statement of profit or loss of "NTS+" is detailed below:

	2013	2012
General and administrative expenses	(128,341)	(86,856)
Financial expenses, net	(31,651)	(4,416)
Other income, including income from non-core operations and rent RR 92,875 (2012: RR 9,539)	102,995	37,859
Other expenses	(45,771)	(15,467)
<b>Loss before income tax</b>	<b>(102,768)</b>	<b>(68,880)</b>
Income tax (expense)/benefit	(49,877)	12,403
<b>Loss for the year</b>	<b>(152,645)</b>	<b>(56,477)</b>
<b>Group's share of loss for the year</b>	<b>(57,242)</b>	<b>(21,179)</b>

The Group has no any commitments in respect of the joint venture.

#### 9. Investments in an associate

In April 2013, the Company acquired Pharmstandard International S.A. an empty entity registered in Luxembourg for a total consideration of RR 1,240 with the purpose of venture investments outside of the Russian Federation.

In August-November 2013, Pharmstandard International S.A. invested US\$ 36.8 million (RR 1,206,457) to purchase about 35% of voting preferred shares of Argos Therapeutics, Inc. ("Argos") incorporated in the USA, Delaware. Argos is a biopharmaceutical company focused on the development and commercialisation of fully personalised immunotherapies for the treatment of cancer and infectious diseases based on its Arcelis™ technology platform. In accordance with the purchase agreement the Company received the right to appoint two members of the Board of directors therefore the Company received a significant influence over Argos and recognised it as an associate applying the equity method for its accounting.

Summarised financial information of this associate, based on its financial statements is set out below:

	2013
Current assets, including cash and cash equivalents RR 1,089,816 and short-term investments RR 447,075	1,621,033
Non-current assets, including plant, property and equipment RR 52,436	52,454
Current liabilities including trade payables and accrued expenses RR 102,045	(103,533)
Non-current liabilities	(329,914)
<b>Equity</b>	<b>1,240,040</b>
<b>Proportion of the Group's ownership</b>	<b>35%</b>
<b>Carrying value of net assets</b>	<b>434,014</b>
Goodwill arising of acquisition of associate	729,935
<b>Carrying amount of investments</b>	<b>1,163,949</b>

## OJSC "Pharmstandard"

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

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

#### 9. Investments in an associate (continued)

The goodwill of RR 729,935 represents the value of expected future economic benefits from outsourcing development activities to Argos and utilization of their results in production of innovative drugs by the Group.

Summarised statement of profit or loss of Argos since the date of recognition of associate is detailed below:

	<u>2013</u>
Revenue	10,322
Research and development expenses	(101,948)
General and administrative expenses	(23,364)
Other expenses	(684)
<b>Loss for the period</b>	<b><u>(115,674)</u></b>
<b>Group's share of loss for the year</b>	<b><u>(40,486)</u></b>

The shares of Argos are traded on NASDAQ since 7 February 2014.

#### 10. Treasury shares

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

In 2012, "Pharmstandard-Leksredstva" OJSC purchased 1,365,000 ordinary shares of the Company representing about 3.61% of the Company's authorized share capital for a total cash consideration of RR 1,976,415.

In April-July 2013, "Pharmstandard-Leksredstva" OJSC purchased 3,752,291 ordinary shares of the Company in the form of Global Depositary Receipts (one ordinary share is equal of four GDR) and 140,000 ordinary shares of the Company total representing about 10.3% of the Company's authorized share capital for a total cash consideration of RR 7,944,034.

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

After these transactions, "Pharmstandard-Leksredstva" OJSC held about 18.74% of issued shares of the Company as treasury shares for the Group.

As described in Note 6 all those shares were used for settlement of the major part of consideration paid for Bever.

In November 2013, the Company purchased 1,436,920 ordinary shares of the Company (also in the form of GDR) from shareholders who did not vote for the plan to spin-off the OTC-branded business line at the extraordinary General Meeting of shareholders of the Company held in September 2013 (see Note 5). Total cash consideration for this purchase was RR 3,132,486.



## OJSC "Pharmstandard"

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

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

#### **11. Acquisition of non-controlling interests**

In August 2013, the Company acquired 11% of non-controlling interests in Donelle Company Limited ("Donelle") of which 5.465% of ordinary shares were held by Alexander Shuster one of the Company's Directors. Donelle is the sole shareholder of CJSC Aphopharm ("Aphopharm") and Aphopharm is a holder of the Afobazol trade mark. Total consideration paid in cash for the acquired non-controlling interests was RR 235,112. The difference of RR 10,381 between the total consideration and the carrying amount of the non-controlling interests acquired of RR 245,493 was credited directly to equity. After this acquisition the Group held 100% of outstanding shares of Donelle.

In May 2013, the Company acquired a 41.93% interest in "Pharmstandard-Biolik" PJSC resulting in an increase in the Company's interests to 96.93%. Total consideration paid in cash for the acquired non-controlling interests was RR 125,253. The difference of RR 53,047 between the total consideration and the carrying amount of the non-controlling interests acquired of RR 72,206 was debited directly to equity.

#### **12. Segment information**

For the management purposes, the Group is organised into two reportable operating segments: (1) production and wholesale of pharmaceutical products and (2) production and wholesale of medical equipment.

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

Management monitors the segments' assets, liabilities, sales, gross profit, segments' results and budgets of these business segments separately for the purpose of making decisions about resource allocation and performance assessment. For the management purposes, budgets of income and expense are planned and analysed 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, 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 including goodwill allocated to specified segment, investments in associates and joint ventures, inventories, financial assets, receivables and operating cash. There were no assets unallocated to segments as of 31 December 2013 and 2012. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Capital expenditure comprises additions to property, plant and equipment.

There were no significant intercompany transactions between these operating segments.

## OJSC "Pharmstandard"

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

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

#### 12. Segment information (continued)

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

Year ended 31 December 2013	Production and wholesale of pharmaceutical products ("Pharmaceutical products")	Production and wholesale of medical equipment	Group
Sales to external customers	54,859,319	1,048,278	55,907,597
<b>Total revenue</b>	<b>54,859,319</b>	<b>1,048,278</b>	<b>55,907,597</b>
Gross profit	23,055,451	342,308	23,397,759
<b>Segment result</b>	<b>15,770,067</b>	<b>26,749</b>	<b>15,796,816</b>
Financial income, net			163,442
Share of loss of joint ventures and associate			(97,728)
<b>Profit before income tax</b>			<b>15,862,530</b>
Income tax expense			(3,942,091)
<b>Profit for the year</b>			<b>11,920,439</b>
Segment assets	61,141,673	1,465,632	62,607,305
<b>Total assets</b>	<b>61,141,673</b>	<b>1,465,632</b>	<b>62,607,305</b>
<b>Segment liabilities</b>	<b>25,875,572</b>	<b>115,197</b>	<b>25,990,769</b>
Unallocated liabilities			7,542,243
<b>Total liabilities</b>			<b>33,533,012</b>
Acquisition of property, plant and equipment (Note 14)	1,427,977	65,806	1,493,783
Depreciation and amortisation	915,753	38,083	953,836
(Impairment charge)/reversal of impairment of property, plant and equipment (Note 14)	(1,488)	1,031	(457)
Impairment of intangible assets (Note 5)	100,000	-	100,000

As at 31 December 2013 the unallocated liabilities of RR 7,542,243 consist of loans and borrowings of RR 7,024,080, income tax payable of RR 332,068 and deferred tax liability of RR 186,095.

## OJSC "Pharmstandard"

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

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

#### 12. Segment information (continued)

Year ended 31 December 2012	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Adjustments *	Group
Sales to external customers	50,061,256	1,330,219	(607,958)	50,783,517
<b>Total revenue</b>	<b>50,061,256</b>	<b>1,330,219</b>	<b>(607,958)</b>	<b>50,783,517</b>
Gross profit	18,443,154	460,076	(143,852)	18,759,378
<b>Segment result</b>	<b>12,238,893</b>	<b>240,397</b>	<b>(39,520)</b>	<b>12,439,770</b>
Financial income, net				92,776
Share of profit of joint ventures				28,740
<b>Profit before income tax</b>				<b>12,561,286</b>
Income tax expense				(2,597,280)
<b>Profit for the year</b>				<b>9,964,006</b>
Segment assets	51,854,043	1,493,626	(231,865)	53,115,804
<b>Total assets</b>	<b>51,854,043</b>	<b>1,493,626</b>	<b>(231,865)</b>	<b>53,115,804</b>
<b>Segment liabilities</b>	<b>12,644,281</b>	<b>212,956</b>	<b>(231,865)</b>	<b>12,625,372</b>
Unallocated liabilities				1,272,660
<b>Total liabilities</b>				<b>13,898,032</b>
Acquisition of property, plant and equipment (Note 14)	1,376,920	29,703		1,406,623
Depreciation and amortisation	946,740	32,082		978,822
(Impairment charge)/reversal of impairment of property, plant and equipment (Note 14)	(1,206)	12,862		11,656
Reversal of impairment of intangible assets (Note 15)	25,000	-		25,000

\* Adjustments have been made because of difference in management view and IFRS. In management accounts Pharmstandard-Medtehnika was consolidated using proportionate method while in IFRS using equity method. In 2013 treatment of Pharmstandard-Medtehnika for management accounts and IFRS was the same.

As at 31 December 2012 the unallocated liabilities of RR 1,272,660 consist of income tax payable of RR 489,992 and deferred tax liability of RR 782,668.

Management considers the Group operates in one geographical segment as major assets of the Group are placed in Russian Federation and major revenue is generated from the operation in Russian Federation.

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

## OJSC "Pharmstandard"

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

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

#### 12. Segment information (continued)

The table below shows the revenue from these customers:

Customer	2013	2012
The Ministry of Health of Russian Federation (federal state open auctions only)	12,178,981	13,042,525
Customer 1	5,862,567	5,408,139
Customer 2*	5,541,438	58,390
Customer 3	5,121,244	4,904,393

\* In 2013, more than 99% of total revenue from this customer was attributed to Velcade®.

The Group's sales to the Ministry of Health of Russian Federation represent about 22% of the total Group's revenue for 2013 (2012: 26%).

#### 13. 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 or jointly 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 2013 and 2012 are detailed below.

##### *Balances with related parties*

2013	Short-term financial assets - (a), Note 19	Long-term financial assets - (b), Note 20	Cash and short-term deposits placed in related bank - Note 18	Trade and other receivables and prepayment - (c) Note 17	Trade payables, other payables and accruals - (d) Note 23
Parent	752,772	-	-	-	-
Other related parties <sup>2</sup>	227,530	72,000	10,050,603	100,082	6,948,528
<b>Total</b>	<b>980,302</b>	<b>72,000</b>	<b>10,050,603</b>	<b>100,082</b>	<b>6,948,528</b>

<sup>2</sup> Other related parties, represent entities under control of the Company's parent and key management.

## OJSC "Pharmstandard"

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

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

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

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

2012	Short-term financial assets (a)	Cash and short- term deposits placed in related bank Note 18	Trade and other receivables and prepayment - (c) Note 17	Trade payables, other payables and accruals - (d) Note 23
Parent	1,442,703	-	-	-
Other related parties	1,621,008	4,959,101	241,029	711,769
<b>Total</b>	<b>3,063,711</b>	<b>4,959,101</b>	<b>241,029</b>	<b>711,769</b>

- (a) This item is comprised of short-term loans provided to Augment and other related parties (refer to sub-sections "Loans provided to parent" and "Loans provided to other related parties" below) and short-term bank deposits in related bank detailed in Note 19, In 2012, this item also included promissory notes issued by related bank denominated in US\$.
- (b) This item is detailed in sub-section "Loans provided to other related parties" below.
- (c) This item is primarily comprised of prepayment for rent and other services, agency fee receivables from sale of certain related party products, receivables recognised due to spin-off (Note 5) and receivables from joint ventures.
- (d) This item primarily represented (i) payables for Koagil VII manufactured by a related party (refer to sub-section "Cost of sales below") and raw materials purchased from another related party; (ii) payables to OTCpharm of RR 3,500,650 (Note 5).

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

Statement of comprehensive income caption	Relationship	2013	2012
Revenue	Other related parties	-	51,227
Interest income from deposits placed in a related bank	Other related parties	18,335	15,489
License fee (included in distribution costs) (A)	Other related parties	(3,515)	(11,314)
Warehouse rental expenses (included in distribution costs) (B)	Other related parties	(113,171)	(91,987)
Office rental expenses (included in general and administrative expenses) (B)	Other related parties	(64,606)	(55,368)
Cost of sales (C)	Other related parties	(3,083,333)	(1,663,570)
Agency fee income (included in other income) (D)	Other related parties	27,122	295,526
Interest income from loans provided to parent and other related parties	Parent and other related parties	38,511	34,541
Other income	Other related parties	12,301	-

##### (A) License fee

Licence 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.

## OJSC "Pharmstandard"

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

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

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

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

##### *(B) Rental expenses*

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

##### *(C) Cost of sales*

The Group holds a purchase contracts for supply of third-party products, primarily Koagil VII, manufactured by a related party. The total cost of RR 3,083,333 (2012: RR 1,663,570) includes the cost of this product in the amount of RR 2,814,606 (2012: RR 1,417,570) sold by the Group primarily through open state auctions. As at 31 December 2013 the Group had RR 18,725 of unsold inventory balances of Koagil VII (2012: RR 8,384). The remaining amount of RR 268,727 (2012: RR 246,000) included in the cost of sales line primarily represents the cost of raw materials purchased from another related party.

##### *(D) Agency fee income*

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

##### *Loans provided to parent*

In 2012 and 2013, the Company's parent "Augment Investments Limited" ("Augment"), a company registered under the laws of Cyprus ( Note 25), applied to the Company with requests to provide short-term interest loans for the purpose of financing the current business activity of Augment not related to the Group.

In 2012, the Group provided unsecured US\$ denominated short-term loans to Augment in the total amount of US\$ 47,500 thousand (RR 1,442,703) with fixed interest rate of 3.5% per annum. In July 2013 these loans were fully repaid.

In October 2013, the Group provided unsecured US\$ denominated short-term loan to Augment of US\$ 60,000 thousand (RR 1,935,978 at the exchange rate as of date of issue of loan) with maturity date of 14 October 2014 and fixed interest rate of 5.25%. In November and December 2013, Augment partly repaid this loan in the amount of US\$ 37,000 thousand (RR 1,209,971).

##### *Loans provided to other related parties*

In December 2012, the Company provided an unsecured short-term loan to another related party of RR 72,000 with maturity date of 27 December 2013 and fixed interest rate of 12% p.a. This loan provided for the purpose of financing the current business activity of that related party. In December 2013, the Company signed an additional agreement to extend the maturity date to 19 October 2015 and the loan was reclassified to long-term (Note 20).

In December 2012, the Company provided an unsecured loan to other related party of RR 10,000 with maturity date of 25 December 2014 and fixed interest rate of 10% p.a.

## OJSC "Pharmstandard"

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

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

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

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

Total compensation to key management personnel, amounted to RR 54,753 for the year ended 31 December 2013 (2012: RR 42,432). Such compensation represents the payroll and bonuses included in general and administrative expenses.

##### *Transactions with key management*

In August 2013, the Group acquired 100% share capital of Bever controlled by Alexander Shuster, one of the Company's Directors, for the total agreed consideration of US\$ 590 million, of which US\$ 48 million was settled in cash and the remaining portion was settled by treasury shares (Note 6). In August 2013, the Group acquired from Alexander Shuster 5.465% of non-controlling interest in Donelle for the total agreed consideration of RR 117,556 (Note 11) settled in cash.

#### 14. Property, plant and equipment

Property, plant and equipment consist of the following:

31 December 2013	Land	Buildings	Plant and machinery	Equipment, motor vehicles and other	Assets under construction	Total
<b>Cost</b>						
Balance at 1 January 2013	442,564	4,166,479	4,014,742	597,494	1,547,101	10,768,380
Additions	-	6,194	66,712	252,121	1,168,756	1,493,783
Transfers	-	623,902	479,970	45,149	(1,149,021)	-
Disposals	-	(774)	(16,870)	(87,662)	(9,193)	(114,499)
Acquisition through business combination (Note 8.2)	-	-	9,015	3,221	-	12,236
Foreign exchange differences	-	8,238	8,968	756	(4,074)	13,888
<b>Balance at 31 December 2013</b>	<b>442,564</b>	<b>4,804,039</b>	<b>4,562,537</b>	<b>811,079</b>	<b>1,553,569</b>	<b>12,173,788</b>
<b>Accumulated depreciation and impairment</b>						
Balance at 1 January 2013	-	529,315	2,256,690	330,725	36,943	3,153,673
Depreciation charge	-	134,015	458,179	113,297	-	705,491
Disposals	-	(264)	(8,959)	(84,967)	-	(94,190)
Impairment/(reversal of impairment)	-	-	796	-	(339)	457
Foreign exchange differences	-	953	1,145	309	2,712	5,119
<b>Balance at 31 December 2013</b>	<b>-</b>	<b>664,019</b>	<b>2,707,851</b>	<b>359,364</b>	<b>39,316</b>	<b>3,770,550</b>
<b>Net book value</b>						
Balance at 1 January 2013	442,564	3,637,164	1,758,052	266,769	1,510,158	7,614,707
Balance at 31 December 2013	442,564	4,140,020	1,854,686	451,715	1,514,253	8,403,238

## OJSC "Pharmstandard"

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

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

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

31 December 2012	Land	Buildings	Plant and machinery	Equipment, motor vehicles and other	Assets under construction	Total
<b>Cost</b>						
Balance at 1 January 2012	32,770	2,908,579	3,148,964	506,898	1,197,948	7,795,159
Additions	-	276	56,029	93,406	1,256,912	1,406,623
Transfers	-	390,775	514,979	15,420	(921,174)	-
Disposals	-	(4,045)	(31,102)	(27,035)	(6,132)	(68,314)
Acquisition through business combinations (Note 7)	409,794	879,739	334,361	9,498	25,203	1,658,595
Foreign exchange differences	-	(8,845)	(8,489)	(693)	(5,656)	(23,683)
<b>Balance at 31 December 2012</b>	<b>442,564</b>	<b>4,166,479</b>	<b>4,014,742</b>	<b>597,494</b>	<b>1,547,101</b>	<b>10,768,380</b>
<b>Accumulated depreciation and impairment</b>						
Balance at 1 January 2012	-	427,114	1,855,579	264,284	38,166	2,585,143
Depreciation charge	-	108,049	421,616	90,113	-	619,778
Disposals	-	(32)	(12,465)	(23,479)	(134)	(36,110)
Impairment/(reversal of impairment)	-	(5,201)	(6,463)	18	(10)	(11,656)
Foreign exchange differences	-	(615)	(1,577)	(211)	(1,079)	(3,482)
<b>Balance at 31 December 2012</b>	<b>-</b>	<b>529,315</b>	<b>2,256,690</b>	<b>330,725</b>	<b>36,943</b>	<b>3,153,673</b>
<b>Net book value</b>						
Balance at 1 January 2012	32,770	2,481,465	1,293,385	242,614	1,159,782	5,210,016
<b>Balance at 31 December 2012</b>	<b>442,564</b>	<b>3,637,164</b>	<b>1,758,052</b>	<b>266,769</b>	<b>1,510,158</b>	<b>7,614,707</b>

In 2013 and 2012, the Group did not borrow money for capital construction and there were no new qualifying assets, therefore no borrowing costs were capitalized.

The Group assets include only an insignificant portion of land on which the Group's factories and buildings, comprising the Group's principal manufacturing facilities, are located, whilst the major portion of the land is held under operating lease agreements with the state municipal bodies. The lease agreements specify lease terms between 1 and 20 years. Long-term agreements have an option to prolong the lease term for another 10 years and include a purchase option after termination of the lease. Purchase price will be determined based on fair value of the land as determined by the municipal authorities. The total amount of rental payments for the use of the land during 2013 was RR 8,556 (2012: RR 8,214). Such payments are reassessed by the state authorities on an annual basis. No such reassessment has been completed for 2014 and beyond as of the date of approval of these consolidated financial statements for issue.



## OJSC "Pharmstandard"

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

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

#### 15. Intangible assets

31 December 2013	Goodwill	Trade marks, patents and exclusive rights	Development costs	Total
<b>Cost</b>				
Balance at 1 January 2013	2,584,302	7,186,198	180,360	9,950,860
Additions (a)	-	14,786,962	98,740	14,885,702
Reclassification to assets held for distribution (Note 5)	(835,000)	(20,686,587)	-	(21,521,587)
Foreign exchange differences	20,254	-	-	20,254
<b>Balance at 31 December 2013</b>	<b>1,769,556</b>	<b>1,286,573</b>	<b>279,100</b>	<b>3,335,229</b>
<b>Accumulated amortisation and impairment</b>				
Balance at 1 January 2013	-	1,907,922	-	1,907,922
Amortisation expense (b)	-	248,345	-	248,345
Reclassification to assets held for distribution (Note 5)	-	(2,023,555)	-	(2,023,555)
<b>Balance at 31 December 2013</b>	<b>-</b>	<b>132,712</b>	<b>-</b>	<b>132,712</b>
<b>Net book value</b>				
Balance at 1 January 2013	2,584,302	5,278,276	180,360	8,042,938
<b>Balance at 31 December 2013</b>	<b>1,769,556</b>	<b>1,153,861</b>	<b>279,100</b>	<b>3,202,517</b>

- (a) In 2013 the Group acquired (i) Bever which is a holder of exclusive contracts of RR 13,936,025 (Note 6) and (ii) exclusive license on manufacturing patent and distribution of product named of Sirturo® of RR 850,937.
- (b) Amortisation of Branded OTC related intangible assets was suspended on 5 July 2013 (Note 5).

31 December 2012	Goodwill	Trade marks and patents	Development costs	Total
<b>Cost</b>				
Balance at 31 December 2011	1,561,361	6,730,141	-	8,291,502
Acquisition through business combinations (Note 7)	1,046,381	456,057	151,600	1,654,038
Additions	-	-	28,760	28,760
Foreign exchange differences	(23,440)	-	-	(23,440)
<b>Balance at 31 December 2012</b>	<b>2,584,302</b>	<b>7,186,198</b>	<b>180,360</b>	<b>9,950,860</b>
<b>Accumulated amortisation and impairment</b>				
Balance at 31 December 2011	-	1,573,878	-	1,573,878
Amortisation expense	-	359,044	-	359,044
Reversal of impairment (a) - (Note 30)	-	(25,000)	-	(25,000)
<b>Balance at 31 December 2012</b>	<b>-</b>	<b>1,907,922</b>	<b>-</b>	<b>1,907,922</b>
<b>Net book value</b>				
Balance at 31 December 2011	1,561,361	5,156,263	-	6,717,624
<b>Balance at 31 December 2012</b>	<b>2,584,302</b>	<b>5,278,276</b>	<b>180,360</b>	<b>8,042,938</b>

- (a) The reversal of impairment mainly relates to increase in consumption of certain pharmaceutical Group's products in 2012. The recoverable amount was determined based on a value in use calculation using cash flow projections developed on the basis of financial budgets approved by management covering a five-year period and cash flows beyond the five-year period are extrapolated using a 5% growth rate that is the mid-term average growth rate for pharmaceuticals market. The discount rate applied to cash flow projections is 14.8%.

## OJSC "Pharmstandard"

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

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

#### 15. Intangible assets (continued)

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

Name	Carrying amount		Remaining amortization period (years)	
	2013	2012	2013	2012
Licenses on patents named of				
Sirturo®	844,539	-	10	-
Epostim®	162,655	181,791	9	10
Afobazol®	-	1,642,942	-	16
Arbidol®	-	1,404,960	-	13
Acipol®	-	680,649	-	13
Flucostat®	-	546,549	-	13

#### *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	
	2013	2012	2013	2012	2013	2012
Carrying amount of goodwill	1,550,702	2,365,448	218,854	218,854	1,769,556	2,584,302

The recoverable amount of the cash-generating units has been determined based on a value in use calculation using cash flow projections developed on the basis of financial budgets approved by management covering a five-year period and cash flows beyond the five-year period are extrapolated using a 5% growth rate that is the same as the mid-term average growth rate for pharmaceuticals and medical equipment market (2012: 5%). The discount rate applied to cash flow projections is 14.8% (2012: 14.8%).

#### *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.

## OJSC "Pharmstandard"

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

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

#### 15. Intangible assets (continued)

*Key assumption used in value in use calculations (continued)*

*Discount rates* - Discount rates reflect management's estimate of the risks specific to each unit. This is the benchmark used by management to assess operating performance and to evaluate future investment proposals. In determining appropriate discount rates for each group of units, regard has been given to the Capital Assets Pricing Model calculation at the reporting date.

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

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

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

*Sensitivity to changes in assumptions*

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

#### 16. Inventories

Inventories consist of the following:

	2013	2012
Raw materials - at cost	2,294,666	3,139,802
Work in progress - at cost	451,305	347,898
Finished goods - at net realisable value	4,740,783	4,951,644
	<u>7,486,754</u>	<u>8,439,344</u>

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

	2013	2012
Balance at 1 January	234,389	58,919
Additional write-downs	206,520	246,032
Unused amounts reversed	(18,819)	(1,278)
Utilised during the year	(206,664)	(68,975)
Foreign exchange differences	1,416	(309)
Balance at 31 December	<u>216,842</u>	<u>234,389</u>

## OJSC "Pharmstandard"

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

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

#### 17. Trade and other receivables

	2013	2012
Trade receivables (net of allowance for impairment of receivables of RR 244,764 (2012: RR 107,118))	23,261,526	14,964,692
Interest receivable - third parties	23,900	56,163
Interest receivable - related parties (Note 13)	21,278	15,505
Other receivables (a)	662,359	-
	<b>23,969,063</b>	<b>15,036,360</b>

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

At 31 December 2013 RR 792,800 of trade and other receivables were denominated in currencies other than Russian Roubles, primarily in US\$ (RR: 157,194) and Euro (RR: 605,169).

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

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

	2013	2012
<b>Balance at 1 January</b>	<b>107,118</b>	135,600
Additional allowance	175,725	21,357
Unused amounts reversed	(38,797)	(45,915)
Utilised during the year	(133)	(2,782)
Translation differences	851	(1,142)
<b>Balance at 31 December</b>	<b>244,764</b>	107,118

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

Cash and short-term deposits consist of the following:

	2013	2012
Cash in bank - Russian Roubles (a)	9,966,621	2,688,925
Cash in bank - US\$ and Euro (a)	28,101	2,311,461
Cash in bank - Ukrainian Hryvnia (a)	1,444	13,944
Short-term bank deposits with original maturity less than 90 days - Russian Roubles (b)	5,130,500	3,262,000
Short-term bank deposits with original maturity less than 90 days - Ukrainian Hryvnia (b)	-	82,698
Short-term bank deposits with original maturity less than 90 days placed in related bank - Russian Roubles (b)	80,000	28,327
Bank deposits on state open auctions placed in related bank - Russian Roubles (c)	56,650	
Bank deposits on state open auctions - Russian Roubles (c)	101,559	75,627
	<b>15,364,875</b>	<b>8,462,982</b>

(a) Substantially all cash balances of the Group are placed in the related bank (Note 13). Cash balances with the related bank carry no interest.

(b) Deposits denominated in RR bear an interest rate of 5%-9.5% p.a. (2012: 5.59%-7.55% p.a.). In 2012, deposits denominated in Ukrainian Hryvnia bore interest rate 20.3%-24.0% p.a.

(c) These items represent cash deposits restricted for use and placed to secure participation in state open auctions announced by the Government of the Russian Federation. These cash deposits bear interest rate from 3% to 4.5% and usually are released within 30-60 days from the date of placing the deposit.

## OJSC "Pharmstandard"

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

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

#### 19. Short-term financial assets

	2013	2012
<i>Accounted for as loans and receivables:</i>		
Promissory notes - Russian Roubles	433,325	990,790
Promissory notes issued by a related bank - US\$ - (Note 13)	-	607,454
Short-term bank deposits placed in related bank - Russian Roubles - (Note 13)	217,100	-
Short-term bank deposits - Russian Roubles	-	400,000
Short-term bank deposits - Ukrainian Hryvnia	25,262	-
Short-term bank deposits placed in related bank - US\$ - (Note 13)	-	941,554
Short-term loan provided to other related parties - Russian Roubles - (Note 13)	10,430	72,000
Short-term loans provided to the parent - US\$ - (Note 13)	752,772	1,442,703
<i>Accounted for as financial assets available for sale:</i>		
Securities	13,574	13,513
Other	859	1,858
	1,453,322	4,469,872

The short-term bank deposits denominated in Russian Roubles as at 31 December 2013 earn interest at a rate of 8% p.a. (2012: 8.5% p.a.); as at 31 December 2012 interest rate for deposits denominated in US\$ was 3.5% p.a.

#### 20. Long-term financial assets

	2013	2012
Long-term loans and deposits		
Long-term loan provided to other related party - Russian Roubles - (Note 13)	72,000	-
Long-term bank deposit - Russian Roubles (a)	400,000	-
<i>Accounted for as financial assets available for sale:</i>		
Other financial investment (b)	65,458	-
	537,458	-

(a) Long-term bank deposit has a maturity date of 16 October 2015 and bears an interest rate of 8% p.a.

(b) Investments to preferred shares of Protagonist Therapeutics, Inc. ("Protagonist") located in the USA, Delaware. Protagonist is a peptide and peptidomimetic therapeutics company pursuing technology platform driven discovery and development of disulfide rich peptides (DRPs). The Group has no control or significant influence over this entity.

#### 21. Short-term borrowings and loans

	2013	2012
Short-term loan - Russian Roubles	7,021,700	-
Other loans	2,380	1,300
	7,024,080	1,300

These loans include (i) RR 4,021,700 loan provided by Citibank with a maturity date of 27 September 2014 and interest rate of 8.65% p.a and (ii) RR 3,000,000 loan provided by Nordea bank with a maturity date of 27 November 2016 and interest rate of 8.79% p.a.; in accordance with contract the loan could be repaid at any time.

## OJSC "Pharmstandard"

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

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

#### 22. Taxes payable other than income tax

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

	2013	2012
Value-added tax	777,722	969,783
Social taxes	70,849	58,674
Property tax	16,765	15,308
Other taxes	42,947	38,733
	908,283	1,082,498

#### 23. Trade and other payables

	2013	2012
Trade payables	1,672,305	1,858,564
Payable to OTCpharm (Notes 5 and 13)	3,500,650	-
Payables for products procurement - third parties (a)	12,562,998	7,751,941
Payables for products procurement, raw materials and other payables - related parties (Note 13)	3,447,878	711,769
Issued promissory notes - US\$ and Euro (b)	255,260	240,514
Payables to employees	426,493	430,755
Interest payables	27,739	-
Other payables (c)	3,038,401	459,111
	24,931,724	11,452,654

- (a) These balances represent payables for branded third parties products manufactured by other pharmaceutical companies.
- (b) This balance primarily represents the interest free promissory notes issued by the Company's Ukrainian subsidiary "Pharmstandard-Biolik" before the date of acquisition. The promissory notes are payable to the companies affiliated with the former non-controlling shareholders of "Pharmstandard-Biolik". These promissory notes are payable on demand.
- (c) These balances primarily represent payables to third parties for products distributed by the Company under the agency contracts (Note 30).

At 31 December 2013 RR 3,281,531 of total payables were denominated in currencies other than Russian Rouble, primarily in US\$ (2012: RR 2,052,699).

#### 24. Other non-current liabilities

	2013	2012
Deferred income (a)	139,100	75,000
Other	11,662	13,920
	150,762	88,920

- (a) The subsidiaries of the Group "Pharmapark" LLC and "Biomed named after I.I. Mechnikov" OJSC (Note 7) receive government grants to finance certain development costs. This amount represents cash proceeds from government grants and it will be credited to profit or loss over useful life of the intangible assets recognised upon completion of the development stage.

## OJSC "Pharmstandard"

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

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

#### 25. 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. Transactions with own shares during 2013 and 2012 are described in Note 10.

As of 31 December 2013 and 2012 54.32% of voting shares of OJSC "Pharmstandard" were held by "Augment Investments Limited" (Augment) controlled by Victor Kharitonin, a Russian citizen.

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

In 2008 and 2009, 969,815 ordinary shares representing 2.56% of share capital of the Company were sold by Augment and were offered at LSE. Also, in 2009 Augment reacquired 55,000 ordinary shares.

After all transactions, as described in this Note, the Company holds 3.8% of issued shares as treasury shares.

In accordance with Russian legislation, dividends may only be declared from accumulated undistributed and unreserved earnings as shown in the Russian statutory financial statements of the Company.

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

#### Earnings per share

Earnings per share are as follows:

	<u>2013</u>	<u>2012</u>
Weighted average number of ordinary shares outstanding <sup>3</sup>	34,629,722	35,385,353
Profit for the year attributable to the shareholders	11,805,787	9,790,915
Basic and diluted earnings per share, Russian Roubles	340.92	276.69

<sup>3</sup> Treasury shares balances affecting the calculation are detailed in Note 10.

## OJSC "Pharmstandard"

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

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

#### 26. Revenue

Revenue breakdown by product groups comprised the following:

	2013	2012
<b>Pharmaceutical products</b>		
<b>Over the Counter ("OTC")</b>		
Branded	13,707,972	12,461,582
Non-branded (a)	2,749,855	2,417,670
	16,457,827	14,879,252
<b>Prescription</b>		
Branded	5,974,312	4,957,477
Non-branded	801,474	938,200
	6,775,786	5,895,677
Third parties products (b)	30,451,243	28,279,120
Other - substances and APIs (a)	1,174,463	1,007,207
<b>Total pharmaceutical products</b>	54,859,319	50,061,256
<b>Medical equipment</b>	1,048,278	722,261
	55,907,597	50,783,517

- (a) Product named "Interferon" and manufactured by "Pharmapark" LLC classifies to category "Other". 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 total sales.
- (b) Third parties products sales include sales of branded pharmaceutical products such as Velcade®, Mildronate®, Coagil VII, IRS®-19, Imudon®, Prezista®, Mabtera®, Pulmozyme® and Reduxin manufactured by other pharmaceutical companies.

#### 27. Cost of sales

The components of cost of sales were as follows:

	2013	2012
Materials and components	6,463,962	6,355,115
Third parties products	23,162,756	22,944,229
Production overheads	1,562,058	1,504,435
Depreciation and amortisation	789,301	847,094
Direct labour costs	531,761	373,266
	32,509,838	32,024,139



## OJSC "Pharmstandard"

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

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

#### 28. Selling and distribution costs

Selling and distribution costs were as follows:

	2013	2012
Advertising	3,537,001	2,746,238
Labour costs	1,570,834	1,304,085
Freight, communication and insurance of goods in transit	260,670	198,922
Trainings and other services	54,255	72,807
Certification expenses	115,868	98,571
Rent	125,001	93,229
Commission and license fee	78,079	188,115
Materials, maintenance and utilities	139,738	113,264
Travel and representative expenses	191,001	136,734
Depreciation	80,659	78,956
Other expenses	40,475	41,392
	<b>6,193,581</b>	<b>5,072,313</b>

#### 29. General and administrative expenses

General and administrative expenses were as follows:

	2013	2012
Labour costs	1,278,439	918,074
Services, legal, audit and consulting expense	115,651	93,921
Travel and representative expenses	41,484	37,408
Taxes other than income tax	21,373	20,611
Property and other insurance	21,272	19,571
Communication expenses	29,787	28,601
Depreciation	83,876	52,772
Rent	118,681	74,118
Materials, maintenance and utilities	164,448	138,844
Other	55,302	41,304
	<b>1,930,313</b>	<b>1,425,224</b>

#### 30. Other income

Other income comprised the following:

	2013	2012
Foreign exchange gain, net	156,568	-
Gain from disposal of property, plant and equipment	47,912	-
Agency fee (a)	1,037,886	340,882
Income from non-core operations (b)	129,745	45,435
Income received as penalties from vendors and customers	127,977	183
Reversal of impairment - property, plant and equipment (Note 14)	2,091	13,808
Reversal of impairment - intangible assets (Note 15)	-	25,000
Other income	6,816	4,623
	<b>1,508,995</b>	<b>429,931</b>

(a) Agency fee was earned by the Company for sale of certain third-parties products, including products manufactured by related parties. Major agency contracts were signed by the Company in 2013 and were treated as non-core operations.

(b) Income from non-core operations primarily includes (i) income from sale of materials and other assets not included in other categories (ii) income from tolling operations (iii) income from other non-core services such as manufacturing production and utilities.

## OJSC "Pharmstandard"

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

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

#### 31. Other expenses

Other expenses comprised the following:

	2013	2012
Foreign exchange loss, net	-	36,837
Loss from disposal of property, plant and equipment	-	4,766
Charity	10,527	5,927
Bank charges (a)	30,958	25,512
Other taxes and penalties (b)	410,681	67,288
Transaction costs (c)	93,797	-
Downtime expenses of Biolik during suspension of production (Note 33)	111,481	-
Research expenses (d)	168,675	36,493
Impairment of property, plant and equipment (Note 14)	2,548	2,152
Impairment of intangible assets (Note 5)	100,000	-
Impairment of short-term financial assets	-	25,000
Write-off of cash placed in Cyprus bank	9,269	-
Other	48,108	48,027
	<b>986,044</b>	<b>252,002</b>

- (a) Bank charges include (i) commission for daily banking transactions, and (ii) commission for certain bank guarantees obtained by the Group.
- (b) Other taxes and penalties primarily include (i) RR 201,381 provision for legal claim of Federal Anti-monopoly Service of Russia and (ii) RR 94,761 additional VAT and penalties accrual as a result of tax audit in 2013.
- (c) These expenses include consulting, legal and registration expenses related to Group's M&A deals, primarily to acquisition of Bever shares (Note 6).
- (d) These expenses represent certain non-recurring research projects.

#### 32. Income tax

	2013	2012
Income tax expense - current	4,044,679	2,742,970
Deferred tax benefit- origination and reversal of temporary differences	(102,588)	(145,690)
<b>Income tax expense</b>	<b>3,942,091</b>	<b>2,597,280</b>

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

	2013	2012
<b>Profit before income tax</b>	<b>15,862,530</b>	<b>12,561,286</b>
Theoretical tax charge at Russian statutory rate of 20%	3,172,506	2,512,257
Effect of the difference in tax rates in countries other than Russia	(23,149)	1,559
Tax effect from treasury shares settlement (Note 6)	556,767	-
Effect from intra-group dividends (taxed at rate of 5-10%) eliminated in consolidation	19,457	-
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	216,510	83,464
<b>Income tax expense</b>	<b>3,942,091</b>	<b>2,597,280</b>

## OJSC "Pharmstandard"

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

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

#### 32. Income tax (continued)

Movements in deferred tax balances were as follows:

	1 January 2012	Temporary differences recognition and reversal in profit and loss	Effect of business combinati- ons in 2012 (Note 7)	31 December 2012	Temporary differences recognition and reversal in profit and loss	Effect of spin-off (Note 5)	Effect from obtaining control over joint venture (Note 8)	31 December 2013
<b>Tax effects of taxable and deductible temporary differences - asset (liability):</b>								
Property, plant and equipment (Note 14)	(285,233)	(8,833)	(277,414)	(571,480)	33,726	-	(244)	(537,998)
Intangible assets (Note 15)	(455,178)	25,453	(86,165)	(515,890)	(10,922)	492,449	61	(34,302)
Trade and other receivables	(2,364)	26,973	7,622	32,231	(93,589)	-	-	(61,358)
Inventories	131,828	88,760	(15,531)	205,057	147,715	-	109	352,881
Trade and other payables	19,637	13,195	3,331	36,163	2,610	-	1,611	40,384
Financial instruments	5,258	(2,816)	-	2,442	4,980	-	-	7,422
Other	2,766	2,960	23,083	28,809	18,068	-	(1)	46,876
<b>Total net deferred tax liability</b>	<b>(583,286)</b>	<b>145,692</b>	<b>(345,074)</b>	<b>(782,668)</b>	<b>102,588</b>	<b>492,449</b>	<b>1,536</b>	<b>(186,095)</b>

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

- ▶ depreciation of property, plant and equipment in excess of the depreciation for tax purposes;
- ▶ fair value adjustments on acquisition;
- ▶ fair value of financial instruments in excess of the cost of these instruments for tax purpose;
- ▶ impairment of trade receivables;
- ▶ write down of inventory to net realizable value, unrealised profit due to intragroup purchases of materials, discounts recognised in taxation as other income;
- ▶ 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 19,084,856 as at 31 December 2013 (2012: RR 11,552,934).

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

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

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

## OJSC "Pharmstandard"

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

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

#### **33. Contingencies, commitments and operating risks (continued)**

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

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in uncertainty regarding further economic growth, availability of financing and cost of capital, which could negatively affect the Group's future financial position, results of operations and business prospects.

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

Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

##### *Taxation*

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

As at 31 December 2013 management believes that its interpretation of the relevant legislation is appropriate and that the Group's tax, currency and customs positions will be sustained.

Because of the uncertainties associated with the Russian and Ukrainian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as at 31 December 2013. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Should the tax authorities decide to issue a claim and prove successful in the court, they would be entitled to recover the amount claimed, together with fines (in Russia amounting to 20% of such amount and interest at the rate of 1/300 of the Central Bank of the Russian Federation rate for each day of delay for late payment of such amount). Management believes that it is not probable that the ultimate outcome of such matters would result in a liability. Therefore, no provision for these contingencies was recorded in these consolidated financial statements.

## OJSC "Pharmstandard"

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

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

#### **33. Contingencies, commitments and operating risks (continued)**

##### *Russian transfer pricing legislation*

The new Russian transfer pricing legislation, which came into force on 1 January 2012, allows the Russian tax authority to apply transfer pricing adjustments and impose additional profits tax liabilities in respect of all "controlled" transactions if the transaction price differs from the market level of prices. The list of "controlled" transactions includes transactions performed with related parties and certain types of cross-border transactions. For domestic transactions the transfer pricing rules apply only if the amount of all transactions with related party exceeds 3 billion roubles in 2012 and 2 billion roubles in 2013. In cases where the domestic transaction resulted in an accrual of additional tax liabilities for one party, another party could correspondingly adjust its profit tax liabilities according to the special notification issued by the authorized body in due course.

The current Russian transfer pricing rules have considerably increased the compliance burden for the taxpayers compared to the transfer pricing rules which were in effect before 2012 due to, inter alia, shifting the burden of proof from the Russian tax authorities to the taxpayers. These rules are applicable not only to the transactions taking place in 2013 and 2012 but also to the prior transactions with related parties if related income and expenses were recognized in 2013 and 2012. Special transfer pricing rules apply to transactions with securities and derivatives.

In 2013 and 2012 the Group determined its tax liabilities arising from "controlled" transactions using actual transaction prices.

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

##### *Insurance policies*

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

##### *Operating lease agreements*

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

##### *Commitment liabilities and guarantees*

In 2012, the Group provided certain unsecured guarantees in the total amount of RR 111,645 with maturity period from two years to three years for related parties to provide some state contracts signed by these related parties. The management believes that provided guarantees have remote financial risks for the Group. No liability related to guarantees was recognised in the statement of financial position as at 31 December 2012. No such guarantees were provided in 2013.

## OJSC "Pharmstandard"

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

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

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

##### *Statutory inspection of "Pharmstandard-Biolik" PJSC ("Biolik")*

In December 2012, the Ukrainian authorities performed an extraordinary inspection of "Biolik" compliance with the applicable production quality standards. The inspection revealed certain formal deficiencies in the controls over production quality resulting in suspension in "Biolik" production process until resolution of those deficiencies. Those deficiencies are primarily due to the reconstruction of production and maintenance work to improve the quality of "Biolik"'s products. In December 2013, "Biolik" production process was renewed for certain products. Management expects that the remaining deficiencies will be resolved and "Biolik" production process completely renewed in the near future. In addition, management believes that the discussed circumstances will not have material adverse effects on the Group.

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

##### *Fair values*

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

Fair values of short-term borrowings and loans are approximately equal to their carrying value. The Group has no long-term borrowings and loans and derivative financial instruments as of 31 December 2013 and 31 December 2012.

##### *Fair value hierarchy*

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

- ▶ Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- ▶ Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly;
- ▶ Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

31 December 2013:

	Total	Level 1	Level 2	Level 3
<b>Assets measured at fair value</b>				
Financial assets				
Securities (Note 19)	13,574	10,826	-	2,748

31 December 2012:

	Total	Level 1	Level 2	Level 3
<b>Assets measured at fair value</b>				
Financial assets				
Securities (Note 19)	13,513	9,842	-	3,671

## OJSC "Pharmstandard"

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

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

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

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

The Group's principal financial instruments comprise bank loans, short-term and long-term bank deposits and cash and cash equivalents. The main purpose of these financial instruments is to raise finance for the Group's operations and investment activities. The Group has various other financial assets and liabilities such as promissory notes, trade receivables, trade and other payables, which relate directly to its operations. During the year the Group did not undertake active trading in financial instruments.

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

##### *Interest rate risk*

Management believes that the Group does not have significant interest rate risk as at 31 December 2013 and 31 December 2012. The Group has certain short-term financial investments (loans and bank deposits, see Notes 18, 19 and 20), at fixed interest rates based on current market rates at the date of initial recognition and has short-term borrowings and loans (Note 21) at fixed interest rates based on current market rates at the date of initial recognition. Therefore, the Group has no risk to interest rates changes due to possible changes in market interest rates.

##### *Foreign exchange risk*

The Group has certain US dollar and Euro denominated cash and cash equivalents (Note 18), short-term bank deposits (Note 19), short-term loans provided to parent (Note 19), promissory notes (Note 19), trade payables (Note 23), issued promissory notes (Note 23) and other payables (Note 23), trade receivables (Note 17) and other liabilities. Therefore, the Group is exposed to foreign exchange risk.

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

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

	Increase/decrease in US\$ rate	Effect on profit before tax
<b>As at 31 December 2013</b>		
US\$/Roubles exchange rate	+20%	(157,781)
US\$/Roubles exchange rate	-10%	78,891
	Increase/decrease in US\$ rate	Effect on profit before tax
<b>As at 31 December 2012</b>		
US\$/Roubles exchange rate	+10%	406,227
US\$/Roubles exchange rate	-10%	(406,227)

## OJSC "Pharmstandard"

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

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

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

##### *Foreign exchange risk (continued)*

	Increase/decrease in Euro rate	Effect on profit before tax
<b>As at 31 December 2013</b>		
Euro/Roubles exchange rate	+20%	(101,901)
Euro/Roubles exchange rate	-9%	45,855
	Increase/decrease in Euro rate	Effect on profit before tax
<b>As at 31 December 2012</b>		
Euro/Roubles exchange rate	+10%	(16,746)
Euro/Roubles exchange rate	-10%	16,746
	Increase/decrease in US\$ rate	Effect on profit before tax
<b>As at 31 December 2013</b>		
US\$/Ukrainian Hryvnia exchange rate	+30%	(91,233)
US\$/Ukrainian Hryvnia exchange rate	-5%	15,206
	Increase/decrease in US\$ rate	Effect on profit before tax
<b>As at 31 December 2012</b>		
US\$/Ukrainian Hryvnia exchange rate	+7%	(13,570)
US\$/Ukrainian Hryvnia exchange rate	-7%	13,570

##### *Liquidity risk*

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

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

	Total	Less than 3 months	3 to 6 months	6 to 12 months	More than 12 months
<b>As at 31 December 2013</b>					
Borrowings and loans (Note 21)	7,347,389	3,151,274	86,731	4,109,384	-
Other current liabilities (a)	3,500,650	3,500,650	-	-	-
Other non-current liabilities	1,879	-	-	-	1,879
<b>Total</b>	<b>10,849,918</b>	<b>6,651,924</b>	<b>86,731</b>	<b>4,109,384</b>	<b>1,879</b>

(a) These payables represents payables to OTCpharm (Note 5).



## OJSC "Pharmstandard"

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

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

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

##### *Liquidity risk (continued)*

As at 31 December 2012	Total	Less than 3 months	3 to 6 months	6 to 12 months	More than 12 months
Borrowings and loans (Note 21)	1,300	-	-	-	1,300
Other current liabilities	25,159	25,159	-	-	-
Other non-current liabilities	5,225	-	-	-	5,225
<b>Total</b>	<b>31,684</b>	<b>25,159</b>	<b>-</b>	<b>-</b>	<b>6,525</b>

##### *Credit risk*

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

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

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

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

	Total	Neither impaired nor past due	Not impaired but past due				
			less 1 month	1-2 months	2-3 months	3 to 6 months	>6 months
31 December 2013	23,969,063	21,930,722	1,185,580	255,609	268,224	209,417	119,511
31 December 2012	15,036,360	14,281,600	516,441	168,713	39,735	21,879	7,992

##### *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 2013 excluding sales to the Ministry of health of the Russian Federation under state open auctions (six distributors in 2012). It is common practice of the Russian pharmaceutical market to work with the limited number of large distributors.

##### *Capital 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.

## OJSC "Pharmstandard"

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

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

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

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

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

	2013	2012
Borrowings and loans	7,024,080	1,300
Trade and other payables	24,931,724	11,452,654
Less: cash and short-term deposits	(15,364,875)	(8,462,982)
<b>Net debt</b>	<b>16,590,929</b>	<b>2,990,972</b>
Capital	27,628,445	37,566,634
<b>Capital and net debt</b>	<b>44,219,374</b>	<b>40,557,606</b>
<b>Gearing ratio</b>	<b>38%</b>	<b>7%</b>

#### **35. Material partly-owned subsidiaries**

Financial information of subsidiaries that have material non-controlling interests is provided below:

Proportion of equity interest held by non-controlling interests:

Name	Country of incorporation and operation	2013 % share	2012 % share
"Pharmstandard-Tomskhimpharm" OJSC	Russian Federation	9	9
<b>Other:</b>			
"Pharmstandard-Biolik" PJSC (Note 11)	Ukraine	3.07	45
Donelle Company Limited (Notes 5 and 11)	Cyprus	-	11
Aphopharm CJSC (Notes 5 and 11)	Russian Federation	-	11
MDR Pharmaceuticals	Cyprus	49.95	49.95
Bigpearl Trading Limited* (Note 7)	Cyprus	49.995	49.995
"Pharmapark" LLC* (Note 7)	Russian Federation	49.995	49.995
"Biomed named after I.I.Mechnikov" CJSC* (Note 7)	Russian Federation	50.155	50.205
"PKB named after I.I.Mechnikov" CJSC* (Note 7)	Russian Federation	50.155	50.205
"Pharmatsevticheskiye innovatsii" LLC* (Note 7)	Russian Federation	49.995	49.995
"EKK" OJSC* (Note 7)	Russian Federation	64.71	64.745
Moldildo Trading Limited (Note 8)	Cyprus	25	-
"Pharmstandard-Medtehnika" LLC Note 8)	Russian Federation	25	-
"Sellthera Pharm" LLC	Russian Federation	25	-

\* These subsidiaries were incorporated in "Bioprocess" group of companies acquired by the Group in July 2012. The Group exercises control over these entities through its controlling interest in Bigpearl Trading Limited (Notes 1 and 7).

## OJSC "Pharmstandard"

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

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

#### 35. Material partly-owned subsidiaries (continued)

The summarised financial information of these subsidiaries is provided below. This information is based on amounts before inter-company eliminations:

<b>Summarised statement of profit or loss for 2013:</b>	<b>Pharmstandard- Tomskkhimpfarm</b>	<b>Other</b>
Revenue	4,286,883	1,994,187
Cost of sales	(2,095,413)	(1,020,938)
Selling and distribution costs	(1,674,197)	(444,289)
Administrative expenses	(102,449)	(315,791)
Other income (expense), net	83,419	(86,944)
Financial income, net	-	10,682
<b>Profit before income tax</b>	<b>498,243</b>	<b>136,907</b>
Income tax	(101,071)	(78,290)
<b>Profit for the year</b>	<b>397,172</b>	<b>58,617</b>
Attributable to non-controlling interests	35,746	78,906

<b>Summarised statement of profit or loss for 2012:</b>	<b>Pharmstandard- Tomskkhimpfarm</b>	<b>Other</b>
Revenue	2,941,410	1,414,566
Cost of sales	(1,369,849)	(689,498)
Selling and distribution costs	(1,224,303)	(212,842)
Administrative expenses	(91,660)	(126,383)
Other income, net	95,579	43,801
Financial income, net	-	2,488
<b>Profit before income tax</b>	<b>351,177</b>	<b>432,132</b>
Income tax	(71,968)	(101,608)
<b>Profit for the year</b>	<b>279,209</b>	<b>330,524</b>
Attributable to non-controlling interests	25,129	147,962

<b>Summarised statement of financial position as at 31 December 2013:</b>	<b>Pharmstandard- Tomskkhimpfarm</b>	<b>Other</b>
Inventories, receivables, cash and short-term deposits and other current assets	3,131,075	2,208,844
Property, plant and equipment and other non-current financial assets	461,561	2,007,924
Trade, other payables and other current liabilities	(415,358)	(1,320,151)
Deferred tax liabilities and other non-current liabilities	(29,489)	(480,837)
<b>Total equity</b>	<b>3,147,789</b>	<b>2,415,780</b>
<b>Attributable to:</b>		
Non-controlling interests	283,301	1,162,547

## OJSC "Pharmstandard"

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

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

#### 35. Material partly-owned subsidiaries (continued)

Summarised statement of financial position as at 31 December 2012:	Pharmstandard- Tomskkhimpfarm	Other
Inventories, receivables, cash and short-term deposits and other current assets	2,661,440	1,453,442
Property, plant and equipment, intangible assets* and other non-current financial assets	462,896	4,336,348
Trade, other payables and other current liabilities	(333,772)	(864,064)
Deferred tax liabilities and other non-current liabilities	(43,760)	(394,029)
<b>Total equity</b>	<b>2,746,804</b>	<b>4,531,697</b>
<b>Attributable to:</b>		
Non-controlling interests	247,555	1,403,583

\* This balance in Aphopharm included the trade mark Afobazol® as at 31 December 2012 (Note 5).

#### *Dividends paid by a subsidiary*

In 2013, an amount of RR 23,498 was paid by the Company's subsidiary "Bigpearl" (Note 7.1) located in Cyprus to non-controlling shareholders.

#### 36. Events after the reporting period

##### *Repayment short-term loan*

In February 2014, loan provided by Nordea bank in the amount of RR 3,000,000 with a maturity date of 27 November 2016 was fully repaid by the Group (Note 21).

##### *Payment to OTCpharm*

In January 2014 cash amounting of RR 3,500,650 was transferred to OTCpharm due to spin-off (Note 5).

##### *Loan provided to parent*

In January 2014, Augment applied to the Company with request to provide short-term interest loan for the purpose of financing the current business activity of Augment not related to the Group. The Company provided a short-term loan to Augment with maturity date not later than 20 January 2015 in the amount of US\$ 15,000 thousand (RR 504,643) with fixed interest rate of 5.25% per annum.

##### *Operating environment in Ukraine*

Subsequent to 31 December 2013, the economic and political uncertainty in Ukraine increased significantly. Furthermore, between 1 January 2014 and 25 April 2014, the Ukrainian Hryvnia devalued to major foreign currencies by approximately 40%, and the National Bank of Ukraine imposed certain restrictions on purchase of foreign currencies at the inter-bank market. International rating agencies have downgraded sovereign debt ratings for Ukraine. The combination of the above events has resulted in a deterioration of liquidity and much tighter credit conditions where credit is available.