

OJSC “Pharmstandard”

Unaudited interim condensed consolidated financial statements

For the six months ended 30 June 2014

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OJSC "Pharmstandard"

Interim condensed consolidated statement of financial position as at 30 June 2014

(in thousands of Russian Roubles)

	Notes	30 June 2014 (unaudited)	31 December 2013 (audited)
Assets			
Non-current assets			
Property, plant and equipment	9	9,135,280	8,403,238
Intangible assets	10	3,070,571	3,202,517
Long-term financial assets	15	317,414	537,458
Investment in an associate	5	1,335,359	1,163,949
Investments in joint ventures	5	356,743	314,612
		<u>14,215,367</u>	<u>13,621,774</u>
Current assets			
Inventories	11	6,631,633	7,486,754
Trade and other receivables	12	23,904,981	23,969,063
VAT recoverable		192,503	337,772
Prepayments		417,077	373,745
Income tax prepayments		356,056	-
Short-term financial assets	14	2,554,425	1,453,322
Cash and short term deposits	13	2,371,727	15,364,875
		<u>36,428,402</u>	<u>48,985,531</u>
Total assets		<u>50,643,769</u>	<u>62,607,305</u>
Equity and liabilities			
Equity attributable to equity holders of the parent			
Share capital	20	37,793	37,793
Treasury shares	6	(1,437)	(1,437)
Foreign currency translation reserve		(64,136)	24,846
Retained earnings		31,081,175	27,567,243
		<u>31,053,395</u>	<u>27,628,445</u>
Non-controlling interests		<u>1,535,366</u>	<u>1,445,848</u>
Total equity		<u>32,588,761</u>	<u>29,074,293</u>
Non-current liabilities			
Deferred tax liability	26	335,783	186,095
Other non-current liabilities	19	157,425	150,762
		<u>493,208</u>	<u>336,857</u>
Current liabilities			
Trade and other payables	18	12,829,354	24,931,724
Short-term borrowings and loans	16	4,024,101	7,024,080
Income tax payable		-	332,068
Taxes payable other than income tax	17	708,345	908,283
		<u>17,561,800</u>	<u>33,196,155</u>
Total liabilities		<u>18,055,008</u>	<u>33,533,012</u>
Total equity and liabilities		<u>50,643,769</u>	<u>62,607,305</u>

Chief Executive Officer

I.K. Krylov

Chief Financial Officer

M.A. Markova

28 August 2014

OJSC "Pharmstandard"

Interim condensed consolidated statement of comprehensive income

For the six months ended 30 June 2014

(in thousands of Russian Roubles)

	Notes	6 months 2014 ----- (unaudited)	6 months 2013 ----- (unaudited)
Revenue	21	17,205,321	16,902,867
Cost of sales	22	(8,069,865)	(9,179,359)
Gross profit		9,135,456	7,723,508
Selling and distribution costs	23	(2,775,463)	(2,660,106)
General and administrative expenses	24	(999,188)	(899,541)
Other income	25	231,618	274,538
Other expenses	25	(603,064)	(247,975)
Interest income		181,607	222,139
Interest expense		(224,414)	(1,675)
Share in loss of equity accounted investments	5	(162,662)	(21,348)
Profit before income tax		4,783,890	4,389,540
Income tax expense	26	(1,180,910)	(973,824)
Profit for the period		3,602,980	3,415,716
Other comprehensive income to be reclassified to profit or loss in subsequent periods:			
Exchange differences on translation of foreign operations		(88,512)	34,020
Other comprehensive income to be reclassified to profit or loss in subsequent periods		(88,512)	34,020
Total comprehensive income for the period		3,514,468	3,449,736
Profit for the period			
Attributable to:			
Equity holders of the parent		3,513,932	3,412,541
Non-controlling interests		89,048	3,175
		3,602,980	3,415,716
Total comprehensive income for the period			
Attributable to:			
Equity holders of the parent		3,424,950	3,442,021
Non-controlling interests		89,518	7,715
		3,514,468	3,449,736
Earnings per share (in Russian roubles)			
- basic and diluted, based on profit for the period attributable to equity holders of the parent	20	96.65	99.47

Chief Executive Officer

I.K. Krylov

Chief Financial Officer

M.A. Markova

28 August 2014

OJSC “Pharmstandard”

Interim condensed consolidated cash flow statement

For the six months ended 30 June 2014

(in thousands of Russian Roubles)

	Notes	6 months 2014 ----- (unaudited)	6 months 2013 ----- (unaudited)
Cash flows from operating activities:			
Profit before income tax		4,783,890	4,389,540
<i>Adjustments for:</i>			
Depreciation and amortisation	9,10	440,719	538,188
Effect of change in bad debt allowance	12	(35,621)	41,657
Write-down of inventories to net realizable value, net		188,385	104,999
(Reversal of impairment) / impairment charge - property, plant and equipment, net	9,25	(944)	1,098
Impairment charge – intangible assets	10,25	-	100,000
Write-off of cash restricted in Cyprus banks		-	9,269
Gain from disposal of property, plant and equipment	25	(41,349)	(8,142)
Share in net loss of joint ventures and associate	5	162,662	21,348
Foreign exchange gain		(17,692)	(111,493)
Interest income		(181,607)	(222,139)
Interest expense		224,414	1,675
Operating cash flows before working capital changes		5,522,857	4,866,000
Decrease / (increase) in trade and other receivables	12	159,898	(612,727)
Decrease / (increase) in inventories	11	636,935	(2,003,055)
Decrease / (increase) in VAT recoverable		143,663	(98,572)
Increase in prepayments		(45,504)	(154,842)
Decrease in trade payables and other payables	18	(4,907,005)	(683,321)
Decrease in taxes payable other than income tax	17	(200,526)	(555,876)
Cash generated from operations		1,310,318	757,607
Income tax paid	26	(1,719,346)	(1,645,089)
Interest paid		(256,296)	(1,619)
Interest received		106,924	198,009
Net cash used in operating activities		(558,400)	(691,092)
Cash flows from investing activities:			
Purchase of property, plant and equipment	9	(1,249,487)	(596,294)
Payments for development expenditures	10	(33,133)	(66,911)
Cash paid to OTCPharm due spin-off	3,18	(3,500,650)	-
Cash paid for acquisition of share in associate	5	(354,233)	-
Cash in new subsidiary (joint venture prior to 1 January 2013)	5	-	259,125
Proceeds from government grants	19	14,750	26,204
Cash received from sale of property, plant and equipment		42,331	17,697
Cash paid for other financial investment	15	(176,046)	-
Cash received from return of short-term financial assets	14	633,325	2,538,806
Cash paid for short-term financial assets	14	(4,248,872)	(2,094,250)
Loans provided	15	(75,500)	(6,000)
Loans repaid	15	65,500	-
Loans provided to related parties	8,14,15	(541,130)	-
Net cash (used in)/from investing activities		(9,423,145)	78,377
Cash flows from financing activities:			
Proceeds from loans and borrowings		-	5,013
Repayment of loans and borrowings	16	(3,000,000)	-
Cash paid for acquisition of non-controlling interests		-	(125,575)
Cash paid for acquisition of treasury shares	6	-	(2,378,749)
Net cash used in financing activities		(3,000,000)	(2,499,311)
Net decrease in cash and cash equivalents		(12,981,545)	(3,112,026)
Net foreign exchange differences		(11,603)	3,201
Cash and cash equivalents at the beginning of the year	13	15,364,875	8,462,982
Cash and cash equivalents at the end of the period	13	2,371,727	5,354,157

OJSC “Pharmstandard”

Interim condensed consolidated statement of changes in equity for the six months ended 30 June 2014
(in thousands of Russian Roubles)

	Equity attributable to equity holders of the parent					Total equity
	Treasury shares	Foreign currency translation reserve	Retained earnings	Total	Non-controlling interests	
Share capital						
37,793	(3,190)	(1,922)	37,533,953	37,566,634	1,651,138	39,217,772
Profit for the period	-	-	3,412,541	3,412,541	3,175	3,415,716
Other comprehensive income for the period	-	29,480	-	29,480	4,540	34,020
Total comprehensive income for the period	-	29,480	3,412,541	3,442,021	7,715	3,449,736
Acquisition of non-controlling interests	-	-	(52,458)	(52,458)	(73,117)	(125,575)
Acquisition of subsidiary (Note 5)	-	-	-	-	21,643	21,643
Acquisition of treasury shares (Note 6)	-	(959)	(2,377,790)	(2,378,749)	-	(2,378,749)
Balance at 30 June 2013 (unaudited)	(4,149)	27,558	38,516,246	38,577,448	1,607,379	40,184,827

	Equity attributable to equity holders of the parent					Total equity
	Treasury shares	Foreign currency translation reserve	Retained earnings	Total	Non-controlling interests	
Share capital						
37,793	(1,437)	24,846	27,567,243	27,628,445	1,445,848	29,074,293
Profit for the period	-	-	3,513,932	3,513,932	89,048	3,602,980
Other comprehensive income for the period	-	(88,982)	-	(88,982)	470	(88,512)
Total comprehensive income for the period	-	(88,982)	3,513,932	3,424,950	89,518	3,514,468
Balance at 30 June 2014 (unaudited)	(1,437)	(64,136)	31,081,175	31,053,395	1,535,366	32,588,761

The accompanying notes on pages 7-27 are an integral part of these interim condensed consolidated financial statements.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements

For the six months ended 30 June 2014

(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 20). 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 30 June 2014 and 31 December 2013:

Entity	Country of incorporation	Activity	2014 effective share	2013 effective share
Subsidiaries:				
1. “Pharmstandard” LLC	Russian Federation	Central procurement	100	100
2. “Pharmstandard-Leksredstva” OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
3. “Pharmstandard-Tomskhimpharm” OJSC	Russian Federation	Manufacturing of pharmaceutical products	91	91
4. “Pharmstandard-Ufavita” OJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
5. “Pharmstandard-Biolik” PJSC	Ukraine	Manufacturing of pharmaceutical products	96.93	96.93
6. “TZMOI” OJSC	Russian Federation	Manufacturing of medical equipment	100	100
7. MDR Pharmaceuticals	Cyprus	Finance and holding company	50.05	50.05
8. Bigpearl Trading Limited*	Cyprus	Intermediary holding company	50.005	50.005
9. “Pharmapark” LLC*	Russian Federation	Manufacturing of pharmaceutical products	50.005	50.005
10. “Biomed named after I.I.Mechnikov” OJSC*	Russian Federation	Manufacturing of pharmaceutical products	49.845	49.845
11. “Pharmatsevticheskiye innovatsii”*	Russian Federation	Assets holder	50.005	50.005
12. “PKB named after I.I.Mechnikov” CJSC*	Russian Federation	Assets holder	49.845	49.845
13. “EKK” OJSC*	Russian Federation	Sundry activity	35.29	35.29
14. “Lekko” CJSC	Russian Federation	Manufacturing of pharmaceutical products	100	100
15. Moldildo Trading Limited **	Cyprus	Intermediary holding company	75	75
16. “Pharmstandard-Medtehnika” LLC **	Russian Federation	Distribution of medical equipment	75	75
17. Pharmstandard International S.A.	Luxembourg	Venture investments	100	100
18. “Sellthera Pharm” LLC ***	Russian Federation	Development and manufacturing Company	75	75
Joint ventures:				
19. “NauchTechStroy Plus” LLC	Russian Federation	Research and development Company	37.5	37.5
20. “Argos Therapeutics” Inc.	The USA	Research and development Company	30.44	35

* 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.

** These entities were recognised as joint venture as at 31 December 2012. Since 1 January 2013 the Group obtained control over them (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 unaudited interim condensed consolidated financial statements were authorised for issue by the Board of Directors of OJSC “Pharmstandard” on 28 August 2014.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

2. Basis of preparation of the financial statements

These interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standard 34 “Interim Financial Reporting”. Accordingly, they do not include all of the information required by International Financial Reporting Standards (“IFRS”) for complete financial statements.

These interim condensed consolidated financial statements should be read in conjunction with the complete consolidated financial statements as of 31 December 2013 and for the year then ended, considering the effect of adoption of new IFRS and revision of existing IAS, which is described below.

The interim condensed consolidated financial statements are presented in the national currency of the Russian Federation, Russian Rouble (RR), which is the functional currency of the Company and its Russian subsidiaries.

Seasonality of operations

Due to the seasonal nature of the Group’s operations, higher revenues in the pharmaceuticals segment (Note 7) are usually expected in the first and fourth quarters of each year when the Group usually supplies pharmaceutical products under state open auctions won by the Group and cold and flu epidemics frequently occur in colder seasons.

Revenues in the medical equipment segment (Note 7) also usually tend to grow in the fourth quarter when the state hospitals make their orders to entirely utilize the budget resources provided to them for acquisition of new equipment in the current year.

Given the seasonality of operations, the Group’s operating results for the six-month period ended 30 June 2014 are not necessarily indicative of the results that may be expected for the year ending 31 December 2014.

Changes in accounting policies

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of the Group’s annual financial statements for the year ended 31 December 2013, except for the adoption of new standards and interpretations as of 1 January 2014, noted below.

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

- 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.
- 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.
- 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.
- Amendment to IAS 36 *Impairment of Assets (amended in May 2013)* - Under the amendment, recoverable amount is required to be disclosed only when an impairment loss has been recognised or reversed.

OJSC “Pharmstandard”

Notes to the interim condensed 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)

- 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.

IFRSs and IFRIC interpretations not yet effective

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

- IFRS 14 *Regulatory Deferral Accounts* (issued on 30 January 2014) – provides to ease the adoption of IFRS for rate-regulated entities (effective for annual periods beginning on or after 1 January 2016). The standard allows an entity to continue applying most of its existing accounting policies for regulatory deferral account balances upon adoption of IFRS. The adoption of this interim standard will not have any effect on the Group’s financial statements.
- IFRS 9 *Financial Instruments* (issued on On 24 July 2014) – *Classification and Measurement* was issued as a complete standard including the requirements previously issued and the additional amendments to introduce a new expected loss impairment model and limited changes to the classification and measurement requirements for financial assets. This amendment completes the IASB’s financial instruments project and the Standard is effective for annual periods beginning on or after 1 January 2018. The adoption 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.
- IFRS 15 *Revenue from Contracts with Customers* (issued on 28 May 2014) - applies to all revenue contracts and provides a model for the recognition and measurement of sales of some non-financial assets (e.g., disposals of property, plant and equipment). IFRS 15 replaces the following standards and interpretations: IAS 11, IAS 18, IFRIC 13, IFRIC 15, IFRIC 18, SIC 31 (effective for annual periods beginning on or after 1 January 2017).
- Amendments to IFRS 16 and IFRS 38 *Clarification of Acceptable Methods of Depreciation and Amortisation* (amended in May 2014). These amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, the ratio of revenue generated to total revenue expected to be generated cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. These amendments are effective from 1 January 2016.
- In December 2013 narrow Annual Improvements to IFRSs – 2010-2012 Cycle and 2011-2013 Cycle were issued. The amendments contain eleven changes to nine standards – IFRS 1, IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24, IAS 38 and IAS 40, excluding consequential amendments and these changes are effective from 1 July 2014.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

3. 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 marks¹, 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 4) 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 25). 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:

	Effect on equity (increase/(decrease))
Intangible assets	(19,398,032)
Receivables and other current assets	19,917
Total assets	(19,378,115)
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)
Total liabilities	(3,627,276)
Net effect on equity	(23,005,391)

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

The purpose of the cash distribution was to provide OTCpharm with initial working capital to launch its independent operations. Further the cash distributed was ultimately used by OTCpharm to pay primarily for the Group supplies of the respective active pharmaceutical ingredients and finished goods in the amount of RR 3,595,791 performed in April and May 2014 (Note 8, 21).

¹ Including legal entities – holders of the respective assets: Aphopharm CJSC; Vindexpharm CJSC; Donelle Company Ltd and Bever.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

3. Spin-off of Branded OTC business (continued)

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. Since 1 April 2014 OTCpharm started its operation independently from the Group and personnel of the Company involved in operation of branded OTC business was transferred to OTCpharm.

4. 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 6).

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 3).

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

5. Investments in joint ventures and associates

5.1. 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.

5.2. Joint venture “NTS+”

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

	6 months 2014 (unaudited)	6 months 2013 (unaudited)
General and administrative expenses	(60,859)	(54,003)
Financial expenses, net	(14,269)	(13,725)
Other income, including (i) income from non-core operations and rent of RR 66,765 (2013: RR 49,043) and (ii) reversal of impairment of property, plant and equipment of RR 127,411 (2013: RR 9,467)	194,247	58,536
Other expenses	(10,933)	(43,152)
Profit (loss) before income tax	108,186	(52,344)
Income tax benefit/(expense)	4,163	(4,584)
Profit (loss) for the year	112,349	(56,928)
Group’s share of profit (loss) for the year	42,131	(21,348)

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

5.3. 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. In February 2014, Pharmstandard International S.A. additionally invested US\$ 10.2 million (RR 354,233) to purchase about 9.5% of voting preferred shares of Argos.

In February 2014, all voting preferred shares of Argos were converted to voting ordinary shares and additionally issued outstanding voting ordinary shares were placed on NASDAQ. After these transactions Pharmstandard International S.A. holds about 30.44% of outstanding ordinary shares of Argos.

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.

The Group recognised Group’s share of Argos’s loss for the 6 months period ended 30 June 2014 in the amount of RR 204,793.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

6. 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 Depository 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 4 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 3). Total cash consideration for this purchase was RR 3,132,486.

7. 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 30 June 2014 and 31 December 2013. 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 interim condensed consolidated financial statements (continued)

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

7. Segment information (continued)

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

Six months period ended 30 June 2014 (unaudited)	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Group
Sales to external customers	12,849,214	283,911	13,133,125
Sales to related parties (Note 8)	4,072,196	-	4,072,196
Total revenue	16,921,410	283,911	17,205,321
Gross profit	9,022,372	113,084	9,135,456
Segment result	5,034,465	(45,106)	4,989,359
Interest expense, net			(42,807)
Share of loss of a joint venture			(162,662)
Profit before income tax			4,783,890
Income tax expense			(1,180,910)
Profit for the period			3,602,980
Acquisition of property, plant and equipment	1,248,304	4,901	1,253,205
Depreciation and amortisation	421,823	18,896	440,719
Six months period ended 30 June 2013 (unaudited)	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Group
Sales to external customers	16,438,688	464,179	16,902,867
Total revenue	16,438,688	464,179	16,902,867
Gross profit	7,596,083	127,425	7,723,508
Segment result	4,225,101	(34,677)	4,190,424
Financial income, net			220,464
Share of loss of a joint venture			(21,348)
Profit before income tax			4,389,540
Income tax expense			(973,824)
Profit for the period			3,415,716
Acquisition of property, plant and equipment	625,948	23,333	649,281
Depreciation and amortisation	519,414	18,774	538,188

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.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

8. Balances and transactions with related parties

The nature of the related party relationships for those related parties with whom the Group entered into transactions or had balances outstanding at 30 June 2014 and 31 December 2013 are detailed below.

Balances with related parties

30 June 2014 (unaudited)	Short-term financial assets – (a), Note 14	Long-term financial assets – (b), Note 15	Cash and short-term deposits placed in related bank – Note 13	Trade and other receivables and prepayment – (c) Note 12	Trade payables, other payables and accruals – (d) Note 18
Parent	1,311,593	–	–	44,227	–
Other related parties ²	60,439	72,000	1,889,025	5,152,802	4,924,637
Total	1,371,593	72,000	1,889,025	5,197,029	4,924,637

31 December 2013 (audited)	Short-term financial assets – (a), Note 14	Long-term financial assets – (b), Note 15	Cash and short-term deposits placed in related bank – Note 13	Trade and other receivables and prepayment – (c) Note 12	Trade payables, other payables and accruals – (d) Note 18
Parent	752,772	–	–	11,633	–
Other related parties	227,530	72,000	10,050,603	88,449	6,948,528
Total	980,302	72,000	10,050,603	100,082	6,948,528

- (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 14.
- (b) This item is detailed in sub-section “Loans provided to other related parties” below.
- (c) This item is primarily comprised of receivables from sale of active pharmaceutical ingredients and unsold finished goods to OTCpharm (see Note 21 and section “Significant transactions” below), prepayment for rent and other services, agency fee receivables from sale of certain related party products primarily owned by OTCpharm, receivables recognised due to spin-off (Note 3), receivables from joint ventures and interest receivables.
- (d) This item primarily represented (i) payables for Koagil VII and Diaskintest manufactured by a related party (refer to sub-section “Cost of sales below”) and raw materials purchased from another related party, payables for products distributed by the Group under agency contracts (primarily to OTCpharm);
(ii) as at 31 December 2013 this item also included payables to OTCpharm of RR 3,500,650 (Note 3).

² Other related parties, represent entities under control of the Company’s parent and key management.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

8. Balances and transactions with related parties (continued)

Significant transactions with related parties

Statement of comprehensive income caption	Relationship	6 months 2014 (unaudited)	6 months 2013 (unaudited)
Agency fee income (included in revenue) (A)	Other related parties	216,820	24,767
Contractual manufacturing income (included in revenue) (B)	Other related parties	259,585	-
Revenue from sale of active pharmaceutical ingredients (included in revenue) (C)	Other related parties	1,261,446	-
Sale of finished goods to OTCpharm (included to revenue) (C)	Other related parties	2,334,345	-
Interest income from deposits placed in a related bank	Other related parties	4,815	9,011
Interest income from loans provided to parent and other related parties	Parent and other related parties	27,769	23,590
License fee (included in distribution costs) (D)	Other related parties	(112,246)	(859)
Warehouse rental expenses (included in distribution costs) (E)	Other related parties	(57,888)	(52,629)
Office rental expenses (included in general and administrative expenses) (E)	Other related parties	(28,811)	(31,843)
Cost of sales (F)	Other related parties	(422,181)	(691,085)
Consulting and expenses for services (included in general and administrative expenses) (G)	Other related parties	(42,350)	-
Other income (H)	Other related parties	60,496	8,053

(A) Agency fee income

The Company held agency contracts with related parties for distribution and sales of certain products owned by those related parties (see Note 21).

(B) Contractual manufacturing income

The Group held certain contracts for toll (“contractual”) pharmaceutical products manufacturing services primarily for OTCpharm as well as for third parties. (Note 21).

(C) Revenue from sales of active pharmaceutical ingredients and finished goods to OTCpharm

The Group sold to OTCpharm active pharmaceutical ingredients and finished goods to enable its independent operations since 1 April 2014 (Notes 3 and 21).

(D) License fee

License fee is paid for use of several trade marks owned by an entity under common control. The Group paid license fee to OTCpharm for usage of trade mark before the date of their re-registrations (Note 3).

(E) Rental expenses

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

(F) Cost of sales

The Group holds a purchase contracts for supply of certain third-party products, primarily Koagil VII and Diaskintest, manufactured by a related party. The total cost of RR 422,181 (2013: RR 691,085) includes the cost of these products in the amount of RR 361,582 (2013: RR 640,985) sold by the Group primarily through open state auctions. As at 30 June 2014 the Group had RR 363,820 of unsold inventory balances of those products (31 December 2013: RR 42,703). The remaining amount of RR 60,599 (2013: RR 50,100) included in the cost of sales line primarily represents the cost of raw materials purchased from another related party.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

8. Balances and transactions with related parties (continued)

Significant transactions with related parties (continued)

(G) Consulting and expenses for services

This line primarily represents expenses for consulting, services, consideration and support of projects related to investments of Company’s subsidiary located in Luxembourg.

(H) Other income

Other income primarily includes income from rent, utilities, sale of materials and other income from non-core operations.

Loans provided to parent

In 2013 and 2014, the Company’s parent “Augment Investments Limited” (“Augment”), a company registered under the laws of Cyprus (Note 20), 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 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).

In January 2014, the Company provided an unsecured US\$ denominated 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.

In March 2014, the Company provided an unsecured US\$ denominated short-term loan to Augment with maturity date not later than 13 September 2014 in the amount of US\$ 1,000 thousand (RR 36,487) with fixed interest rate of 5.25% per annum.

Loan provided to other related party

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 15).

In December 2013, the Company provided an unsecured short-term loan to other related party of RR 10,000 with maturity date of 25 December 2014 and fixed interest rate of 10% p.a.

Compensation to key management personnel

Total compensation to key management personnel, amounted to RR 12,090 for the 6 months period ended 30 June 2014 (2013: RR 14,203). Such compensation represents the payroll and bonuses included in general and administrative expenses.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

9. Property, plant and equipment

During the six months period ended 30 June 2014 the Group acquired property, plant and equipment with a cost of 1,253,205 (2013: RR 649,281). Property, plant and equipment with net book value of 29,513 were disposed of by the Group during the six months period ended 30 June 2014 (2013: RR 9,555), resulting in gain on disposal of RR 41,349 (2013: gain on disposal of RR 8,142). Total depreciation of the property, plant and equipment for the six months period ended 30 June 2014 was RR 383,470 (2013: RR 343,808). Property, plant and equipment of the Ukrainian subsidiary “Pharmstandard-Biolik PJSC” also decreased by RR 107,819 due to Ukrainian Hryvnia inflation in the six months period ended 30 June 2014.

10. Intangible assets

There were no acquisitions and disposals of the intangible assets for the six months period ended 30 June 2014 and 2013.

Total amount paid for development expenditures recognised as increase of carrying value of intangible assets classified as development costs was RR 33,133 for the six months period ended 30 June 2014 (2013: RR 66,911).

Total amortization of the intangible assets for the six months period ended 30 June 2014 was RR 57,249 (2013: RR 194,380). This amount is included in the cost of sales line item (Note 22). For more information see Note 3.

Goodwill related to acquisition of the Ukrainian subsidiary “Pharmstandard-Biolik PJSC” decreased by RR 107,831 due to Ukrainian Hryvnia inflation in the six months period ended 30 June 2014.

11. Inventories

Inventories consist of the following:

	30 June 2014 (unaudited)	31 December 2013 (audited)
Raw materials - at cost	4,176,976	2,294,666
Work in progress - at cost	488,952	451,305
Finished goods - at net realisable value	1,965,705	4,740,783
	6,631,633	7,486,754

12. Trade and other receivables

	30 June 2014 (unaudited)	31 December 2013 (audited)
Trade receivables (net of allowance for impairment of receivables of RR 207,880 (31 December 2013: RR 244,764))	15,149,919	23,182,722
Trade receivables from related parties	5,138,248	78,804
Interest receivable – third parties	54,588	23,900
Interest receivable – related parties (Note 8)	58,781	21,278
Receivable for promissory notes (a) – Note 25	3,500,000	-
Other receivables (b)	3,445	662,359
	23,904,981	23,969,063

- (a) In 2nd Quarter 2014, the Group acquired promissory notes issued by a related bank for RR 3,419,888 and sold these promissory notes for a total cash consideration of RR 3,500,000 (Note 25). On 1 July 2014, this receivable was fully repaid by a buyer of those promissory notes.
- (b) Other receivables include cash rebates on procurement due from vendors.

At 30 June 2014 RR 241,890 of trade and other receivables were denominated in currencies other than Russian Roubles, primarily in US\$ (RR: 215,139) and Euro (RR: 13,675).

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).

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

13. Cash and short-term deposits

Cash and short-term deposits consist of the following:

	30 June 2014 (unaudited)	31 December 2013 (audited)
Cash in bank – Russian Roubles (a)	581,656	9,966,621
Cash in bank – US\$ and Euro (a)	1,398,530	28,101
Cash in bank – Ukrainian Hryvnia	12,870	1,444
Short-term bank deposits with original maturity less than 90 days – Russian Roubles (b)	270,000	5,130,500
Short-term bank deposits with original maturity less than 90 days – US\$ (b)	8,408	–
Short-term bank deposits with original maturity less than 90 days placed in related bank – Russian Roubles (b)	–	80,000
Bank deposits on state open auctions placed in related bank – Russian Roubles (c)	–	56,650
Bank deposits on state open auctions – Russian Roubles (c)	100,263	101,559
	2,371,727	15,364,875

- (a) Substantially all cash balances of the Group are placed in the related bank (Note 8). Cash balances with the related bank carry no interest.
- (b) Deposits denominated in RR bear an interest rate of 7.8-8.75% p.a. (31 December 2013: 5%-9.5% p.a.). Deposits denominated in US\$ bear an interest rate of 6.5% 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.

14. Short-term financial assets

	30 June 2014 (unaudited)	31 December 2013 (audited)
<i>Accounted for as loans and receivables:</i>		
Promissory notes – Russian Roubles	570,575	433,325
Short-term bank deposits placed in related bank – Russian Roubles – (Note 8)	50,000	217,100
Short-term bank deposits – Russian Roubles	600,000	–
Short-term bank deposits – Ukrainian Hryvnia	–	25,262
Short-term loan provided to other related parties – Russian Roubles – (Note 8)	10,439	10,430
Short-term loans provided to the parent – US\$ – (Note 8)	1,311,593	752,772
<i>Accounted for as financial assets available for sale:</i>		
Securities	11,502	13,574
Other	316	859
	2,554,425	1,453,322

The short-term bank deposits denominated in Russian Roubles as at 30 June 2014 earn interest at a rate of 6.5-8.32% p.a. (31 December 2013: 8% p.a.).

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

15. Long-term financial assets

	30 June 2014 (unaudited)	31 December 2013 (audited)
Long-term loans and deposits		
Long-term loan provided to other related party – Russian Roubles – (Note 8)	72,000	72,000
Long-term bank deposit – Russian Roubles (a)	-	400,000
Other long-term loan	10,000	-
<i>Accounted for as financial assets available for sale:</i>		
Other financial investment (b)	235,414	65,458
	317,414	537,458

- (a) As at 30 June 2014 this deposit was reclassified to short-term financial assets (Note 14) and on 1 July 2014 the bank fully repaid this deposit.
- (b) As at 30 June 2014 this item includes: (i) RR 67,261 (31 December 2013: RR 65,458) of investments to preferred shares of Protagonist Therapeutics, Inc. (“Protagonist”) located in the USA, Delaware; and (ii) RR 168,153 of investments to preferred shares of Proteon Therapeutics, Inc. located in the USA, Delaware. The Group has no control or significant influence over these entities.

16. Short-term borrowings and loans

	30 June 2014 (unaudited)	31 December 2013 (audited)
Short-term loan – Russian Roubles (a)	4,021,700	7,021,700
Other loans	2,401	2,380
	4,024,101	7,024,080

- (a) As at 30 June 2014 this loan includes RR 4,021,700 unsecured loan provided by Citibank with a maturity date of 27 September 2014 and interest rate of 8.65% p.a. As at 31 December 2013 these loans include (i) RR 4,021,700 unsecured loan provided by Citibank and (ii) RR 3,000,000 unsecured loan provided by Nordea bank with a maturity date of 27 November 2016 and interest rate of 8.79% p.a.; in February 2014, this loan was fully repaid by the Group.

17. Taxes payable other than income tax

	30 June 2014 (unaudited)	31 December 2013 (audited)
Value-added tax	598,114	777,722
Social taxes	57,788	70,849
Property tax	19,206	16,765
Other taxes	33,237	42,947
	708,345	908,283

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Notes to the interim condensed consolidated financial statements (continued)

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

18. Trade and other payables

	30 June 2014 (unaudited)	31 December 2013 (audited)
Trade payables	1,189,912	1,672,305
Payable to OTCpharm due spin-off (Notes 3 and 8)	-	3,500,650
Payables for products procurement – third parties (a)	3,065,231	12,562,998
Payables for products procurement, raw materials and other payables – related parties (Note 8)	4,924,637	3,447,878
Issued promissory notes – US\$ and Euro (b)	268,292	255,260
Payables to employees	497,233	426,493
Interest payables	2,994	27,739
Other payables (c)	2,881,055	3,038,401
	12,829,354	24,931,724

- (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 21).

At 30 June 2014 RR 2,369,523 of total payables were denominated in currencies other than Russian Rouble, primarily in US\$ (31 December 2013: RR 3,281,531).

19. Other non-current liabilities

	30 June 2014 (unaudited)	31 December 2013 (audited)
Deferred income (a)	138,155	139,100
Other	19,270	11,662
	157,425	150,762

- (a) The subsidiaries of the Group “Pharmapark” LLC and “Biomed named after I.I. Mechnikov” OJSC 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.

20. 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 2011 - 2013 are described in Note 6.

As of 30 June 2014 and 31 December 2013 54.32% of voting shares of OJSC “Pharmstandard” were held by “Augment Investments Limited” (Augment) controlled by Victor Kharitonin, a Russian citizen; 27.57% are traded at the London stock exchange (LSE); 14.31% are traded at Moscow stock exchange and 3.80% are held by the Company 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.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

20. Share capital (continued)

Earnings per share

Earnings per share are as follows:

	6 months 2014	6 months 2013
	----- (unaudited) -----	
Weighted average number of ordinary shares outstanding (Note 6)	36,355,683	34,306,494
Profit for the period attributable to the shareholders	3,513,932	3,412,541
Basic and diluted earnings per share, Russian Roubles	96.65	99.47

21. Revenue

Revenue breakdown by product groups and by services comprised the following:

	6 months 2014	6 months 2013
	----- (unaudited) -----	
Pharmaceutical products		
Over the Counter (“OTC”) – (a)	3,636,992	6,635,232
Prescription		
Branded	2,681,563	2,523,642
Non-branded	355,496	398,735
	3,037,059	2,922,377
Third parties products - (b)	5,202,126	5,901,628
Other – substances and APIs (Note 8) – (a)	1,711,777	511,279
Total pharmaceutical products	13,587,954	15,970,516
Contractual manufacturing (Notes 8 and 22) – (c)	286,930	53,380
Agency fee income (Note 8) - (d)	712,181	414,792
Sale of finished goods to related party (Note 8) - (a)	2,334,345	-
Medical equipment	283,911	464,179
	17,205,321	16,902,867

- (a) Since 1 April 2014, the revenue from sale of the majority OTC products is recognised by OTCpharm. In April and May 2014, the Group sold finished OTC products and raw materials to OTCpharm to enable it to launch independent operations (Note 3). Since April 2014, the Company’s subsidiary “Pharmstandard” LLC also performs function of a supplier for OTCpharm of certain active pharmaceutical ingredients.
- (b) Third parties products sales include sales of branded pharmaceutical products such as Mildronate, Coagil VII, IRS®-19, Imudon®, Prezista, Mabtera, Reduxin and other manufactured by other pharmaceutical companies.
- (c) The Company’s subsidiaries provide toll (“contractual”) manufacturing services primarily for OTCpharm. Since 2014, the management of the Group re-classified those services from other income presented on net basis to revenue and cost of sales. For the purpose of comparative analysis, the prior period figures were restated accordingly. The above changes in presentation do not affect net profit.
- (d) The Company held agency contracts with related parties (including OTCpharm for distribution and sales of certain products owned by a related party) and third parties. Since 2014, the management of the Group re-classified agency services from other income presented on net basis to revenue and cost of sales. For the purpose of comparative analysis, the prior period figures were restated accordingly. The above changes in presentation do not affect net profit.

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

22. Cost of sales

The components of cost of sales were as follows:

	6 months 2014	6 months 2013
	------(unaudited)-----	
Materials and components	3,005,394	2,693,985
Third parties products	3,509,613	4,938,531
Production overheads	763,662	842,949
Depreciation and amortisation	345,929	458,825
Direct labour costs	228,239	206,433
Contractual manufacturing (Notes 8 and 21)	217,028	38,636
	<u>8,069,865</u>	<u>9,179,359</u>

The total amount of RR 8,069,865 includes (i) RR 972,344 of cost of sales of OTC-branded products sold by the Group to OTCpharm due to start of operating activity of OTCpharm; and (ii) RR 673,865 of cost of materials sold by the Group to OTCpharm as active pharmaceutical ingredients (Notes 3 and 21)

23. Selling and distribution costs

Selling and distribution costs were as follows:

	6 months 2014	6 months 2013
	------(unaudited)-----	
Advertising	1,383,878	1,439,937
Labour costs	846,199	764,214
Freight, communication and insurance of goods in transit	101,927	101,508
Trainings and other services	29,611	27,567
Certification expenses	37,543	40,656
Rent	67,802	56,104
Commission and license fee	119,376	46,823
Materials, maintenance and utilities	69,704	54,847
Travel and entertainment	61,181	69,278
Depreciation	36,910	41,082
Other expenses	21,332	18,090
	<u>2,775,463</u>	<u>2,660,106</u>

24. General and administrative expenses

General and administrative expenses were as follows:

	6 months 2014	6 months 2013
	------(unaudited)-----	
Labour costs	634,323	604,947
Services, legal, audit and consulting expense	86,133	35,646
Travel and entertainment	12,369	17,828
Taxes other than income tax	8,733	9,881
Property insurance	11,173	10,134
Freight and communication	12,978	13,680
Depreciation	57,880	38,281
Rent	59,952	59,681
Materials, maintenance and utilities	79,064	77,835
Other	36,583	31,628
	<u>999,188</u>	<u>899,541</u>

OJSC “Pharmstandard”

Notes to the interim condensed consolidated financial statements (continued)

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

25. Other income and other expenses

Other income comprised the following:

	6 months 2014 ----- (unaudited) -----	6 months 2013 ----- (unaudited) -----
Foreign exchange gain, net	-	213,958
Gain from disposal of property, plant and equipment	41,349	8,142
Income from non-core operations (a)	92,927	51,678
Gain from disposal of promissory notes (Note 12)	80,112	-
Reversal of impairment – property, plant and equipment (Note 9)	7,973	196
Other	9,257	564
	231,618	274,538

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

Other expenses comprised the following:

	6 months 2014 ----- (unaudited) -----	6 months 2013 ----- (unaudited) -----
Foreign exchange loss, net	377,439	-
Charity	25,188	657
Bank charges (a)	9,908	16,745
Other taxes and penalties	62,887	44,227
Research expenses (b)	40,546	36,762
Impairment of property, plant and equipment (Note 9)	7,029	1,294
Impairment of intangible assets (Note 3)	-	100,000
Write-off of cash in Cyprus banks	-	9,269
Other	80,067	39,021
	603,064	247,975

- (a) Bank charges include (i) commission for daily banking transactions; and (ii) commission for certain bank guarantees obtained by the Group.

- (b) These expenses represent certain non-recurring research projects

26. Income tax

	6 months 2014 ----- (unaudited) -----	6 months 2013 ----- (unaudited) -----
Income tax expense – current	1,031,222	1,040,811
Deferred tax expense (benefit)– origination and reversal of temporary differences	149,688	(66,987)
Income tax expense	1,180,910	973,824

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

	6 months 2014 ----- (unaudited) -----	6 months 2013 ----- (unaudited) -----
Profit before income tax	4,783,890	4,389,540
Theoretical tax charge at Russian statutory rate of 20%	956,778	877,908
Effect of the difference in tax rates in countries other than Russia	47,157	-
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	176,975	95,916
Income tax expense	1,180,910	973,824

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Notes to the interim condensed consolidated financial statements (continued)

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

26. Income tax (continued)

Movements in deferred tax balances were as follows:

	31 December 2013 (audited)	Temporary differences recognition and reversal in profit and loss	30 June 2014 (unaudited)
Tax effects of deductible temporary differences – asset (liability):			
Property, plant and equipment	(537,998)	12,392	(525,606)
Intangible assets	(34,302)	19,539	(14,763)
Trade and other receivables	(61,358)	(2,550)	(63,908)
Inventories	352,881	(178,852)	174,029
Trade and other payables	40,384	3,793	44,177
Financial instruments	7,422	2,560	9,982
Other	46,876	(6,570)	40,306
Total net deferred tax liability	(186,095)	(149,688)	(335,783)

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

- depreciation of property, plant and equipment in excess of the depreciation for tax purposes;
- fair value adjustments on acquisition;
- fair value of financial instruments in excess of the cost of these instruments for tax purpose;
- impairment of trade receivables;
- write down of inventory to net realizable value;
- amortisation of trade marks in excess of the amortisation for tax purposes; and
- deemed cost adjustments upon conversion to IFRS.

27. 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.

During the first half of 2014 economic and political instability in Ukraine was increasing. The Group's assets and operations in Ukraine are not significant. The Group's assets and liabilities, related to its activities in Ukraine are recognized based on appropriate measurements as of June 30, 2014. The Group continues to monitor the situation in Ukraine and to execute a number of measures in order to minimize the effects of possible risks. The risk assessment is reviewed constantly to reflect the current situation.

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. 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 30 June 2014 management believes that its interpretation of the relevant legislation is appropriate and that the Group's tax, currency and customs positions will be sustained.

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Notes to the interim condensed consolidated financial statements (continued)

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

27. Contingencies, commitments and operating risks (continued)

Taxation (continued)

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 30 June 2014. 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 interim condensed consolidated financial statements.

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, 2 billion roubles in 2013 and 1 billion roubles in 2014. In cases where the domestic transaction resulted in an accrual of additional tax liabilities for one party, another party could correspondingly adjust its profit tax liabilities according to the special notification issued by the authorized body in due course.

The current Russian transfer pricing rules have considerably increased the compliance burden for the taxpayers compared to the transfer pricing rules which were in effect before 2012 due to, inter alia, shifting the burden of proof from the Russian tax authorities to the taxpayers. These rules are applicable not only to the transactions taking place in 2012-2014 but also to the prior transactions with related parties if related income and expenses were recognized in 2012-2014. Special transfer pricing rules apply to transactions with securities and derivatives.

In 2012-2014 the Group determined its tax liabilities arising from “controlled” transactions using actual transaction prices.

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

Insurance policies

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

Operating lease agreements

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

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Notes to the interim condensed consolidated financial statements (continued)

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

27. Contingencies, commitments and operating risks (continued)

Commitment liabilities

In 2012, the Group provided certain unsecured guaranties in the total amount of RR 111,645 with maturity period from two years to three years for related parties to provide some state contracts signed by these related parties. The management believes that provided guarantees have remote financial risks for the Group. No liability related to guarantees was recognised in the statement of financial position as at 30 June 2014.

Statutory inspection of “Biolik”

In December 2012, the Ukrainian authorities performed an extraordinary inspection of “Biolik” compliance with the applicable production quality standards. The inspection revealed certain formal deficiencies in the controls over production quality resulting in suspension in “Biolik” production process until resolution of those deficiencies. Those deficiencies 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.

28. Events after the reporting period

Acquisition of Biocad shares

On 30 April 2014, the Company signed contract with shareholders of “Biocad Holdings Limited” (“Biocad”), a company registered under the law of Cyprus with the purpose of acquiring 20% of the outstanding Biocad shares for the total cash consideration of US\$ 100 million.

Biocad is the controlling shareholder in several companies involved in the research and development, production and distributing of various pharmaceutical and biopharmaceutical products, primarily in Russian Federation. Those major subsidiaries jointly known as “Biocad group” are including: “Biokad” CJSC, “Biocad Pharm” LLC, “I-Mab” LLC - companies registered under the law of Russian Federation and other companies registered under the law China, India, Brasil, Ukraine and Belarus.

On 23 July 2014, the Company finalized the acquisition, paid US\$100 million (RR: 3,503,870 at the rate of the date of payment) and all acquired shares were transferred to the Company. In accordance with the shareholder’s agreement the Company obtained significant influence over strategic and operating policies of the Biocad and this acquisition will be accounted for using equity method based on IAS 28.

Financial guarantees

In July 2014, the Company provided unsecured financial guaranties in the total amount of RR 500,000 with maturity period not later than 21 April 2015 to certain pharmacy chains to facilitate increase of direct sales of Group’s products to these pharmacy chains.