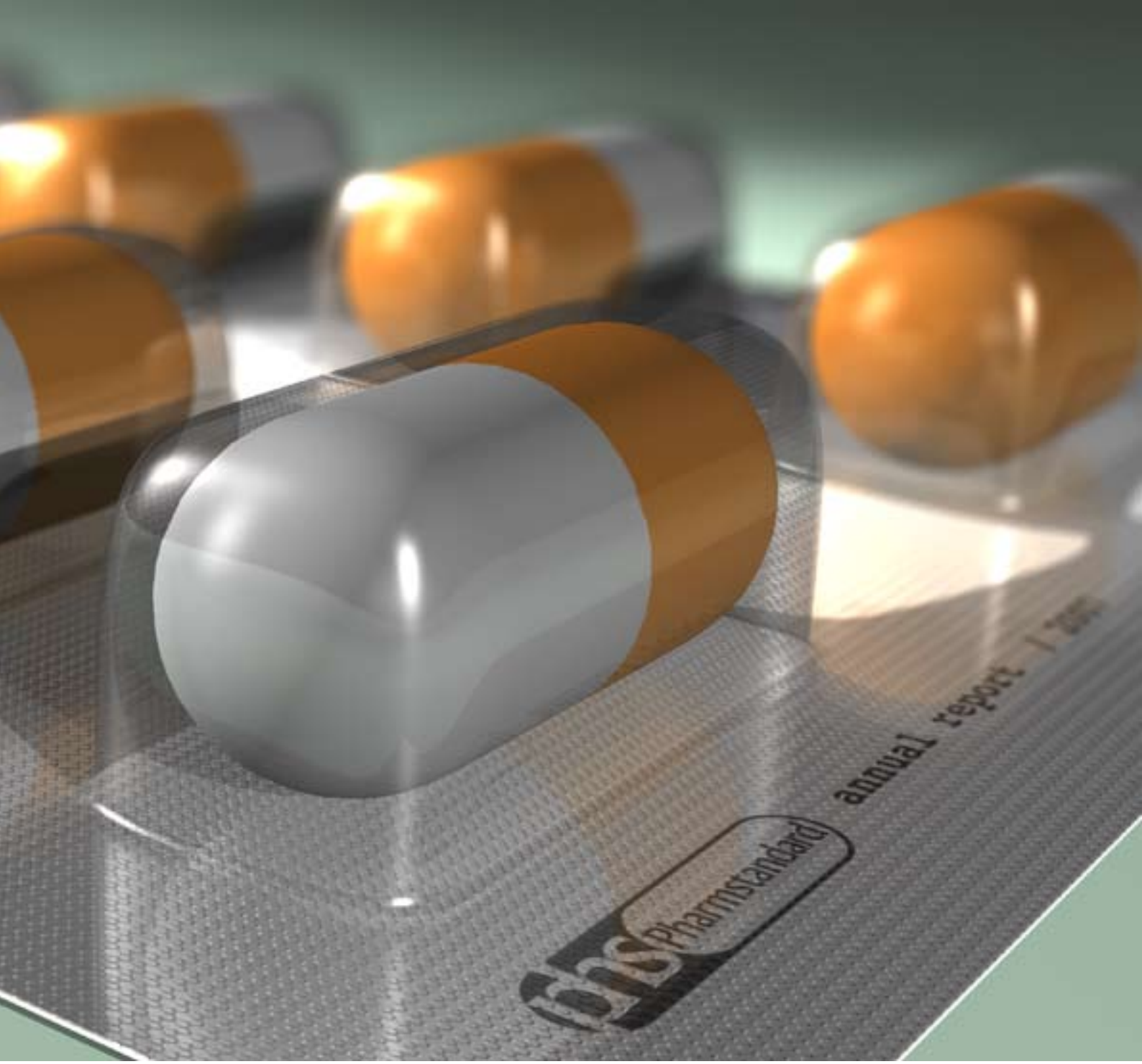
Pharmstandard

Annual report 2007

I welcome the opportunity to introduce to you the first Annual Report of OJSC Pharmstandard for 2007. It was a very important period in Pharmstandard's life, as we became a London listed company, and we appreciate the trust our investors have placed in us. In my opinion, we have justified and responded to your confidence and expectations for 2007 reflected by a market capitalization increase of more than 80% since flotation



01 Introduction

SIGNIFICANT EVENTS AND AWARDS IN 2007

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January	"Pharmstadnard-Leksredstva" started production of Flukostat® (anti-fungal product) acquired from Masterlek company in August 2006.
April	The Company's leading brand Arbidol won "Platinum Ounce 2006" award as the best non-prescription product in the Russian pharmaceutical market. In 2007 Arbidol became a leader of commercial segment in Russia.
May	On 4th of May OJSC "Pharmstandard" successfully completed its IPO and placed 43% of its share capital to the international and domestic institutional investors. Company shares were granted listing at MISEX and RTS (Moscow). Pharmstandard GDRs got listing at London Stock Exchange. Market capitalization of the company during initial offering achieved $2.2 billion.
July	Pharmstandard and Solvey Pharma (France) signed a long-term agreement on manufacturing two products IRS®19 and Imudon® in Russia. Production line will be constructed in Tomskhimpharm (Tomsk). Start of production is planed in Q3 2008.
September	"Pharmstadnard-Leksredstva" started production of Arbidol® (capsules) acquired from Masterlek company in August 2006. In-house production should decrease production costs and derive positive effect to the Company EBITDA margin.
November	Pharmstandard GDR's has been included in MSCI Index (with weight 0.47% in MSCI Russia and 0.04% in MSCI EM).
December	Pharmstandard won prestigious award "Company of the Year 2007" as a leading domestic pharmaceutical company.
December	"Pharmstandard – Leksredstva" – one of the biggest pharmaceutical production plants in Russia celebrated 85th anniversary.
December	In 2007 Pharmstandard became the leader of commercial segment at the Russian pharmaceutical market and entered top 3 companies of the market overall.

OJSC "Pharmstandard" successfully completed its IPO and placed 43% of its share capital to the international and domestic institutional investors.

Rastan® and Arbidol®

Winners of "Platinum Ounce" awards in 2007

Events after the accounting period

- Pharmstandard won three "Platinum Ounce" awards in 2007:
  - Pharmstandard won "Company of the Year 2007 Platinum Once" award as the best domestic pharmaceutical company in Russia
  - Arbidol – the Company's leading brand won "Platinum Ounce 2007" award as the best non-prescription product in the Russian pharmaceutical market.
  - Rastan® won "Breakthrough of the year 2007" award as the most technological new product launched in 2007 in Russia.
- In January 2008 OJSC Pharmstandard acquired 19,88% shares of «DIPAKA TRAIDING LIMITED» (Cyprus), which owns 100% shares of Russian pharmaceutical company Mir-pharm and several patents and trademarks, including Mexiprim®. Mir-pharm is Russian highly technological API producer and holds research base for drugs and APIs development. According to contract with Mir-pharm Pharmstandard accomplishes exclusive distribution and promotion of Mexiprim®. In future Pharmstandard plans to use Mir-pharm R&D resources for development and production of drugs and APIs.
- In February 2008 Pharmstandard and Grindex (Latvia) signed long-term collaboration agreement about Mildronate® product. According to Agreement "Pharmstandard" will accomplish exclusive distribution and promotion of Mildronate® preparation in Russian Federation form 01 February 2008. Agreement anticipates possibility of the drug production at Pharmstandard facilities.
- In March 2008 changes in beneficiary's structure of Pharmstandard's largest shareholder. Mr. V. Kharitonin and Mr. E. Kulkov acquired an additional 17% stake of Augment Investments Limited previously owned by Mr. R. Abramovich, Mr. E. Shvidler and structures affiliated with the management of Millhouse LLC.
- In April 2008 Pharmstandard won "Best IPO 2007" award in frame of 4th Russian IPO congress organized by Institute of Financial Markets and Management (Russia).
- In May 2008 Pharmstandard granted FSFM permission for additional 5% of shares to float outside Russian Federation in form of GDR.

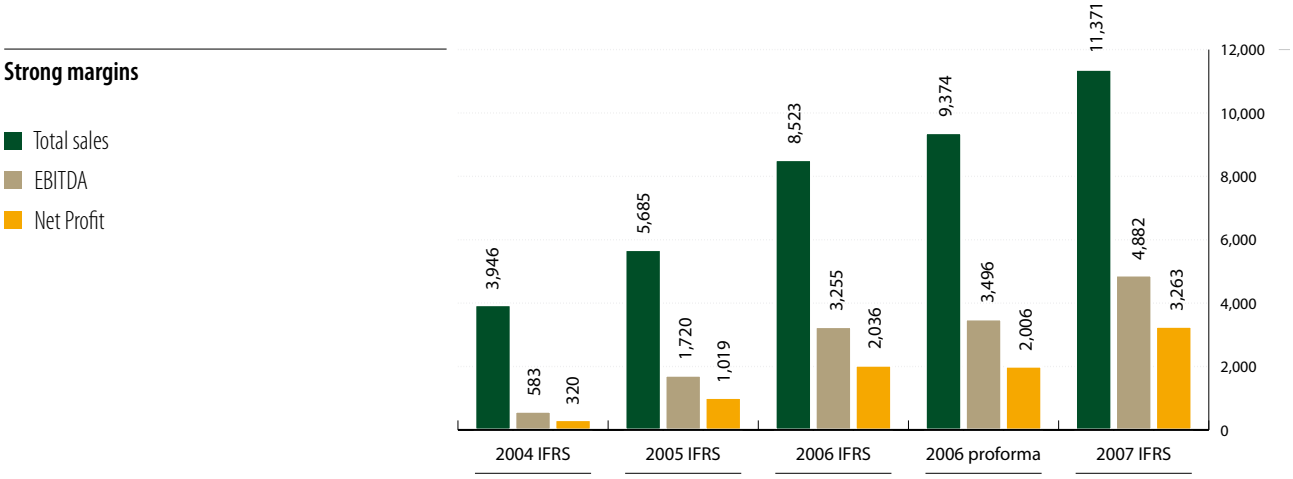
HIGHLIGHTS

>> Financial & Business Highlights

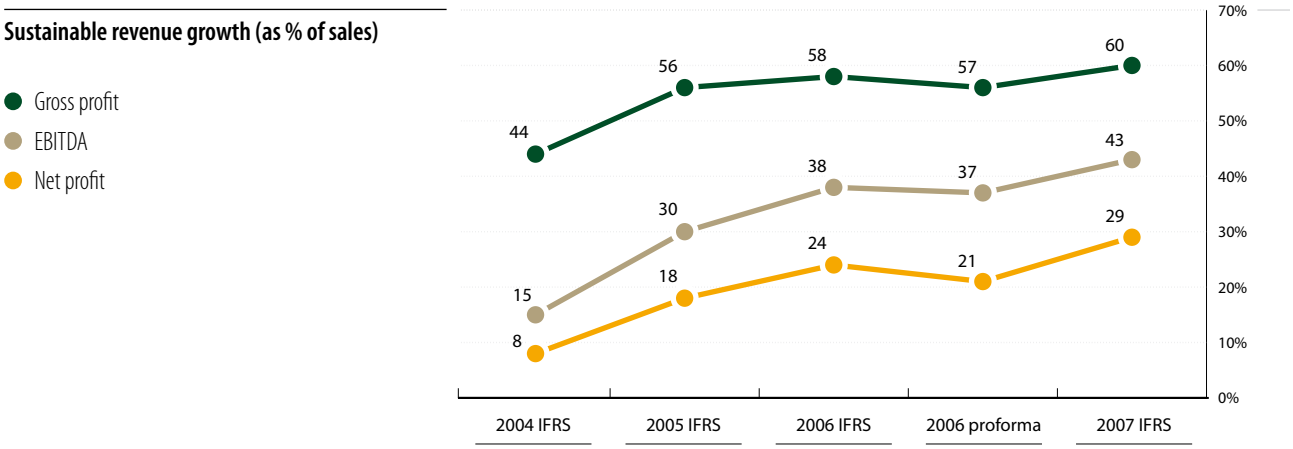
	2007 IFRS (RUR mln)	2006 IFRS (RUR mln)	Growth 2007 vs 2006	2006 Pro-Forma[1] (RUR mln)	Growth 2007 vs 2006 Pro-Forma
Revenue	11,371	8,523	+33%	9,374	+21%
Gross profit	6,852	4,942	+39%	5,233	+31%
EBITDA	4,882	3,255	+50%	3,496	+40%
Net income	3,263	2,036	+60%	2,006	+63%
EPS	86.34	50.21			

[1] *Pro-Forma assumes inclusion of MasterLek as part of Pharmstandard as of 1 January 2006*

Strong margins



Sustainable revenue growth (as % of sales)



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Pharmstandard achievments in 2007

Became a leading domestic pharmaceutical company in Russia (measured by sales):

- #3 pharma company overall in Russia
- #1 pharma company in the commercial segment
- Significant growth in sales and profitability:
- Revenue growth +33% and achieved $445 mln
- Gross profit groth +39% and achieved $268 mln or 60% of sales
- EBITDA growth +50% and achieved $191 mln or 43% of sales
- Net profit growth + 60% and achieved $ 128 mln or 29% of sales

Market leading brands and new launches:

- Arbidol is a leader of Russian Consumer spending pharma market (measured by sales)
- 6 brands among top-20 best selling domestic brands in Russia
- Launched 10 new products – $ 13,7 mln or 3% of total sales

New long-term projects and acquisitions:

- Co-production contract with Solvay Pharma (IRS®19, Imudon®)
- Acquisition 20% of Mir-Pharm company (R&D base for future development)
- Exclusive sales contract with Grindex (Mildronate®) in Russia
- Successful completion of Masterlek integration

HIGHLIGHTS

Shareholders Highlights

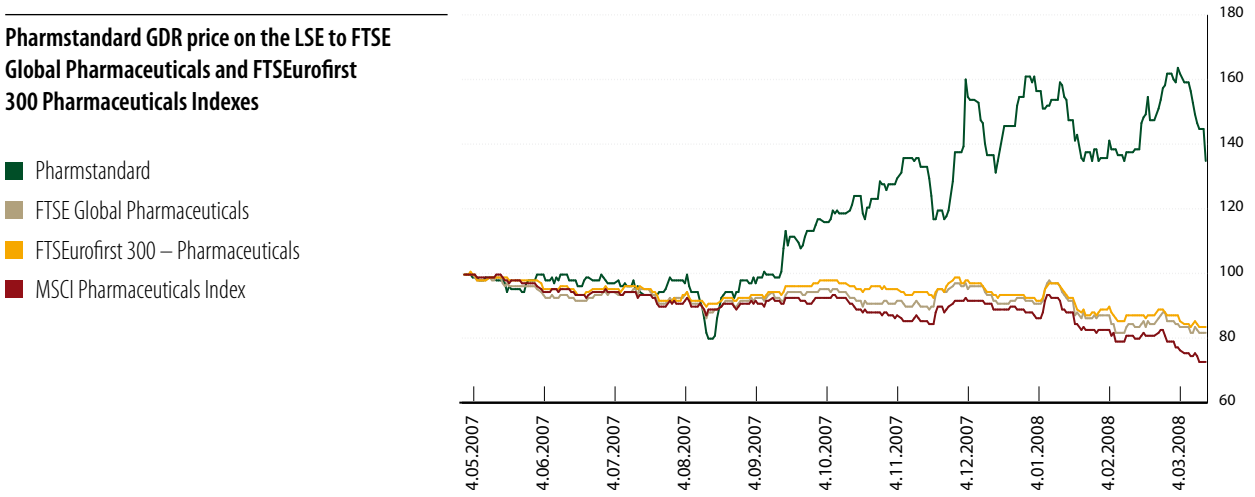
OJSC Pharmstandard placed its shares on RTS, MICEX and GDRs on LSE since IPO in May 4, 2007. The offering structure was:

- 25.0% of share capital in form of GDR on LSE (offer price US$14.55)
- 18.3% of share capital in form of ordinary shares on RTS and MICEX (offer price US$58.20)

Pharmstandard ownership structure as of 27 June 2008

	(%)
Augment Investments Limited	54.2%
Free Float	46.8%
LSE (in form of GDR)	27.5%
RTS, MICEX (ordinary shares)	18.3%

Pharmstandard GDR price on the LSE to FTSE Global Pharmaceuticals and FTSEurofirst 300 Pharmaceuticals Indexes



Ordinary shares performance at the RTS compared to RTS Index

Management of the Company and investor relation staff are open for dialogues about Company plans and objectives and maintain relationships with institutional shareholders through a conferences, regular conference calls and meetings and 2 roadshows in 2007

Investor relations

Since May 2007, when Company became a public and placed it's shares on RTS and MICEX in Russia and GDR's on LSE, the Company provided audited reports on a semi-annual basis. Starting from year 2007 we implemented practice to issue also quarterly non-audited trade updates for our shareholders.

We publish our Annual Report including audited figures by the date of Annual General Meeting. The AGM of the Company takes place in Moscow and formal notification is sent to shareholders at least four weeks in advance of the meeting. Managing Director makes a business presentation in accordance with Russian legislation requirements to the AGM and all Directors are available during the meeting for the questions.

Management of the Company and investor relation staff are open for dialogues about Company plans and objectives and maintain relationships with institutional shareholders through a conferences, regular conference calls and meetings and 2 roadshows in 2007

Roadshows in 2007

- April 23 – May 4

  IPO Roadshow

  (Moscow, London, Frankfurt, Stockholm, New-York, Boston)
- September 24–28

  Non-deal Roadshow

  (London, Frankfurt, New-York)

Conferences in 2007

December, 18	Moscow	Alfa Bank "Consumer Focus Day"
December, 10-11	London	Merrill Lynch "Russia & New Frontiers Forum"
November, 16	Moscow	UBS "Russia Consumer Conference"
September, 27-28	New-York	UBS "Global Life Science Conference"
September, 18	Moscow	UBS Group Seminar

HIGHLIGHTS

Covering Analysts

Aton Management	Anna Kochkina
Citigroup	Marat Ibragimov
Goldman Sachs International	Mlada Yegikyan
ING	Robert Kerekes
J.P. Morgan	Elena Jouronova
Kapital Investment	Marina Samohvalova
Merrill Lynch	Odile Lange-Broussy
Merrill Lynch	Andreas Schmidt
Renaissance Capital	Natasha Zagvozdina
UBS	Svetlana Sukhanova

Investor Relations department of the Company locates in headquarter in Moscow and acts as a central point for contact with institutional shareholders. (Phone: +7 (495) 970 00 30, e-mail: ir@pharmstd.ru)

Corporate governance

OJSC Pharmstandard comply in all material respects with Russian corporate governance practices which are applicable to us. Throughout 2007 OJSC Pharmstadnard has complied fully with ethical standards and acted according to requirements of the London Stock Exchange.

The company's governing bodies are:

- the General Meeting,
- the Board of Directors

Annual General Meeting

The Annual General Meeting is the highest decision-making body of the Company, comprising all shareholders.

The Annual General Meeting will be held at Petrovka str 11/20, Moscow, Russia, Marriot Aurora Hotel, "Stoleshniki" conference room at 10.00 am Moscow time on 27 June 2008.

Board of directors

Viktor KHARITONIN (1972)	Mr. Kharitonin has served as chairman of our board of directors since May 2006. He served as general director of LLC Profit House from 1997 through 2003, and currently serves as an executive director of LLC Pharmstandard and as a director of Croydon Partners Limited and PHS Russian Holdings (Lux) S.ar.l. Mr. Kharitonin graduated from the Novosibirsk State University.
Igor KRYLOV (1964)	Mr. Krylov has served as a member of our board of directors since May 2006. Mr. Krylov has more than 12 years experience working in the pharmaceutical industry and previously held positions with Eli Lilly and Aventis. He graduated with honours from the Kyrov Military Medical Academy.
Egor KULKOV (1971)	Mr. Kulkov has served as a member of our board of directors since May 2006. Mr. Kulkov has held a number of senior financial positions in various companies, and currently serves as head of the operational department at Commercial Bank Aresbank and as a general director at each of LLC Gloverton and Mellot Intertrade Corporation. He graduated from the Novosibirsk State University.
Pavel MILEYKO (1972)	Mr. Mileyko has served as a member of our board of directors since May 2006. Prior to June 2005, he served as general director of LLC Maknetiktrans. Since January 2007, he served as an assistant to the executive director of LLC Pharmstandard. Mr. Mileyko graduated from the Novosibirsk State University.
Olga POKROVSKAYA (1969)	Ms. Pokrovskaya has served as a member of our board of directors since October 2006. She also serves as a member of the board of directors of Evraz Group S.A. She has more than 15 years of financial experience and previously served as Head of Corporate Finance of OJSC Sibneft from 1998 through 2006. She currently serves as Head of Corporate Finance of LLC Millhouse. Ms. Pokrovskaya graduated from the State Financial Academy and holds a certified public accountant's certificate.
Natalia PAVLOVA (1973)	Ms. Pavlova has served as a member of our board of directors since October 2006. She also serves as a member of the board of directors of OJSC Alpari and as Chairman of the board of directors of OJSC Registrator R.O.S.T. where, prior to joining LLC Millhouse in 2003, she served as Head of Issuer Services. She currently serves as Head of Corporate Department at LLC Millhouse. Ms. Pavlova graduated from the Moscow State University.

Board of directors

(continue)

Natalia MAMCHENKO (1974)	Ms. Mamchenko has served as a member of our board of directors since October 2006. She has previously held various managerial positions in the financial sector at OJSC Sibneft, with the government of Chukotka and at LLC Millhouse. Ms. Mamchenko serves as Vice Head of the Finance and Budget Department at LLC Millhouse. She graduated from the State Financial Academy.
Alexander MELNIKOV (1968)	Mr. Melnikov has served as a member of our board of directors since October 2006. He has previously held various managerial positions with OJSC Sibneft from 1999 through 2002. Since 2002, he has served as the Head of Assets and Investment Department of LLC Millhouse. Mr. Melnikov graduated from the Moscow State Technical University.
Ivan TYRYSHKIN (1973)	Mr. Tyryshkin has served as an independent member of our board of directors since October 2006. He also serves as a member of the board of directors of OJSC RTS. He previously served as President of NP RTS from 2001 to 2003 and as President of CJSC Russkoe Zerno from 2003 to 2004. Since 2006, he has served as both a managing director and a general director of LLC ATON. Mr. Tyryshkin graduated from the Russia Economic Academy.

Senior Management

Igor KRYLOV (1964)	Mr. Krylov has served as a Chief Executive Officer. Mr. Krylov has more than 12 years experience working in the pharmaceutical industry and previously held positions with Eli Lilly and Aventis. He graduated with honours from the Kyrov Military Medical Academy.
Elena ARKHANGELSKAYA (1970)	Ms. Arkhangelskaya has served as our Chief Financial Officer since 2003. She has 10 years experience working in the pharmaceutical industry and previously held senior positions at Eli Lilly. Ms. Arkhangelskaya graduated from the State Financial Academy and has obtained a master of business administration degree from the American Institute of Business and Economics.
Olga MEDNIKOVA (1969)	Ms. Mednikova has served as our Chief Sales and Marketing Officer since 2004. She has 12 years experience working in the healthcare industry and previously held senior management positions in marketing and promotion at Glaxo Wellcome and IVAX. Ms. Mednikova graduated from the State Medical University in Samara and holds a MD PhD.

Sergey DUSHELIKHINSKY (1971)	Mr. Dushelikhinsky has served as our Chief Commercial Officer since 2005. He has 10 years experience in sales and 9 years experience serving in supervising positions, and previously worked for CJSC Veropharm and FTK Vremya. Mr. Dushelikhinsky graduated from the Moscow Technical University.
Sergey PYLTSYN (1956)	Mr. Pyltsyn has served as our Chief Human Resources Officer since 2003. He has nine years experience in the pharmaceutical industry, and, from 1997 to 2000, worked for Eli Lilly where he held senior management positions. Mr. Pyltsyn graduated from the Rostov State Medical University.
Viktor FEDLYUK (1973)	Mr. Fedluk has served as our Head of Legal Department since 2003. He has nine years of experience in the legal profession, and worked for JSC Sibneft from 1996 to 2003. Mr. Fedluk graduated from the Ukraine National Legislation Academy.
Maxim STETSYUK (1977)	Mr. Stetsuk has served as our Head of Investor Relations and Business Development since 2005. He has eight years of experience in the pharmaceutical industry, and previously worked for Abbott Labs and Eli Lilly. Mr. Stetsuk graduated from the State Academy of Management.

Audit Committee

Our audit committee consists of Mr. Tyryshkin, Mr. Mileyko and Ms. Pokrovskaya. The committee is chaired by an independent director, Mr. Tyryshkin. The audit committee is authorised to carry out the following functions relating to the control of our financial and business operations:

- to evaluate our potential auditors and to prepare recommendations for our board of directors in connection with the election of the auditor;
- to draft the agreement to be entered into with auditors and to prepare recommendations for our board of directors on the fees of auditors;
- to review the scope and results of auditor procedures and their financial efficiency and assess the opinion of the auditors; and
- to review our financial statements and analyse all changes in accounting policies and practice or any material corrections made upon an audit and make appropriate reports and recommendations to our board of directors.

HIGHLIGHTS

Remuneration and Nomination Committee

Our remuneration and nomination committee consists of Mr. Tyryshkin, Ms. Mamchenko and Mr. Kulkov. The committee is chaired by Mr. Tyryshkin. The committee assists the board of directors with the development of our remuneration and benefits policies, elaborates the remuneration system for the members of the board of directors as well as our General Director, considers and interviews potential new members of the board of directors and a nominee for the General Director's position and makes recommendations to our board of directors with respect to these matters.

Corporate Code

The corporate code sets out internal control procedures for our financial and business operations. The Corporate Code specifies the procedures for (i) the internal control of our financial and business operations and (ii) the functions of, and procedures for, our internal audit service with respect to compliance with internal controls and (iii) the procedures for our internal audit service with respect to compliance with internal controls.

In addition, the Corporate Code regulates the use of insider information by our management and employees. Thus, the Corporate Code provides that members of our board of directors, General Director and our internal and external auditors shall use insider information (as such term is defined in the Corporate Code) only for our benefit, pursuant to applicable law and in accordance with the Corporate Code. The Corporate Code also provides for certain procedures that we can implement in order to ensure compliance by all relevant individuals with such regulation.

The Corporate Code also establishes a requirement for the members of our board of directors and the General Director to disclose any trading in our shares.

Dividend

The Board of Directors recommends not to pay dividends for the year ended December 31, 2007 as there is a big chance for the following M&A deal which Company prefer to cover from it's free cash-flow.

LETTER FROM THE CEO

I welcome the opportunity to introduce to you the first Annual Report of OJSC Pharmstandard for 2007. It was a very important period in Pharmstandard's life, as we became a London listed company, and we appreciate the trust our investors have placed in us. In my opinion, we have justified and responded to your confidence and expectations for 2007 reflected by a market capitalization increase of more than 80% since flotation.

We have achieved our goals in 2007 as a result of the mutual endeavors of all Pharmstandard's team and our focus on the current strategy. We became one of the top three pharmaceutical companies in the Russian market by sales. Our growth in 2007 was primarily attributable to organic growth as well as non-organic. We successfully integrated Masterlek into our business and benefited from the resulting significant synergies. We developed and launched 10 new products. We built a strong marketing and sales force team and increased significantly our market share.

Pharmstandard is today not only the biggest domestic pharmaceutical company by sales but also enjoys one of the largest and modern production facilities in the Russian market. We will continue to follow our strategy to consolidate our position in the pharmaceutical market as well as grow through promoting our market leading brands and launching new products.

I look to the future with confidence that Pharmstandard continues to demonstrate profitable business growth and delivering long term value for our shareholders.

To the best knowledge of the members of the Board of Directors:

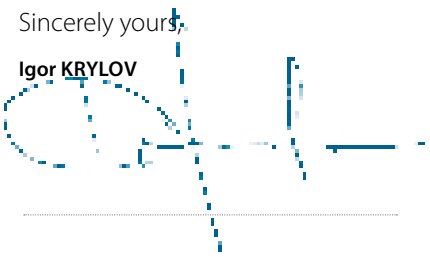
(a) the consolidated financial statements set out on pages 60 to 109 have been prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and

(b) the business and performance review set out on pages 18 to 43 includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that the Company faces.

For and on behalf
of the Board of Directors

Sincerely yours,

Igor KRYLOV



02 Business report

The Russian market is continuing to develop in terms of the breakdown of pharmaceutical product consumption and increase of pharmaceutical product consumption per capita.

MARKET OVERVIEW

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"The past year has given food for thought for both optimists and pessimists as it was a record-setting year in terms of investment raised by the Russian pharmaceutical industry. Over the course of the year several M&A deals were concluded in the market, including, the ownership of Akrikhin changing hands several times and Makiz Pharma being added to STADA's Russian assets. Additionally, the market saw Servier constructing new facilities in Russia at a high tempo. However, all the above was outshone by Pharmstandard's IPO. Investors had been on the lookout for a Russian pharmaceutical wonder COMPANY, and judging by Pharmstandard's stock price dynamics we are living through this wonder. Pharmstandard has also involved itself in the M&A field when it acquired the Russian company Masterlek, as well as the completion of the modernisation of its facilities in Kursk where the manufacturing capacity from the closed St. Petersburg enterprise Pharmstandard-October and other closed plants was relocated."*

Russian Pharmaceutical Market

The Russian market is continuing to develop in terms of the breakdown of pharmaceutical product consumption and increase of pharmaceutical product consumption per capita. The state-supported sector decreased the absolute market value without however affecting the overall demand, as the retail market experienced customers continuing to purchase efficacious and thus more expensive drugs. However, the Russian pharmaceutical market in 2007 declined from the aggressive growth rate, demonstrated since 2005.

There were a number of transitional developments in the pharmaceutical sector including a coverage of 2006 FRP (Federal Reimbursement Program) debts which were finally paid and changes in regulation and financing of the FRP with implementation of the decentralization of pharmaceutical products purchasing from federal to the regional level.

Due to weakening of the U.S. dollar, which is traditionally the main currency used for calculating the Russian market by market research agencies, including Pharmexpert, the market picture was distorted.

* *The Russian Pharmaceutical market, 2007 results, Pharmexpert, Market Research Center*

The Russian pharmaceutical market amounted to $11.38 billion in 2007 in retail prices, an increase of 6% compared to 2006, including a 16% growth in the commercial segment (consumer spending segment) and a 20% decline in the FRP segment.

According to Pharmexpert, the Russian pharmaceutical market amounted to $11.38 billion in 2007 in retail prices, an increase of 6% compared to 2006, including a 16% growth in the commercial segment (consumer spending segment) and a 20% decline in the FRP segment.

Based on the result of 2007, Pharmexpert forecasts the market to reach $13.5 billion in 2008, a growth rate of 19%, which is below their previous forecast of $15.5 billion based on results of 2006. The difference between the new and previous forecasts is due to the decline of the FRP in 2007 and the forecast of the same level of budget spending for the FRP in 2008 as 2007. Pharmexpert forecasts commercial segment growth in 2008 to be at least at the same rate as in 2007. Additionally Pharmexpert forecasts the Russian pharmaceutical market to reach $22.25 billion in 2012.

DSM forecasts the Russian pharmaceutical market to reach $13.4 billion in 2008 and $20.6 billion in 2012.

Market structure

The Russian pharmaceutical market comprises three major segments, namely the commercial market (consumer spending market), the FRP market (Federal reimbursement program) and the hospital market. According to the results of 2007 the commercial segment makes up 69% of the market, the FRP segment 18% and the hospital segment13% vs. 63%, 23%, and 14% respectively in 2006.

The following table illustrates the breakdown of sales (in consumer prices) and sales growth in 2007 and 2006 by pharmaceutical segment (US$ billion).

Segment	2006 $billion	Growth, %	2007 $billion	Growth, %
Commercial	6.7	20%	7.8	16%
FRP	2.5	79%	2.0	-20%
Hospital	1.5	7%	1.6	5%
Total	**10.7**	**28%**	**11.4**	**6%**

The commercial segment of the Russian pharmaceutical market reached $7.8 billion up 16% in value as compared to 2006. The FRP has been implemented since 2005 within the frame work of the National Priority Project "Zdorovie" (Health). Its main objective was centralized

MARKET OVERVIEW

drug provision to specified population categories. In 2007 $2.0 billion worth of drugs (at "substituted" prices) were distributed within the FRP framework.

The hospital segment has reached $1.58 billion in 2007 with 5% growth vs. 2006.

Generic products are more widely utilized than original products in Russia since they are more affordable to both consumers and the Government, which bears a large portion of the expense.

The following table illustrate market structure of generic and original products in each market segment by value (%).

Segment	Generics	Original
Commercial	92%	8%
FRP	75%	25%
Hospital	83%	17%

In terms of product origin, domestically manufactured pharmaceutical products historically have exceeded imported products in volume terms. Domestic manufacturers have to date focused primarily on generic products, as they require lower initial investment than original products and addressed the demand for more affordable drugs for end users and payers.

According to Pharmexpert, in 2007 domestic products accounted for the 84% of total sales by volume and 16% of total sales by value, whilst imported products accounted for the remaining 16% and 84% respectively.

All pharmaceuticals products sold in Russian market can be broadly categorized as prescription or OTC (Over-the-Counter) products. According to Pharmexpert, in 2007 prescription products accounted for 63% of the market and OTC for 37% of the market in sales value terms and 34% and 66% of the market in volume terms respectively.

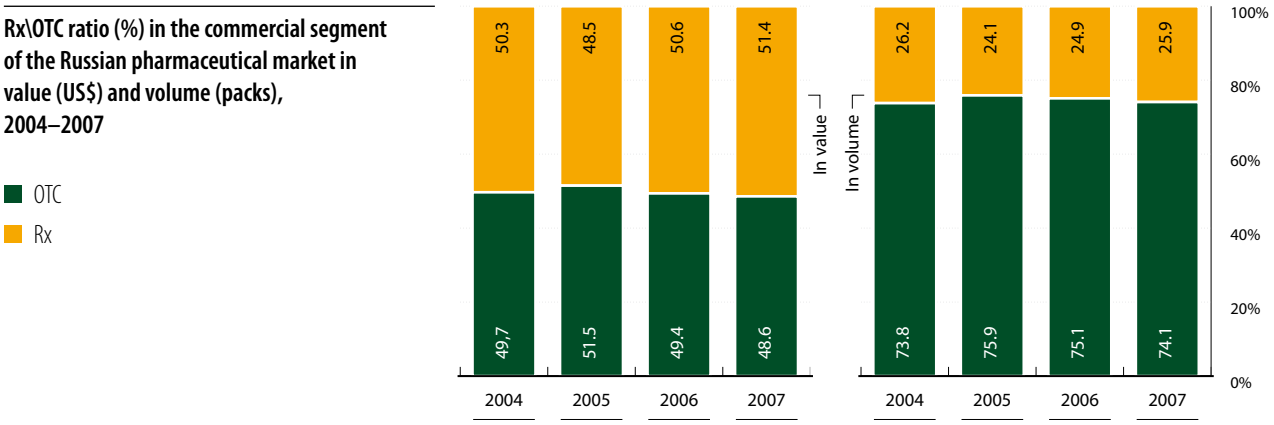
In 2007, for the first time, the top 10 corporations rankings in the commercial segment was headed by Pharmstandard

Commercial segment

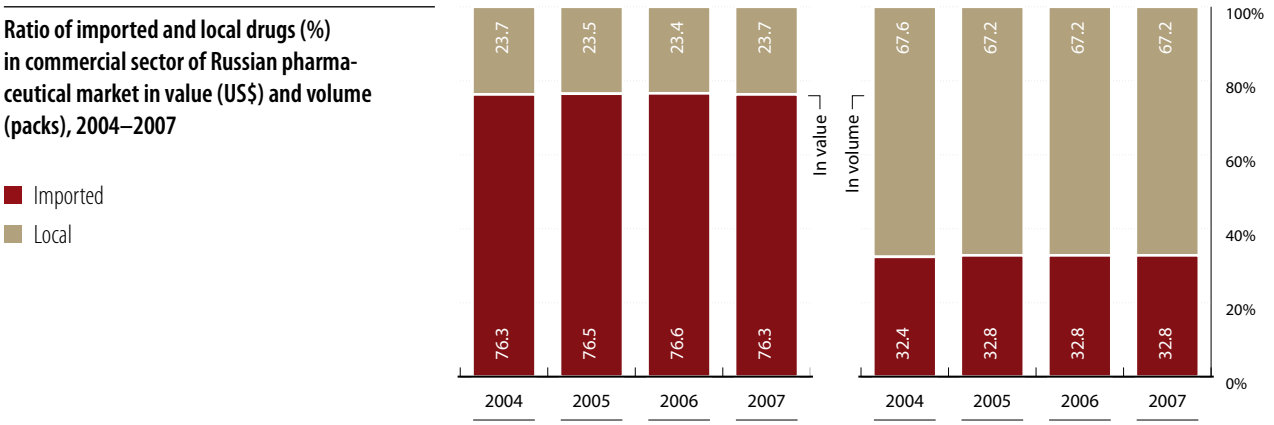
The commercial segment continued to grow in 2007 experiencing 16% growth. In 2007, for the first time, the top 10 corporations rankings in the commercial segment was headed by Pharmstandard. The changes to the dynamics of the commercial segment structure by Rx/OTC drugs is related to the development of the reimbursement program. When this program was launched in 2005 the share of Rx drugs in the commercial segment decreased, as many of them started being provided to the beneficiaries within the program's framework. In 2006, when many beneficiaries left the program and started purchasing drugs on their own at drugstores the share of Rx drugs in drugstore sales increased. In 2007, the ratio kept shifting towards Rx drugs because still less beneficiaries remained in the reimbursement program, and many of those remaining had to pay for the drugs themselves in order not to terminate their treatment course.

The share of the commercial segment between Russian and foreign manufactures has been stable since 2004.

Rx\OTC ratio (%) in the commercial segment of the Russian pharmaceutical market in value (US$) and volume (packs), 2004–2007



Ratio of imported and local drugs (%) in commercial sector of Russian pharmaceutical market in value (US$) and volume (packs), 2004–2007



MARKET OVERVIEW

Market Trends

Sales in the commercial segment of the Russian pharmaceutical market accounted for 69% of the total market in 2007. We believe that growth in the commercial segment has been, and will continue to be, driven by the following trends:

- **Increased real disposable income per capita.** According to the Economist Intelligence Unit, real disposable income per capita in Russia is expected to grow at a compound annual growth rate of 13.9% from 2005 to 2010. Generally, an increase in disposable income raises demand for pharmaceutical products after a considerable time lag, whereas a fall in disposable income has an immediate negative effect. According to Pharmexpert, per capita spending on pharmaceutical products in Russia grew from $27 in 2001 to $80 in 2007.
- **Broadening availability of generic products and changing of pharmaceutical product consumption.** Both private and governmental entities in Russia are seeking to find ways to reduce or contain healthcare costs. The broadening availability of generic products, which are typically priced lower than original products, has met this increasing demand for affordable pharmaceutical products. Cheap local drugs at drug stores will be continuously replaced by competitive high quality products including branded products.
- **Continued improvement in health awareness.** We expect that continuing improvement in health awareness and diagnostic capabilities will give rise to greater utilization of preventive and curative pharmaceutical products, and thus greater healthcare expenditures.
- **Aging Population.** Along with the rest of Europe, Russia has an aging population. The percentage of Russians aged 60 or over will grow from 16.5% in 1990 to 27% in 2050 (according to the United Nations, Department of Economic and Social Affairs, Population Division. World Population Prospects: The 2006 Revision, Highlights. - New York, 2007). We expect that the health problems associated with an aging population will help drive demand for curative pharmaceutical products and medical technologies, and thus lead to greater healthcare expenditures.

Since its introduction in 2005, the FRP has become a key element of Russia's pharmaceutical market structure. The FRP was introduced as a plan of reimbursement of pharmaceutical expenses for certain socio-economic demographic groups

- **New trends in pharmacotherapy.** New trends in pharmacotherapy include the discovery of additional therapeutic effects of existing generic pharmaceutical products and increased access to new generations of pharmaceutical substances.

Supply Chain

Wholesale distributors form the central part of the pharmaceutical market supply chain. The extensive territory of the country, the special requirements for a pharmaceutical logistical infrastructure, including licensing, and the large number of hospitals and retail outlets to which the products must be delivered, give rise to the need for wholesalers. Wholesale distributors supply pharmaceutical products to retail chains, stand-alone pharmacies and hospitals, and also participate in tenders held by the local state and municipal health care departments to supply products to the FRP.

Consequently, most pharmaceutical sales in Russia are made through a number of national, regional and local wholesale distributors who operate as intermediaries between manufacturers and retail and hospital segments. In 2007, there were approximately 950 pharmaceutical distributors in Russia, with the five largest, namely SIA International, Protek, Katren, ROSTA, Alliance Healthcare (former Apteka Holding), Genesis, Moron and Biotek, accounting for 87% of the market.

The customer base in the Russian pharmaceutical market is broad, comprising approximately 10,000 hospitals and 22,500 clinics according to the Russian Federal Service of State Statistics. The commercial segment comprises pharmacy chains and stand-alone outlets. There are over 65,000 pharmacy outlets in Russia. Whilst the sector remains largely unconsolidated, the share of large retail chains is gradually increasing.

Federal Reimbursement Programme (FRP)

Since its introduction in 2005, the FRP has become a key element of Russia's pharmaceutical market structure. The FRP was introduced as a plan of reimbursement of pharmaceutical expenses for certain socio-economic demographic groups. In particular, the plan applies to disabled people and veterans, and also covers medicine-related expenses for treatment of chronic illnesses, such as HIV/AIDS,

MARKET OVERVIEW

tuberculosis and diabetes. Consequently, the FRP plays a significant role in creating market demand for prescription products.

In 2006, $2.84 billion worth of drugs (at distribution prices) were supplied to the privileged population categories under this programme. Out of that value, only $1.29 billion worth of drugs were covered by the programme budget. A solution to the financial problem was delayed. Many pharmaceutical manufactures and distributors cut their drug supplies as the state failed to pay for the reimbursement prescriptions. As a result, the necessary medication was distributed to specific population categories with significant delays. This problem was finally resolved in December 2007 when all debts were covered.

In 2007, $2.0 billion worth of drugs (at "substituted" prices) were distributed within the FRP framework. International companies accounted for 92% of sales by value in the FRP in 2007, with Janssen-Cilag, Roche, Novartis, Sanofi-Aventis and Novo-Nordisk accounting for the largest proportion. The share of local products has not grown in the three years of program implementation, however the opportunities of substituting some costly imported drugs with their analogues have not been exhausted so far. Going forward Government focused on including generic domestic products on the FRP list. Recently, the Russian Government created the Department of Domestic Pharmaceutical Industry within the Ministry of Industry and Energy (MIE).

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Arbidol®

Our product portfolio includes market-leading brands

We are the leading domestic pharmaceutical company in Russia, the third largest pharmaceutical company operating in Russia overall and the largest pharmaceutical company operating in Russia in the commercial segment (consumer spending) of the Russian pharmaceutical market, by sales value. We develop, manufacture, market and sell generic and, to a lesser extent, original pharmaceutical products in various formulations, primarily in Russia. Our product portfolio includes market-leading brands, such as Arbidol® (antiviral for systemic use), Pentalgin® (analgesics), Terpincod® (cough and cold), Complivit® (vitamins) and Flucostat® (antifungal). In 2007, we ranked first, by sales value, in the commercial segment of the Russian pharmaceutical market, and Arbidol® was the leading brand, by sales value, in this segment (the second in the total market).

Our pharmaceutical product portfolio includes products that do not require a medical prescription ("over-the-counter" or "OTC" products), as well as prescription products. In 2007 OTC products accounted for 85% and prescription products accounted for 15% of our pharmaceutical product sales. Our pharmaceutical product portfolio covers a wide range of therapeutic segments. Sales of products within our five core therapeutic segments, namely analgesics, cough and cold, vitamins, antiviral for systemic use and antifungal (the "Core Therapeutic Segments") accounted for 73% of our pharmaceutical product sales in 2007. Our pharmaceutical product portfolio consists of both branded pharmaceutical products, which may be trademarked and which we promote through our direct sales force, and non-branded pharma-

BUSINESS OVERVIEW

ceutical products, which are older products that have demonstrated sustainable demand from consumers without the need for continued active promotion. Branded pharmaceutical products accounted for 90% of pharmaceutical product portfolio sales in 2007. Sales of branded pharmaceutical products increased in 2007 vs. 2006 by 40%.

Following the acquisition of Masterlek in August 2006, leading Masterlek brands experienced strong sales growth under the Pharmstandard management in 2007: Arbidol® grew by 56%, Flucostat® by 16%, Amixin® by 14% respectively. The total growth of these three brands in 2007 was RUR 928 million (on a pro-forma basis).

In addition to our pharmaceutical business, we also develop, manufacture, market and sell medical equipment, such as sterilizing and distilling machines, and disposable medical products, such as syringes. Medical equipment and disposables accounted for 14% of our sale of goods in 2007.

We generated sale of goods and profit of RUR 11,371.3 million and RUR 3,263.2 million, respectively, in 2007. Our EBITDA (as defined in "Presentation of Financial and Other Information") was RUR 4,882 million for the year ended 31 December 2007. We believe that we had industry leading growth in EBIDTA margin and profitability in 2007.

The key elements of our business operations are as follows:

Sales and marketing

Our sales and marketing activities form an integral part of our strategic focus. We believe we maintain one of the largest sales forces in Russia among domestic pharmaceutical companies. As of 31 December 2007, our sales force comprised 340 members, all of whom have either a medical degree or previous work experience in the pharmaceutical industry. Our trained and incentivized sales force is divided into two groups that focus on promoting either OTC products or prescription products. Our sales force maintains strong relationships with key market participants, particularly pharmacists and specialist doctors, with the aim of developing brand loyalty and awareness. Our corporate sales and marketing department is based in Moscow and supports our sales force with brand and sales management and customer support initiatives. In 2007 we fully implemented an Electronic Territory

Our goal is to further strengthen our position as the leading domestic pharmaceutical company in Russia by sales and remain in the ranks of the top 3 pharmaceutical companies operating in Russia overall.

Management System ("ETMS") software system to further integrate our sales and marketing function with our overall business processes.

Manufacturing

Our production capacity of 1,3 billion packs as at 31 December 2007 is one of the largest among domestic pharmaceutical companies in Russia and has allowed us to become one of the largest domestic pharmaceutical companies in Russia by volume of products sold. We produce a wide variety of product formulations (for example, capsules and tablets) and packaging, each of which represents a unique stock keeping unit ("SKU"), which allows us to target different customer segments with the same well-recognised umbrella brands. Each of our five modern manufacturing facilities is certified to be compliant with Russian good manufacturing practice ("GMP") standards. Through new capital investments, we have achieved EU GMP certification for solid (tablets) and liquid (syrups) dosage forms at our manufacturing facility in Kursk. We review our cost efficiency at each manufacturing facility on a monthly basis to help to ensure a controlled cost environment, and aim to leverage our most cost-efficient facilities by concentrating production at those sites wherever possible.

Strategy

Our goal is to further strengthen our position as the leading domestic pharmaceutical company in Russia by sales and remain in the ranks of the top 3 pharmaceutical companies operating in Russia overall. The key elements of our strategy are as follows:

- **Promote our market-leading brands to drive sales growth and profitability.** We intend to strengthen our market position in Russia by continuing to leverage our strong brand loyalty and brand awareness through effective sales and marketing of our market-leading brands. We will continue promoting these brands by introducing line extensions of trusted and established products, such as our well-known branded product ranges Pentalgin®, Codelac®, Complivit®, Arbidol® and Flucostat®. We will also continue to focus on promoting those brands for which we can charge higher prices.

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- **Launch new pharmaceutical products in a timely manner to capture market share.** We intend to maintain strong growth and capture market share by leveraging the brand loyalty and brand awareness of our market-leading brands to develop and launch new products in our Core Therapeutic Segments. We will continue to focus on developing pharmaceutical compounds that have been successful for major originator pharmaceutical companies and which we believe we can successfully introduce in the Russian market. Specifically, we intend to:
  - focus on the timely identification and development of new generic OTC products, including the development of line-extensions of current brands, such as new formulations of current analgesics and cough and cold products and new specialised vitamin products;
  - focus on the timely identification and development of new generic prescription products that complement our Core Therapeutic Segments and develop products to penetrate new therapeutic areas;
  - launch these new pharmaceutical products in a timely manner to capture significant market share; and
  - leverage our sales and marketing infrastructure to promote our new product launches and achieve a leading market position for each of our new branded products.
- **Maintain our focus on cost control.** Our focus and ability to control costs is an important element of both our operating and financial performance. We will continue to evaluate and react to manufacturing and distribution cost inefficiencies. We also plan to further rationalise our manufacturing costs to maximise gross profit margins by managing our product mix based on the demand for our pharmaceutical products at our manufacturing facilities.
- **Expand our sales and marketing capabilities.** Our sales team has more than doubled in the last two years and we expect our sales force to number about 450 by the end of 2008. We also expect that our sales force will be further specialised by therapeutic area in 2008. We believe an expanded, and more specialised, sales and marketing team will facilitate our increased calling efforts on medical practitioners, regional and

Complivit®

Our product portfolio includes market-leading brands

national distributors and other customers, thereby increasing their awareness of our product portfolio and driving further sales growth. We also expect to strengthen our ability to manage customer relationships and react to the demands of our customers more rapidly and efficiently by utilising our recently implemented ETMS software system, which enables real-time reporting by our sales force.

- **Grow through acquisitions and realise synergies.** We intend to complement our organic growth by continuing to assess acquisition opportunities, including for specific brands, trademarks and patents. For example, in 2006, we acquired Masterlek, which contributed approximately 30 products to our product portfolio, including market-leading brands, such as Arbidol® and Flucostat®, which collectively had sales of RUR 2,818 million in 2007. We derived synergy effect by switching the manufacturing of these products from third-party facilities to our own modern and efficient facilities. We also got the benefit from promoting and distributing these brands by our experienced sales force.

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- **Exploit opportunities from government healthcare expenditure as they arise.** Whilst our growth strategy does not depend on government healthcare expenditure, we believe we are well positioned to benefit from potential changes in the administration of the FRP as they arise. In addition, we expect growth in the market for sterilising machines due to the launch of the Priority National Health Project ("PNHP"), which aims, in part, to equip Russian hospitals with modern equipment, where we believe our products have a cost-competitive advantage.

Products

Our products are divided into pharmaceuticals, which primarily comprise generic products sold either in the OTC market or with a prescription, and medical equipment and disposables. Our pharmaceutical product portfolio covers a wide range of therapeutic segments, but focuses on our Core Therapeutic Segments.

The following table shows our sales and percentage of total sales for these product areas for the periods indicated:

	Year ended 31 December 2006 (RUR in millions) (audited)	Year ended 31 December 2007 (RUR in millions) (audited)
Pharmaceutical products	7,230.0	9,708.0
Of which:		
OTC products	6,031.5	8,235.2
Branded	5,340.6	7,547.6
Non-branded	690.8	687.6
Prescription products	1,198.5	1,472.8
Branded	899,4	1,207.0
Non-branded	299.2	265.8
Medical equipment and disposables	1,196.4	1,608.7
Other[1]	96.4	54.6
Total sales	**8,522.8**	**11,371.3**

[1] *We also derive revenue from the lease of certain of our warehouses.*

Pharmaceutical products

We were the leading domestic pharmaceutical company in Russia in 2007 and the third largest pharmaceutical company operating in Russia overall, by sales value. We develop, manufacture, market and sell more than 200 generic pharmaceutical products in various formulations, and two original pharmaceutical products, Arbidol® and Phosphogliv®. Original pharmaceutical products refer to products that typically result from the research and development of a new drug chemical entity or molecule.

Our pharmaceutical product portfolio focuses on our five Core Therapeutic Segments, namely analgesics, cough and cold, vitamins, antiviral for systemic use and antifungal (the "Core Therapeutic Segments"), which together accounted for 73% of our pharmaceutical product sales in 2007.

The following table sets forth certain information concerning our pharmaceutical products within the ATC 2 therapeutic category for the periods specified. Products within the following ATC 2 categories accounted for 85% of our pharmaceutical product sales in 2007. Our antiviral for systemic use segment generated the highest sales in 2007, accounting for 24%, of our pharmaceutical product sales.

ATC 2 Category	Sales for the year ended 31 December 2006		Sales for the year ended 31 December 2007	
	Value	Volume	Value	Volume
	(RUR in millions)	(packs in millions)	(RUR in millions)	(packs in millions)
J05 – Antivirals for systemic use[1]	1,035.6	12.045	2,317.2	25.065
R05 – Cough and cold	1,608.2	52.506	1,868.6	47.655
N02 – Analgesics	1,408.1	142.621	1,547.3	144.976
A11 – Vitamins	963.9	44.768	875.0	39.713
J02 – Systemic agents for fungal infections[1]	220.0	2.003	503.3	4.576
A05 – Cholagogues and hepatic protectors	286.9	20.570	380.4	18.135
N05 – Psycholeptics	269.8	81.286	365.5	71.440
L03 – Immunostimulating agents[1]	138.7	0.451	256.9	0.703
C01 – Cardiac therapy	188.2	55.479	166.9	54.579

[1] *Sales only formed part of our consolidated sales from August 2006*

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OTC pharmaceutical products

Our OTC business consists of branded and non-branded pharmaceutical products which do not require a medical prescription. These products are purchased either in a pharmacy or other retail outlet selling OTC medications. OTC pharmaceutical products accounted for 84% of our pharmaceutical product sales in 2007.

The following table sets forth our top 15 OTC pharmaceutical products for the periods specified.

Product	ATC 2 therapeutic segment	Sales for the year ended 31 December 2007		Sales for the year ended 31 December 2006	
		Value	Volume	Value	Volume
		(RUR in millions)	(packs in millions)	(RUR in millions)	(packs in millions)
Arbidol® [1]	Antiviral	2,316	25.1	1,485	17.3
Terpincod®	Cough and cold	1,322	18.9	1,163	17.5
Pentalgin® – N	Analgesics	833	18.1	796	17.9
Flucostat® [1]	Anti-fungal	502	4.6	435	4.2
Pentalgin® – ICN	Analgesics	481	10.7	410	9.7
Complivit® (excluding Mama® and Active)	Vitamins	441	8.2	545	10.5
Codelac®	Cough and cold	412	8.2	375	8.7
Corvalol	Psycholeptics	149	39.8	155	39.8
Afobazole®	Psycholeptics	39	0.3	121	1.1
Askophen®	Analgesics	85	25.7	80	24.9
Ingalipt	Throat praparations	85	3.4	49	1.9
Validol	Cardiac therapy	79	39.9	69	36.9
Complivit® Active	Vitamins	72	1.4	68	1.3
Complivit® "Mama"	Vitamins	65	1.2	50	0.9
Activated charcoal	Antidiarrhoeals	60	51.1	47	42.5
Total		**6,941**	**256.6**	**5,848**	**235.1**

[1] *Sales only formed part of our consolidated sales from August 2006*

We actively promoted 13 of our OTC brands in 2007, which together accounted for 65% of our total OTC product sales in 2007. Our OTC product portfolio includes well-known brands, such as Arbidol®, Pentalgin®, Terpincod®, Complivit® and Flucostat®. We believe these products, as a result of strong brand recognition and our active promo-

Biosulin®, Phosphogliv®, Rastan®

Our product portfolio includes rDNA (gene-engineering) pharmaceutical products

tion, occupy a "top-of-mind" position among pharmacists, specialist doctors and consumers which, in turn, strengthens the Pharmstandard brand. Our well-known brands Complivit®, Pentalgin® and Codelac® are also major umbrella brands under which we seek to regularly introduce new formulations to widen the customer segments we target.

Prescription pharmaceutical products

Our prescription pharmaceutical business consists of branded and non-branded pharmaceutical products that are only available for purchase with a medical prescription and that are sold to patients in finished form. Prescription pharmaceutical products accounted for 15% of our pharmaceutical product sales in 2007. Our prescription product sales grew by 23% in 2007. In 2007 we have launched 5 new

BUSINESS OVERVIEW

proscription products, four of them were in the list of top-15 prescription product drivers.

Our portfolio of prescription products focuses on four core market segments: nitrites and nitrates, acid pump inhibitors, ACE inhibitors, hepatic protectors & lipotropics human insulin's, growth hormone, macrolides, anti-fungal. Products within these core segments accounted for 38% of our prescription product sales in 2007.

The following table sets forth our top 15 prescription pharmaceutical products for the periods specified.

Product	ATC 4 therapeutic segment	Sales for the year ended 31 December 2007		Sales for the year ended 31 December 2006	
		Value	Volume	Value	Volume
		(RUR in millions)	(packs in millions)	(RUR in millions)	(packs in millions)
Phosphogliv®	Hepatic protectors & lipotropics	356	1.1	253	0.7
Amixin ®	Antiviral	247	0.6	217	0.5
Biosulin®	Drugs, used in diabets	120	0.2	50	0.1
Renipril® (including Renipril® HT)	Cardiovascular	68	2.0	55	1.4
Rastan®	Hormones	53	0.1		
Cocarboksilaza	Vitamins	47	2.2	36	1.7
Pikamilon®	Nootropics	45	2.5	34	1.8
Lidokain	Anaesthetics	38	0.3	17	0.1
Nitrokor®	Cardiac therapy	38	3.2	35	3.3
Azitrox®	Macrolides and similar types	37	0.3	34	0.2
Piracetam	Psychoanaleptic, excluding anti-obesity products	37	2.3	24	1.8
Termikon®	Anti-fungal	37	0.3	35	0.3
Sul'fokamfokain®	Respiratory system product	34	1.8	38	2.3
Ciclodol®	Anti-Parkinson drugs	29	1.0	1	0.1
Phenazepam®	Psycholeptics	24	1.7	4	0.8
Total		**1,210**	**19.6**	**833**	**15.1**

Pentalgin-N®, Pentalgin Plus®

Our product portfolio includes market-leading brands

Recent launches and near-term pipeline of pharmaceutical products

In 2007 we have introduced 10 new pharmaceutical products (5 OTC products and 5 prescription products) including biogeneric insulin and growth hormone, which accounted for 3% of our pharmaceutical product sales in 2007. Our biogeneric product of insulin is included on the FRP list for 2007, while our biogeneric version of human growth hormone was first launched in January 2007.

We believe we are the first Russian pharmaceutical company to develop and implement production of rDNA (gene-engineering) pharmaceutical products of human insulin and human growth hormone.

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The following table sets forth certain information concerning our registration applications by therapeutic segment for both prescription products and OTC products as of 31 December 2007.

Recent product launches	ATC	Sales value 2007 (USD mln)	Market value 2007 (USD mln)	Key Market brands
Maxicold®	R05A0-Cold Preparations without Anti-Infectives	2	175.6	Coldrex, Fervex, Teraflu
Passifit®	N05B5-Herbal Hypnotics/ Sedatives	1	68.3	Novo-Passit, Persen
Immunex®	L03A0- Immunostimulating Agents Excluding Interferons	0.4	107.9	Immunal, Immunorm
Complivit® Ca D3	A12A- calcium products	1.2	45	Calcium D3, Calcium
Complivit® 365	A11A- Multivitamins, combinations	0.2	231.8	Vitrum, Complivit, Multi-Tabs
Biosulin®	A10C2-Human Insulins and Analogues	4.9	239.5	Humulin, Protaphan, Actrapid
Rastan®	H04C0-Growth Hormones	2.2	21	Genotropin, Saizen, Humatrope
Artrozan ®	M01A1-Anti-Rheumatics, Non-Steroidal Plain	0.6	241.1	Movalis, Voltaren, Diclofenac
Mexiprim®	C01X0- All Other Cardiac Preparations	1.1	93.2	Mexidol
Benfolipen®	A11D (tablets) - vitamin B1 and combinations	0.1	15	Milgamma, Neuromultivit

Following our strategic intentions we are going to launch 9 OTC and 5 prescription products in 2008 including extension for our Complivit and Pentalgin umbrella brands and new rDNA product Neupomax (colony-stimulating factors) for the treatment of neutropenia in oncology patients.

Product Approvals and Launches 2008

New product launches in 2008	Date of expected launch	ATC	ATC value, 2007 (USD mln)	Key market brands
Influnorm®	May-08	R05A – cold preparations without anti-infectives	175	Coldrex, Fervex, Teraflu
Pentalgin® Plus	Mar-08	N02B – non-narcotics analgesics and antipyretics	248	Tempalgine, Baralgine, Nurofen, Solpadeine
Complivit® ophtalmo	Sep-08	A11A – multivitamins with minerals	232	Vitrum, Multi-Tabs, Supradine
Complivit® Se	Sep-08	A11A – multivitamins with minerals	232	Vitrum, Multi
Complivit® Fe	Sep-08	A11A – multivitamins with minerals	232	Vitrum, Multi
Complivit® Mg	Sep-08	A11A – multivitamins with minerals	232	Vitrum, Multi
Neurocomplit®	Mar-08	A11D – vitamin B1 and combinations	43	Milgamma, Multi-Tabs B complex, Neuromultivit
Lactazar®	Sep-08	A15A – appetite stimulants		Lactasa
Neosmectine®	Jan-08	A07B – intestinal absorbent antidiarrhoeals	45	Smecta, Carbone Activated
Combilipen®	Mar-08	A11D3 (injections) – vitamin B1 and combinations	34	Milgamma, Multi-Tabs B complex
Octolipen®	Nov-08	A05B0 – hepatic protectors	209	Tioctacid, Berlition
Neupomax®	Sep-08	L03A1 – colony-stimulating factors	13	Neupogen, Granocyte
Formetin®	Jun-08	A10B2 – biguanide antidiabetics	21	Glucofazh, Siofor
Bloctran®	Apr-08	C09C0 – antgiotensine-2 antagonists plain	21	Losap, Diovan, Kozaar

Sales and Marketing

Our sales force is divided into three groups, one of which focuses on promoting OTC products to pharmacies and medical professionals, a second which focuses on promoting prescription products to general practitioners and specialist doctors and a third which focuses on promoting our endocrinology products. As of 31 December 2007, 134 members of our sales force were assigned to OTC product promotion and 157 were assigned to prescription product promotion.

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In 2007, we spent RUR 528.8 million, or 70%, of our marketing budget marketing our OTC products primarily through television, print and point of sale materials. In January 2007, we launched our first advertising campaign for Arbidol® and Flucostat®, two products we acquired from Masterlek.

Medical equipment and disposables

We develop, manufacture, market and sell medical equipment, including sterilizing and distilling machines, and disposables, such as syringes, at our Tyumen manufacturing facility. Medical equipment and disposables accounted for 14% of our sale of goods in 2006 and the same 14% of our sale of goods in 2007.

The following table sets forth the sales of our principal medical equipment and disposables products for the periods specified.

Product	Sales for the year ended 31 December 2006		Sales for the year ended 31 December 2007	
	Value (RUR in thousands)	% of Sales	Value (RUR in thousands)	% of Sales
Medical equipment	445.1	37.2	1,211.2	75.2
Syringes and disposable systems	661.2	55.3	318.8	19.8
Spare parts	32.8	2.7	28.6	2
Other	57.3	4.8	50.1	3
Total	**1,196.4**	**100**	**1,608.7**	**100**

Manufacturing and Facilities

Sourcing raw materials

The majority of the raw materials used to manufacture our pharmaceutical products are supplied from a variety of external sources, primarily brokers. As of 31 December 2007, we had more than 500 raw materials, and we obtained approximately 55% of our raw material requirements from our top-10 suppliers in 2007. We import the majority of our raw materials for our pharmaceutical products since certain

types of raw materials are not produced in Russia, fail to meet quality standards or are produced in insufficient quantities. We import our raw materials from a number of countries, including China, Hungary and India. Raw materials for our medical equipment and disposables business are supplied by 20 primary furnishers.

Facilities

The following table sets forth information relating to our principal manufacturing facilities for finished pharmaceutical products.

Location	Approximate size	Own/Lease	Formulations	Shifts	As at and for the year ended 31 December 2007	
	(sq m)				Capacity (packs in thousands) [1]	Utilisation (%) [2]
Leksredstva (Kursk)	14,900	Lease	syrups and liquid forms	3	46,456	98
			tablets	3	638,705	49
			sprays	3	12,288	47
			powders	3	2,241	63
			capsules	3	18,870	23
Tomskhimpharm (Tomsk)	29,000	Own	syrups and liquid forms	3	5,400	44
			tablets	3	326,949	33
UfaVita (Ufa)	5,850	Lease	ampoules	3	10,346	56
			frozen-dried preparation	3	3,360	0
			syrups and liquid forms	3	9,053	25
			tablets	3	159,711	52
			vitamin bars	3	33,660	39
			insulin	2	14,400	15
			saline infusion	2	0	0
Phitopharm (N. Novgorod)	1,200	Lease	ointments	2	13,600	47
			powders	1	10,000	0
			syrups and liquid forms	2	23,699	72
			tablets	2	8,295	97
Total					**1,337,033**	

[1] *Based on one, two or three daily shifts (8 hours each) and 5 working days per week*
[2] *Total production divided by capacity*

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The following table sets forth information relating to our manufacturing facility for medical equipment and disposables in Tyumen, which encompasses approximately 239,000 square meters.

Production Form	Capacity [1]
	As at 31 December 2007
Syringes	552 million
Needles for syringes	1,200 million
Sterilising machines (up to 100 liters)	8,400
Sterilising machines (greater than 100 liters)	318
Distilling machines	6,200

[1] *Based on one, two or three daily shifts (8 hours each) and 5 working days per week.*

Distribution

We distribute our pharmaceutical products primarily through 5 wholesale distributors that collectively accounted for 58% of our pharmaceutical sales in 2007. Our headquarter in Moscow coordinates our activities to ensure efficient product distribution. Key account managers are responsible for the performance of particular groups of distributors and report to a commercial manager.

The following table provides the share of our commercial pharmaceutical product sales (excluding our exports) in 2007 attributable to our five largest distributors.

Distributor	% of sales
Genesis	19
Katren	14
Protek	10
SIA International	9
Rosta	6
Total	**58**

Employees

As of 31 December 2007, we had 5,456 full-time employees, of whom 54 % were represented by trade unions. We have not experienced any business interruption as a result of labour disputes and we consider our relationship with our employees to be good.

The following table shows our headcount as at the years ended 31 December 2006 and 2007.

Staff	As at 31 December	
	2006	2007
Production/Logistics	3,929	3,949
Research and development	102	140
Sales and marketing	347	600
Management and administrative	888	767
Total	**5,266**	**5,456**

The following table shows our headcount as at 31 December 2007 at each of our manufacturing facilities and at our headquarters in Moscow.

Staff	Kursk	Ufa	Tomsk	N. Novgorod	Tyumen	St. Petersburg	HQ
Production/Logistics	1,218	1,049	355	98	1,181	48	-
Research and development	41	28	18	4	8	-	41
Sales and marketing	2	-	-	-	-	-	598
Management and administrative	91	198	94	30	154	33	167
Total	**1,352**	**1,275**	**467**	**132**	**1,343**	**81**	**806**

In 2007 we increased the staff at headquarters by 39% from 582 to 806 employees. Most new people were employed to sales and marketing department to promote our leading brands Arbidol®, Flucostat®, Phosphogliv®, Rastan®.

We increased the staff in our manufacturing facilities in Kursk and Ufa on 13% and 8% respectively because of increase of production capacities and installment of new production lines. We continue the concentration of production process and transfer production to more effective sites. As a results we decrease the staff of N. Novgorod on 57% in December 2007.

RISK MANAGEMENT

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Producing and distribution of pharmaceutical products and medical equipment for domestic and foreign markets are closely connected with some specific financial and operational risks. The Company pays considerable attention to risk management processes, whereas high rate of financial results hardly depends on it.

Coordination of risk management activity in the Company bases on a complex of internal standards and analytical tools. There is a special department created for implementation effective audit and controlling.

Codelac®

Our product portfolio includes market-leading brands

Aggregative operational and financial risks chart is set in table below:

category	specification	possible risks	control mode	probability
Financial	risk of inflation	Increase in API and other raw material prices; disconnection of raw material and product prices	construction of corporate data system; market monitoring	low
		noncompetitive product prices	marketing policy; market monitoring	low
	foreign currency risk	Risk in currency of borrowing and accounts payable	forecasting activity; prequalification	medium
	liquidity risk	Lack of monetary assets for repayment (taxes, labour costs, loan, % etc.)	controlling of movement of funds	high
		risk of changes in fair value of derivatives	on demand outsourcing	medium
	credit risk	losses from creation of reserves for overdue accounts receivable	credit policy, checking of mutual exchanges	high
operational	staff risk	abuse of official position	creating and regulation of business procedures	medium
		incorrect organization of information flow	inspection of business processes, organization of professional trainings	low
		risk of loss of key managers and specialists	proper compensation package	medium
		lack of skilled personnel	efficiency upgrading of HR department	high
	risk of procedures	Incorrect organization of business processes	qualified personnel; system of controlling measures	low
		risk of insufficient information security	systematic control of access to data	medium
	risk of IT system	processing risk	creating and actualization of information reserve storages	low
	external risks	intense competition risk	development of marketing strategy; market monitoring; promotion	low
		losses from mergers and acquisitions	preliminary weighted analysis; creating of databases	low
		losses from contractual delinquency within participation in Federal Reimbursement Program	accumulation of information; controlling of contractual fidelity; diversification of accounts receivable	low

Our sale of goods increased by RUR 2,848.5 million, or 33%, from RUR 8,522.8 million in 2006 to RUR 11,371.3 million in 2007

03 Management's Discussion and Analysis

of Financial Condition and Results Of Operations development

INTRODUCTION

>>

The following discussion of our financial condition and results of operations should be read in conjunction with our Consolidated Financial Statements and the notes thereto and the other information included elsewhere in this Report.

On 2 August 2006, the Company acquired all of the share capital of CJSC "Masterlek" ("Masterlek") and, as a result, from 2 August 2006 the Company's Consolidated Financial Statements include the activities of Masterlek.

This section contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in such forward-looking statements as a result of various factors, including those described under "Risk Factors" and "Cautionary Note Regarding Forward-Looking Statements."

Flucostat®

Our product portfolio includes market-leading brands

RESULTS OF OPERATIONS

>>

The following table sets forth our income statement line items for the years ended 31 December 2006 and 2007 in absolute terms and as a percentage of sales (foreign exchange gain losses included for 2007):

	Year ended 31 December 2006		Year ended 31 December 2007	
	RUR in mln	%	RUR in mln	%
Sale of goods	**8,522.8**	**100**	**11,371.3**	**100**
Pharmaceutical products	7,230.0	85	9,708.0	85
OTC products	6,031.5	71	8,235.2	72
Branded	5,340.6	63	7,547.6	66
Non-branded	690.9	8	687.6	6
Prescription products	1,198.5	14	1,472.8	13
Branded	899.3	10	1,207.0	11
Non-branded	299.2	4	265.8	2
Medical equipment and disposables	1,196.4	14	1,608.7	14
Other sales	96.4	1	54.6	1
Cost of sales	(3,581.2)	42	(4,519.7)	40
Gross profit	**4,941.5**	**58**	**6,851.6**	**60**
Selling and distribution costs	(1,268.2)	15	(1,626.0)	14
General and administrative expenses	(498.9)	6	(570.5)	5
Other expenses	(207.0)	2	(41.4)	0
Interest income	24.0	0	28.7	0
Interest expense	(291.4)	3	(320.4)	3
Profit before income tax	2,700.1	32	4,321.9	38
Income tax expense	(664.0)	8	(1,058.7)	9
Profit for the period	**2,036.1**	**24**	**3,263.2**	**29**
Attributable to participants of the Company	1,897.7	-	3,227.9	-
Attributable to minority interests	138.4	-	35.3	-

RESULTS OF OPERATIONS

Sale of Goods

We sell our pharmaceutical products almost entirely to wholesale distributors and our medical equipment and disposable products through distributors and directly to hospitals. We have increased sales over the period under review through selective acquisitions and organically. We have grown our sales organically by improving sales volumes of our higher priced brands and by expanding the product ranges offered within those brands.

Our sale of goods increased by RUR 2,848.5 million, or 33%, from RUR 8,522.8 million in 2006 to RUR 11,371.3 million in 2007. This increase was primarily attributable to an increase of RUR 2,511.4 million in both prescription branded product sales and OTC branded and non-branded product sales. We generated the growth in Pharmstandard products primarily through increased sales volumes of our higher priced products, without growing our overall production volumes.

Pharmaceutical products

OTC product sales increased by RUR 2,203.7 million, or 37%, from RUR 6,031.5 million in 2006 to RUR 8,235.2 million in 2007. This increase in OTC sales principally occurred due to our active marketing strategy. Our Arbidol® brand generated an increase of RUR 831.0 million, or 56%, in sales in 2007 as compared to 2006. We also increased sales of Terpincod® by RUR 159.0 million, or 14.0%, in 2007 as compared to 2006. This principally resulted from increased sales volumes and, to a much lesser extent, through small pricing increases resulting from increased sales in the commercial sector. Our sales of Pharmstandard OTC non-branded products stayed approximately the same at RUR 687 million, or 7%, in 2007.

Prescription product sales increased by RUR 274.3 million, or 23%, from RUR 1,198.5 million in 2006 to RUR 1,472.8 million in 2007. This increase was primarily attributable to the contribution to sales by our brands Phosphogliv®, Amixin® and Biosulin®. In particular, sales of Phosphogliv® for such period increased RUR 103.0 million, or 41%, in 2007 as compared to 2006. To a lesser extent, the increase was attributable to a growth in: Amixin®, which growth in sales came to RUR 29.0 million, or 14%; Biosulin®, which achieved growth of RUR 70.0 million, or 140%, in 2007 as compared to 2006.

We generated the growth in Pharmstandard products primarily through increased sales volumes of our higher priced products, without growing our overall production volumes

Medical equipment and disposables

Sales in our medical equipment and disposables segment increased by RUR 412.3 million, or 34%, from RUR 1,196.4 million for 2006 to RUR 1,608.7 million for 2007. This increase was primarily attributable an supply of federal tender of sterilizers .

Cost of Sales

Our cost of sales comprises materials and components, production overheads, direct labour costs and depreciation. Our costs of sales increased by RUR 938.5 million, or 26.0%, from RUR 3,581.2 million in 2006 to RUR 4,519.7 million in 2007., primarily because of the first full year consolidation of the operations of Masterlek and increase of depreciation and amortisation. Cost of sales, as a percentage of sales was 39.7% in 2007 and decreased by 2.3% in comparison to 2006 as a result of a strong growth in sales of our higher priced brand products and as a result of our benefiting from synergies. We also experienced an increase in depreciation and amortisation by RUR 221.0 million, or 85.0%, from RUR 260.3 million in 2006 to RUR 481.3 million in 2007 resulting from the depreciation of intangible assets of Arbidol®, Flucostat®, Amixin®. The largest factor of our cost of sales is materials and components which, as a percentage of cost of sales, were 65.9% and 66.3% in the years ended 31 December 2006 and 2007, Materials and components increased by RUR 636.8 million, or 27.0%, from RUR 2,360.6 million in 2006 to RUR 2,997.5 million in 2007 The research and development costs associated with our operations have not been significant to date and are principally included in our production overhead and direct labour costs.

Gross Profit

As a result of the foregoing factors, gross profit increased by RUR 1,910.0 million, or 39.0%, from RUR 4,941.5 million in 2006 to RUR 6,851.6 million in 2007. As a percentage of sales, gross profit increased from 58.0% in 2006 to 60.3% in 2007.

Operating costs and expenses

Our operating costs and expenses increased by RUR 429.5 million, or 24.0%, to RUR 2,196.5 million in 2007, compared to RUR 1,767.0

RESULTS OF OPERATIONS

million in 2006. Our operating costs and expenses were 19.3% of sales in 2007 compared to 20.7% of sales in 2006.

Our selling and distribution costs increased by RUR 357.9 million, or 28%, to RUR 1,626.0 million in 2007, compared to RUR 1,268.2 million in 2006. This increase primarily consisted of marketing and advertising costs incurred by implementation of marketing strategy. Our labour costs increased as a result of our recruitment of additional sales representatives during the period and, to a lesser extent, an increase in salaries of our sales force.

Our general and administrative expenses increased by RUR 71.6 million, or 14%, to RUR 570.5 million in 2007, compared to RUR 498.9 million in 2006. This increase in general and administrative expenses primarily resulted from an increase in labour costs by RUR 68.5 million from RUR 288.0 million in 2006 to RUR 356.5 million in 2006 principally resulting from an increase in salary and bonuses and an accrual for holiday leave.

Operating profit (foreign exchange gain losses included for 2007)

As a result of the foregoing factors, our operating profit increased by RUR 1,480.5 million, or 47.0%, from RUR 3,174.5 million in 2006 to RUR 4,655.0 million in 2007. Our operating profit was 40.9% of sales in 2007, compared to 37.2% of sales in 2006.

Other expenses

Our other expenses decreased by RUR 165.5 million, or 80%, from RUR 207.1 million in 2006 to RUR 41.4 million in 2007. Other expenses in 2007 principally resulted from the loss on disposal of property, plant and equipment at our facilities at Tyumen and at St Petersburg (as part of our closure of these facilities).

Interest expense, net

Our interest expense, net increased by RUR 24.2 million, or 9%, from RUR 267.4 million in 2006 to RUR 291.6 million in 2007. The increase in interest expense was principally attributable to interest payments under the Citibank Loan Agreement drawn in December 2006 for the purpose of repaying in full the shareholder loan for Masterlek acquisition.

Income Tax Expense

The enacted statutory income tax rate for Russia was 24% for the years ended 31 December 2006 and 2007. We had tax expenses of RUR 1,058.7 million in 2007, which reflected an effective tax rate of 9.3%, compared to a tax expense of RUR 664.0 million in 2006, which reflected an effective tax rate of 7.8%. We had additional tax expense in both periods in excess of the statutory rate as a result of the incurrence of non-tax deductible expenses.

Minority interests

Our minority interests decreased by RUR 103 million, from RUR 35 million in 2007 compared to RUR 138 million in 2006. In April 2006, June 2006 and July 2006 we acquired an additional interest in our subsidiaries in Ufa and Tyumen which resulted in the Company's interest increasing from 56% to 91% and from 55% to 89% of these share capital, respectively.

Profit (foreign exchange gain losses included for 2007)

As a result of the foregoing factors, profit attributable to our shareholders increased by RUR 1,227.2 million, or 60%, from RUR 2,036.1 million in 2006 to RUR 3,263.2 million in 2007.

TRENDS AFFECTING OUR RESULTS OF OPERATIONS IN 2007

>> *Focus on improving operating profit margins*

We are focused on improving operating profit as a percentage of sales. Since 2004, we have achieved significant improvements in our operating profit margin (from 17% in 2004 to 40.9% in 2007) by increasing the proportion of our more highly priced and profitable branded products, implementing cost efficiencies and reducing our sourcing costs.

With the acquisition of Masterlek, and the related shift from third-party outsourced production services to our own manufacturing facilities for the Masterlek products, we achieved synergy effect from increase of gross profit margin of Masterlek products (Arbidol®, Flucostat®).

The table below sets forth the development of our operating profit for the years ended 31 December 2006 and 2007 in absolute terms and as a percentage of sales (foreign exchange gain losses included for 2007):

	Year ended 31 December 2006		Year ended 31 December 2007	
	(RUR in mln)	% of Sales	(RUR in mln)	% of Sales
Operating Profit	3,174.4	37.2%	4,655.0	40.9%

Expansion of sales force

In recent years, we have undertaken a significant expansion of our sales force as part of our ongoing strategic focus on maintaining strong relationships with key market participants. Our total sales force has grown from 69 at the end of 2004 to 340 at the end of December 2007. We expect our sales force to number over 450 by the end of 2008. We also seek to ensure that our sales force is incentivised by offering them the opportunity to earn an additional percentage of their annual salary by meeting certain quarterly sales targets, which are reviewed and revised quarterly. We currently offer up to an additional 33% of annual salary paid quarterly which is in accordance the current market situation. We plan to further incentivise our sales force by implementing new training programs and a performance management program and continuing to offer competitive compensation packages.

LIQUIDITY AND CAPITAL RESOURCES

>> Overview

Our liquidity requirements arise primarily from the need to fund our working capital, our capital expenditure program and the development and expansion of our product portfolio through selective acquisitions. During the periods covered by our Consolidated Financial Statements, we have primarily financed our operations and investments through free cash flow and short-term borrowings from banks and related parties. We intend to fund future acquisitions, if any, through free cash flow and borrowings.

The following table summarises our cash flows during the years ended 31 December 2006 and 2007.

	Year ended 31 December 2006	Year ended 31 December 2007
		(RUR in mln)
Net cash from operating activities	1,220.3	2,081.4
Net cash from (used in) investing activities	(4,481.3)	(1,729.8)
Net cash from (used in) financing activities	3,209.9	352.0
Cash and cash equivalents, end of period	193.0	193.0

Net cash from operating activities

Substantially all of our cash flows from operating activities for the periods covered by our Consolidated Financial Statements were generated from sales of pharmaceutical products and medical devices. Our standard commercial contract with distributors includes credit terms ranging up to 90 days.

Net cash from operating activities was RUR 2,081 million and RUR 1,220 million in the year ended 31 December 2007 and 2006, respectively. The increase in net cash flow from primary activities were generated by reduction in the part of receivables in 2007, due to the payment of FRP program debts related to sales in 2006, and, furthermore, by growth in balance item VAT recoverable. Additionally the effect in part of higher priced products, associated with the acquisition of Masterlek in 2006, gave rise to an economic benefits inflow to the Company, which resulted in an incremental increase in net cash flow.

LIQUIDITY AND CAPITAL RESOURCES

Net cash from investing activities

Net cash used in investing activities was RUR 4,481 million and RUR 1,730 million in the years ended 31 December 2006 and 2007, respectively. Our most significant investing activities for the periods consisted of the acquisition of property, plant and equipment and intangible assets, cash paid for financial assets, cash used to buy subsidiaries and cash paid to purchase TZMOI.

With respect to the acquisition of property, plant and equipment, we paid RUR 805.7 million, RUR 521.6 million in the years ended 31 December 2006 and 2007, respectively. These acquisitions were primarily attributable to capital investments in new production capacity at our manufacturing facility in Kursk, including a new central manufacturing laboratory and new production lines for tablets, capsules and sprays, at our manufacturing facility at Ufa, including new production lines for solutions, human growth hormone and tablets, and at our manufacturing facility in Tomsk, including new production lines for Masterlek's products.

In 2007, we acquired an intangible assets (trade marks) for RUR 165.2 million including RUR 160.0 million (in 2006 for RUR 84.3 million).

In 2007, we paid RUR 824.7 million in installments, for the acquisition of TZMOI shares (2006: RUR 707.0 million).

In 2007, we acquired a long-term financial asset represented by 19.88% of the shares of "Dipaka Trading Limited" for RUR 245.4 million. This company is the sole shareholder of the Russian pharmaceutical company "Mirpharm". Moreover, this company owns several medical patents and trademarks, and a manufacturing facility of API in Belgorod.

Net cash from financing activities

Net cash from financing activities was RUR 352.0 million in the year ended 31 December 2007. This amount consisted of the repayment in an amount of RUR 330.0 million of the current part of the Citibank Loan received in 2006 and a minor part of another loan.

Contractual obligations and other commitments

As of 31 December 2006, we had no material contractual obligations, other than capital expenditure, certain other liabilities incurred in the ordinary course of business, such as trade payables, wages and tax expenses and the remaining amount payable with respect to our acquisition of TZMOI. We paid RUR 824.8 million in 2007 to the vendors of TZMOI.

We do not engage in any significant off-balance sheet financing.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risks with respect to foreign currency exchange rates, interest rates, the creditworthiness of the counterparties with whom we expect payments under normal commercial conditions and fluctuations in the prices we pay for our raw materials. We centrally manage and monitor our exposure to these risks in accordance with our treasury policies by seeking to minimise external financial risks.

Credit risk

Our principal credit risk is the risk that a distributor fails to fulfill its payment obligations under a sales contract. Under the general terms on which we transact business, all of our sales are made on credit terms depending on our credit policy with respect to a particular customer. We manage our exposure in this respect by having policies in place to ensure that sales of products are made to customers with an appropriate credit history. Our credit committee, comprising our CEO, CFO and Director of Commercial Operations sets a credit policy, which is revised when particular circumstances require, which generally divides customers into three categories: those with a maximum credit limit, those for whom the credit committee will set a credit limit and those who are required to make prepayments. The majority of our sales are to customers who fall into the first category 58% of our sales in 2007 were made to our five largest customers). The carrying amount of accounts receivable, net of provisions, represents the maximum amount of exposure to credit risk at the end of each quarter. We believe we have no significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, our management believes that there is no significant risk of loss beyond the provision already made.

Currency Risk

A proportion of our expenses is in currencies other than the rouble (the measurement and presentation currency of our Consolidated Financial Statements). We incur currency risk whenever we enter into transactions denominated in a currency other than our measurement currency. Generally, our foreign currency transactions are settled in roubles but linked to the US dollar or euro and include a substantial proportion of our raw material expenses and borrowings (and the

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

related interest payments thereon). Therefore, our cost of sales and operating costs and expenses as presented in our Consolidated Financial Statements, as well as the amount of payables and borrowings shown in the balance sheet could be impacted by changes in the US dollar-rouble exchange rate. Our principal method for minimising currency risks is to maintain a proportion of our transactions denominated in roubles in order to avoid exposure to currency fluctuations. We do not expect the level of our exposure to currency risk to change throughout the remainder of 2008.

Interest rate risk

We are exposed to interest rate risk through interest cash flow and market value fluctuations as the majority of interest rates on our long-term borrowings are floating and based on LIBOR. In September 2007, when LIBOR rate interest was approximately 5.7%, we entered into an Interest Rate Swap agreement in respect OF all interest payments due in respect to the Citibank loan basically swapping the LIBOR rate interest obligations into a fixed rate of 4.932% per annum. In this CONNECTION, the Group MITIGATEDTHE RISK OF fluctuations IN LIBOR rates.

Liquidity risk

Our 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. We perform continuous monitoring of cash deficit risks and continuous monitoring of repayment of its financial liabilities on time. Moreover, we perform daily planning and control cash flow procedures.

Capital Risk Management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital. The Group manages its capital structure and adjusts it, in accordance with external market conditions. To maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue

new shares or sell assets to reduce debt (while taking into consideration terms and conditions set by the Citibank Loan Agreement).

Commodity price risk

We do not believe we are subject to material risk due to movements in raw material commodity prices for the production of our products because we do not rely on any one commodity to a significant extent and the prices of the raw materials we purchase do not generally increase or decrease in tandem with each other.

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

04 Consolidated Financial Statements

INDEPENDENT AUDITORS' REPORT

>> To the Shareholders and Management of OJSC "Pharmstandard"

We have audited the accompanying consolidated financial statements of OJSC "Pharmstandard" and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2007, and the consolidated statement of operations, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2007, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

10 April 2008

Consolidated Balance Sheet

at 31 December 2007

(in thousands of Russian Roubles)

	Notes	2007	2006
ASSETS			
Non-current assets			
Property, plant and equipment	8	3,691,266	3,788,581
Investment property		–	14,522
Intangible assets	9	4,468,477	4,473,639
Long-term financial assets	14	245,398	–
		8,405,141	**8,276,742**
Current assets			
Inventories	11	1,760,195	1,406,952
Trade receivables	12	4,176,200	3,373,741
VAT recoverable		358,767	222,675
Prepayments		130,479	169,232
Short-term financial assets	14	111,899	104,866
Cash and cash equivalents	13	192,589	192,966
		6,730,129	5,470,432
Non-current assets classified as held for sale	10	158,855	22,655
Total assets		**15,294,125**	**13,769,829**

(in thousands of Russian Roubles)

	Notes	2007	2006
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the parent			
Share capital	18	37,793	37,793
Retained earnings		9,004,021	5,838,906
		9,041,814	**5,876,699**
Minority interest		560,879	463,664
Total equity		**9,602,693**	**6,340,363**
Non-current liabilities			
Long-term borrowings and loans	15	1,954,576	3,523,997
Deferred tax liability	25	1,047,799	1,080,828
Derivative financial instruments	15, 27	44,598	–
Other non-current liabilities		36,826	47,767
		3,083,799	**4,652,592**
Current liabilities			
Trade and other payables and accruals	17	1,046,520	2,092,882
Current portion of long-term borrowings	15	1,310,374	351,415
Income tax payable		37,934	184,118
Other taxes payable	16	212,806	148,459
		2,607,633	**2,776,874**
Total liabilities		**5,691,432**	**7,429,466**
Total equity and liabilities		**15,294,125**	**13,769,829**

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

General Director **I. K. Krylov**

Chief Financial Officer **E. V. Arkhangelskaya**

10 April 2008

The accompanying notes on pages 60-109 are an integral part of these consolidated financial statements.

Consolidated Statement of Operations

For the Year Ended 31 December 2007

(in thousands of Russian Roubles)

	Notes	2007	2006
Revenue -sale of goods	19	11,371,345	8,522,780
Cost of sales	20	(4,519,749)	(3,581,237)
Gross profit		**6,851,596**	**4,941,543**
Selling and distribution costs	21	(1,626,041)	(1,268,160)
General and administrative expenses	22	(570,519)	(498,929)
Other income	23	274,142	–
Other expenses	23	(315,591)	(206,996)
Financial income	24	28,729	23,987
Financial expense	24	(320,367)	(291,363)
Profit before income tax		**4,321,949**	**2,700,082**
Income tax expense	25	(1,058,709)	(664,014)
Profit for the year		3,263,240	2,036,068
Attributable to:			
Equity holders of the Parent		3,227,895	1,897,671
Minority interests		35,345	138,397
		3,263,240	**2,036,068**
Earnings per share (in Russian roubles) - basic and diluted, for profit of the year attributable to equity holders of the parent	18	85.41	50.21

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

General Director **I. K. Krylov**

Chief Financial Officer **E. V. Arkhangelskaya**

10 April 2008

The accompanying notes on pages 60-109 are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the Year Ended 31 December 2007

(in thousands of Russian Roubles)

	Notes	2007	2006
Cash flows from operating activities:			
Profit before income tax		4,321,949	2,700,082
Adjustments for:			
Depreciation and amortisation	8,9	527,600	284,797
Allowances for impairment of receivables, inventories and financial assets	11,12,23	152,364	43,202
Loss recognised on non-current assets classified as held for sale	23	24,101	–
Impairment charge	8,23	42,403	–
(Gain) loss on disposal of property, plant and equipment and investments property and non-current assets classified as held for sale	23	(15,044)	160,145
Foreign exchange gain	23	(259,098)	–
Gain from revaluation of short-term financial assets	24	(10,578)	–
Financial income	24	(18,151)	(23,987)
Financial expense	24	320,367	291,363
Operating cash flows before working capital changes		**5,085,913**	**3,455,602**
Increase in trade receivables	12	(892,491)	(1,099,267)
Increase in inventories	11	(385,398)	(74,735)
(Increase) decrease in VAT recoverable		(136,091)	151,436
Decrease in prepayments		38,753	109,937
Decrease in trade payables, other payables and advances received	17	(184,189)	(109,509)
Increase (decrease) in taxes payable other than income tax		64,346	(212,060)
Cash generated from operations		**3,590,843**	**2,221,404**
Income tax paid	25	(1,237,928)	(702,129)
Interest paid		(282,917)	(322,940)
Interest received		11,361	23,987
Net cash from operating activities		**2,081,359**	**1,220,322**

Consolidated Statement of Cash Flows

(continued)

For the Year Ended 31 December 2007

(in thousands of Russian Roubles)

	Notes	2007	2006
Cash flows from investing activities:			
Purchase of property, plant and equipment and intangible assets	8,9	(686,802)	(889,911)
Cash paid for subsidiaries acquisition	5	–	(3,945,860)
Cash in acquired subsidiaries		–	76,097
Cash paid for long-term financial assets	14	(246,308)	–
Cash paid to settle the obligation for OJSC "TZMOI" shares acquired in 2005	7	(824,723)	(707,000)
Cash received from sale of investment property and property, plant and equipment	8	17,574	135,346
Cash received from sale of short-term financial assets	14	32,513	158,670
Cash paid for short-term financial assets	14	(81,300)	(34,466)
Cash received from sale of non-current assets classified as held for sale	10	34,133	370,466
Deposits repaid by related bank, net	7	–	71,649
Loans repaid by related parties	7	25,153	283,743
Net cash used in investing activities		**(1,729,760)**	**(4,481,266)**
Cash flows from financing activities:			
Capital contribution from the Participant of the Company		–	802,400
Cash paid for minority interest in OJSC "Pharmstandard Ufavita"		–	(802,400)
Proceeds from loans and borrowings	15	–	3,875,412
Repayment of loans and borrowings	15	(351,976)	(513,530)
Repayment of loans to related parties		–	(3,994,242)
Proceeds from loans from related parties		–	3,924,242
Repayment of finance lease liabilities		–	(81,955)
Net cash from (used in) financing activities		**(351,976)**	**3,209,927**
Net decrease in cash and cash equivalents		**(377)**	**(51,017)**
Cash and cash equivalents at the beginning of the year	**13**	**192,966**	**243,983**
Cash and cash equivalents at the end of the year	**13**	**192,589**	**192,966**

The accompanying notes on pages 60-109 are an integral part of these consolidated financial statements.

Consolidated Statement of Changes in Equity

For the Year Ended 31 December 2007

(in thousands of Russian Roubles)

	Equity attributable to equity holders of the parent					
	Share capital	Retained earnings	Net assets attributable to the Participant of the Company	Total	Minority interests	Total equity
Balance at 31 December 2005	–	–	2,790,388	2,790,388	1,134,474	3,924,862
Profit for the period	–	1,265,114	632,557	1,897,671	138,397	2,036,068
Contribution from the Participant of the Company for acquisition of additional shares in OJSC "Pharmstandard Ufavita"	–	–	802,400	802,400	–	802,400
Acquisition of additional shares in OJSC "Pharmstandard Ufavita" by minority shareholders	–	–	–	–	11,986	11,986
Effect of acquisition of additional shares in OJSC "Pharmstandard Ufavita" by the Company	–	–	199,291	199,291	(199,291)	–
Issuance of shares in connection with legal reorganization	37,793	4,386,843	(4,424,636)	–	–	–
Effect of acquisition of minority interest in OJSC "TZMOI"	–	186,949	–	186,949	(621,902)	(434,953)
Balance at 31 December 2006	**37,793**	**5,838,906**	**–**	**5,876,699**	**463,664**	**6,340,363**

Consolidated Statement of Changes in Equity

(continued)

For the Year Ended 31 December 2007

	Equity attributable to equity holders of the parent				
	Share capital	Retained earnings	Total	Minority interests	Total equity
Balance at 31 December 2006	37,793	5,838,906	5,876,699	463,664	6,340,363
Profit for the period	–	3,227,895	3,227,895	35,345	3,263,240
Disposal of part of an ownership interests in subsidiaries	–	(66,476)	(66,476)	66,476	–
Effect of acquisition of minority interest	–	3,696	3,696	(4,606)	(910)
Balance at 31 December 2007	**37,793**	**9,004,021**	**9,041,814**	**560,879**	**9,602,693**

The accompanying notes on pages 60-109 are an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

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

1. Corporate Information

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

Entity	Country of incorporation	Activity	2007 % share	2006 % share
"Pharmstandard" LLC (*)	Russian Federation	Central procurement	100	99
"Pharmstandard-Leksredstva" OJSC	Russian Federation	Manufacturing of pharmaceutical products	99	99
"Pharmstandard-Tomskhimpharm" OJSC	Russian Federation	Manufacturing of pharmaceutical products	91	91
"Pharmstandard-Ufavita" OJSC	Russian Federation	Manufacturing of pharmaceutical products	94	97
"Pharmstandard-Octyabr" OJSC	Russian Federation	Manufacturing of pharmaceutical products	93	93
"Pharmstandard-Phitofarm-NN" LLC	Russian Federation	Manufacturing of pharmaceutical products	99	99
"TZMOI" OJSC	Russian Federation	Manufacturing of medical equipment	89	90
"TMK" LLC**	Russian Federation	Manufacturing of medical equipment	100	100
"Masterlek" CJSC	Russian Federation	Manufacturing pharmaceutical products	100	100
"Black Bird Investment Enterprises Corp"	British Virgin Islands	Finance company	100	100

* *Before 1 April 2007, this entity performed the functions of managing company and trading house of the Group, which were then transferred to the Company. Since 1 April 2007, Pharmstandard LLC is specialized in procurement activities, primarily representing purchase of API (raw materials) for the Group production entities.*

** *As of 31 December 2007 this entity is classified as non-current asset held for sale (Note 10).*

These consolidated financial statements were authorised for issue by the Board of Directors of the OJSC "Pharmstandard" on 10 April 2008.

2. *Basis of Preparation of the Financial Statements*

Statement of compliance

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

Basis of accounting

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

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

Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial period except that the Group has adopted those new/revised standards mandatory for financial years beginning on or after 1 January 2007.

The changes in accounting policies result from adoption of the following new or amended standards and interpretations:

- IFRS 7 "Financial Instruments: Disclosures";
- IAS 1 (amended 2005) "Presentation of Financial Statements – Capital Disclosures";
- IFRIC 8 "Scope of IFRS 2";
- IFRIC 9 "Reassessment of Embedded Derivatives";
- IFRIC 10 "Interim Financial Reporting and Impairment".

IFRS 7 "Financial Instruments: Disclosures" requires disclosures that enable users to the financial statements to evaluate the significance of the Group's financial instruments and the nature and extent of risks arising from those financial instruments. The new disclosures are included in these consolidated financial statements. While there has been no effect on the financial position or results, comparative information has been revised where needed.

The amendment of IAS 1 "Presentation of Financial Statements – Capital Disclosures" requires disclosures regarding an entity's objectives, policies and processes for managing capital. These new disclosures are shown in Note 27.

IFRIC 8 clarifies that IFRS 2 applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. If the identifiable consideration given appears to be less than the fair value of the equity instrument granted, under IFRIC 8 this situation typically indicates that other consideration has been or will be received. IFRS 2 therefore applies.

IFRIC 9 clarifies, that an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.

IFRIC 10 "Interim Financial Reporting and Impairment" requires that an entity must not reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. As the Group had no impairment losses previously reversed, this interpretation had no impact on the financial position of the Group.

There were no significant effects of these changes in policies on these consolidated financial statements. However, the adoption of IFRS 7 will significantly affect the disclosures relating to financial instruments as presented in the Note 27 of these consolidated financial statements.

IFRSs and IFRIC Interpretations not yet effective

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

- IFRIC 11 "IFRS 2 - Group and Treasury Share Transactions";
- IFRIC 12 "Service Concession Arrangements";
- IFRIC 13 "Customer Loyalty Programmes";
- IFRIC 14 "The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction";
- IFRS 8 "Operating segments";
- IAS 23 (amended 2007) "Borrowing costs".
- IFRS 2 "Share-based Payments" – Vesting Conditions and Cancellations;
- IFRS 3R "Business Combinations" and IAS 27R "Consolidated and Separate Financial Statements";
- IAS 1 Revised "Presentation of Financial Statements";
- Amendments to IAS 32 and IAS 1 "Puttable Financial Instruments"

IFRIC 11 addresses the issues whether the certain transactions should be accounted for as equity-settled or as cash-settled under the requirements of IFRS 2, and concerns the accounting treatment for share-based payment arrangements that involve two or more entities within the same group. An entity shall apply this interpretation for annual periods beginning on or after 1 March 2007.

IFRIC 12 addresses the accounting issues relating to the service concession arrangements. An entity shall apply this Interpretation for annual periods beginning on or after 1 January 2008.

IFRIC 13 "Customer Loyalty Programmes" was issued in June 2007 and becomes effective for financial years beginning on or after 1 July 2008. This Interpretation requires customer loyalty credits to be accounted for as a separate component of the sales transaction in which they are granted.

IFRIC 14 "The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" was issued in July 2007 and becomes effective for financial years beginning on or after 1 January 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 19 "Employee benefits".

IFRS 8 "Operating segments" was issued in November 2006 and becomes effective for financial years beginning on or after 1 January 2009. IFRS 8 requires disclosure of information about the Group's operating segments and replaced the requirements of disclosures of IAS 14 "Segment reporting". Entities that do not early adopt IFRS 8 will continue to apply IAS 14 "Segment reporting".

IAS 23 (amended 2007) "Borrowing costs" is effective for financial years beginning on or after 1 January 2009 and requires capitalization of borrowing costs that relate to a qualifying asset.

IFRS 2 "*Share-based Payments*" – Vesting Conditions and Cancellations.

This amendment to IFRS 2 *Share-based payments* was published in January 2008 and becomes effective for financial years beginning on or after 1 January 2009. The Standard restricts the definition of "vesting condition" to a condition that includes an explicit or implicit requirement to provide services. Any other conditions are non-vesting conditions, which have to be taken into account to determine the fair value of the equity instruments granted. In the case that the award does not vest as the result of a failure to meet a non-vesting condition that is within the control of either the entity or the counterparty, this must be accounted for as a cancellation.

IFRS 3R Business Combinations and IAS 27R Consolidated and Separate Financial Statements

The revised standards were issued in January 2008 and become effective for financial years beginning on or after 1 July 2009. IFRS 3R introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognised, the reported results in the period that an acquisition occurs, and future reported results. IAS 27R requires that a change in the ownership interest of a subsidiary is accounted for as an equity transaction. Therefore, such a change will have no impact on goodwill, nor will it give raise to a gain or

loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by IFRS 3R and IAS 27R must be applied prospectively and will affect future acquisitions and transactions with minority interests.

IAS 1 Revised Presentation of Financial Statements

The revised IAS 1 Presentation of Financial Statements was issued in September 2007 and becomes effective for financial years beginning on or after 1 January 2009. The Standard separates owner and non-owner changes in equity. The statement of changes in equity will include only details of transactions with owners, with all non-owner changes in equity presented as a single line. In addition, the Standard introduces the statement of comprehensive income: it presents all items of income and expense recognised in profit or loss, together with all other items of recognised income and expense, either in one single statement, or in two linked statements. The Group is still evaluating whether it will have one or two statements.

Amendments to IAS 32 and IAS 1 Puttable Financial Instruments

Amendments to IAS 32 and IAS 1 were issued in February 2008 and become effective for annual periods beginning on or after 1 January 2009. The amendment to IAS 32 requires certain puttable financial instruments and obligations arising on liquidation to be classified as equity if certain criteria are met. The amendment to IAS 1 requires disclosure of certain information relating to puttable instruments classified as equity.

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

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

Subsidiaries

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

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

Business combinations

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

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

Losses allocated to minority interest do not exceed the minority interest in the equity of the subsidiary unless there is a binding obligation of the minority to fund the losses. All such losses are allocated to the Group.

Increases in ownership interests in subsidiaries

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

Acquisition of subsidiaries from parties under common control

Purchases of subsidiaries from parties under common control are accounted for using the pooling of interest method. The assets and liabilities of the subsidiary transferred under common control are recorded in these consolidated financial statements at the carrying amounts of the transferred entity (the Predecessor) at the date of the transfer. Related goodwill inherent in the Predecessor's original acquisition is also recorded in these consolidated financial statements. Any difference between the total book value of net assets, including the Predecessor's goodwill, and the consideration paid is accounted for in these consolidated financial statements as an adjustment to equity.

These consolidated financial statements, including corresponding figures, are presented as if the subsidiary had been acquired by the Group on the date it was originally acquired by the Predecessor.

3.2 Cash and Cash Equivalents

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

3.3 Trade Receivables

Trade receivables, which generally have a short term, are carried at original invoice amount less an allowance for any uncollectible amounts. Allowance is made when there is objective evidence that the Group will not be able to collect the debts. Impaired debts are derecognised when they are assessed as uncollectible.

3.4 Value Added Tax

The Russian tax legislation permits settlement of value added tax ("VAT") on a net basis.

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

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

3.5 Inventories

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

3.6 Non-current Assets Held for Sale

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

3.7 Property, Plant and Equipment

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

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

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

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

3.8 Goodwill

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

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

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

3.9 Other Intangible Assets

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

3.10 Investments and Other Financial Assets

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

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

Financial assets at fair value through profit or loss

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

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

Loans and receivables

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

Available-for-sale financial investments

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

Fair value

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

Amortised cost

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

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

Assets carried at amortised cost

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

Available-for-sale financial investments

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity 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 in profit or loss.

3.11 Borrowings

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

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

3.12 Income Taxes

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

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

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

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

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

3.13 Leases

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

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

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

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

3.14 Derecognition of Financial Assets and Liabilities

Financial assets

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

Financial liabilities

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

3.15 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 statement of operations. 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.

3.16 Equity

Share capital

Ordinary shares are classified as equity.

Dividends

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

3.17 Revenue Recognition

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

3.18 Employee Benefits

Under provision of the Russian legislation, social contributions are made through a unified social tax ("UST") calculated by the Group by the application of a regressive rate (from 26% to 2%) to the annual gross remuneration of each employee. The Group allocates the UST to three social funds (state pension fund, social and medical insurance funds), where the rate of contributions to the pension fund varies from 20% to 2% depending on the annual gross salary of each employee. The Group's contributions relating to UST are expensed in the year to which they relate. Total contributions for UST amounted to RR 244,179 during the year ended 31 December 2007 (2006: RR 203,187) and they were classified as labour costs in these consolidated financial statements.

3.19 Foreign Currency Transactions

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

3.19 Foreign Currency Transactions (continued)

The functional currency of the foreign operations is the United States Dollar (US$). As at the reporting date, the assets and liabilities of that subsidiary are translated into the presentation currency of the Group (the Russian Rouble) at the rate of exchange ruling at the balance sheet date and its statement of operations is translated at the weighted average exchange rate for the year. The exchange differences arising on the translation are taken directly to a separate component of equity. In 2007 and 2006, the foreign subsidiary did not perform any operations and held minor assets and liabilities, therefore its translation into the presentation currency had no effect on these consolidated financial statements.

3.20 Impairment of Non-Financial Assets

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

4. Significant Accounting Judgements and Estimates

4.1 Judgements

In the process of applying the Group's accounting policies, management has made the following judgements, apart from those involving estimates, which have the most significant effect on the amounts recognised in the consolidated financial statements:

Lease agreements

A lease is classified as finance lease if it transfers substantially all the risks and rewards incidental to ownership, otherwise it is classified as operating lease. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. If the lease term is for longer than 75 percent of the economic life of the asset, or that at the inception of the lease the present value of the minimum lease payments amount to at least 90 percent of the fair value of the leased asset, the lease is classified by the Group as finance lease, unless it is clearly demonstrated otherwise.

The Group has entered into several lease agreements with the state municipal bodies for land on which the Group's factories and buildings, comprising the Group's principal manufacturing facilities, are located. The lease agreements specify lease terms between 10 and 50 years with an option to prolong the lease term for another 10 years. In addition, the lease agreements include a purchase option after termination of the lease. Purchase price will be determined based on fair value of the land as determined by the municipal authorities. The Group has classified these lease agreements as operating leases. More details are provided in Note 8.

4.2 Estimation Uncertainty

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

Useful life of property, plant and equipment

The Group assesses the remaining useful lives of items of property, plant and equipment 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 on depreciation recognised in the statement of operations.

Impairment of non-financial assets

The determination of impairments involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment. The determination of the recoverable amount of a cash-generating

unit involves the use of estimates by management. Methods used to determine the value in use include discounted cash flow-based methods, which require the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. These estimates, including the methodologies used, may have a material impact on the fair value and ultimately the amount of any asset impairment.

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.

Fair values of assets and liabilities acquired in business combinations

The Group is required to recognize separately, at the acquisition date, the identifiable assets, liabilities and contingent liabilities acquired or assumed in the business combination at their fair values, which involves estimates. Such estimates are based on valuation techniques, which require considerable judgment in forecasting future cash flows and developing other assumptions.

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 2007 and 2006 was RR 1,180,469. More details are provided in Note 9.

Allowance for doubtful accounts

The Group maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected. As of 31 December 2007, allowances for doubtful accounts have been created in the amount of RR 167,933 (2006: RR 79,308).

Inventory provision

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

Current taxes

Russian tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group's entities may be assessed additional taxes, penalties and interest, which can be significant. The periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As of 31 December 2007 management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax, currency and customs positions will be sustained. More details are provided in Note 26.

5. Business Combinations

The Group acquired 100% interest in CJSC "Masterlek" ("Masterlek") which is involved in the marketing and sale of pharmaceutical products and a related immaterial company on 1 August and 22 September 2006, respectively.

The aggregated effect of these acquisitions is presented in the following table:

	Fair value recognised on acquisition	IFRS carrying value immediately before the acquisition
Property, plant and equipment	4,851	4,851
Intangible assets (Note 9)	3,278,151	4,232
Cash and cash equivalents	76,097	76,097
Trade and other receivables	443,810	443,810
Inventories	307,080	307,080
Other current assets	29,187	24,955
	4,139,176	**861,025**
Trade and other payables	367,589	367,589
Deferred tax liability (Note 25)	787,342	586
	1,154,931	**368,175**
Fair value of net assets	2,984,245	492,850
Goodwill arising on acquisition (Note 9)	**961,615**	
Consideration paid	**3,945,860**	

Goodwill related to the acquisition of Masterlek represents the fair value of the expected synergies and other benefits from combining the Masterlek's trade marks with production assets of the Group.

From the date of the acquisition to 31 December 2006, CJSC "Masterlek" contributed RR 264,883 (adjusted for the interest expense relating to cost of financing the acquisition) to the net profit of the Group. If the acquisition had taken place at the beginning of the year, the profit of the Group in 2006 would have been RR 2,006,339 (i.e. aggregate profit of the Group and Masterlek as adjusted for the additional interest expense relating to cost of financing the acquisition) and revenue of the Group in 2006 would have been RR 9,374,153.

6. Segment Information

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

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, receivables and operating cash. There were no assets unallocated to segments as of 31 December 2007 and 2006. Seg-

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

ment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Segment result is segment revenue less segment expenses. Segment expenses consist of cost of sales, selling and distribution costs, general and administrative expenses and other income and expenses that can be directly attributed to the segment on a reasonable basis. Capital expenditure comprises additions to property, plant and equipment. Impairment loss and provisions relate only to those charges made against allocated assets.

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

Year ended 31 December 2007	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Eliminations	Group
Sales to external customers	9,762,637	1,608,708	–	11,371,345
Total revenue	**9,762,637**	**1,608,708**	**–**	**11,371,345**
Gross profit	6,127,524	724,072	–	6,851,596
Segment result	**4,163,254**	**450,333**	**–**	**4,613,587**
Financial expense, net				(291,638)
Profit before income tax				4,321,949
Income tax expense				(1,058,709)
Net profit				**3,263,240**
Segment assets	13,711,609	1,582,516	–	15,294,125
Total assets	**13,711,609**	**1,582,516**	**–**	**15,294,125**
Segment liabilities	1,208,628	96,362	–	1,304,990
Unallocated liabilities				4,386,442
Total liabilities				**5,691,432**
Capital expenditure (Note 8)	446,758	37,375	–	484,133
Intangible assets acquisition (Note 9)	165,220	–	–	165,220
Non-current financial asset acquisition (Note 14)	245,398	–	–	245,398
Depreciation and amortisation	466,755	60,845	–	527,600

Year ended 31 December 2006	Production and wholesale of pharmaceutical products	Production and wholesale of medical equipment	Eliminations	Group
Sales to external customers	7,326,380	1,196,400	–	8,522,780
Inter-segment sales	–	15,867	(15,867)	–
Total revenue	**7,326,380**	**1,212,267**	**(15,867)**	**8,522,780**
Gross profit	4,551,045	396,091	(5,593)	4,941,543
Segment result	**2,817,508**	**155,543**	**(5,593)**	**2,967,458**
Financial expense, net				(267,376)
Profit before income tax				2,700,082
Income tax expense				(664,014)
Net profit				**2,036,068**
Segment assets	12,106,791	1,663,038	–	13,769,829
Total assets	**12,106,791**	**1,663,038**	**–**	**13,769,829**
Segment liabilities	1,380,061	115,395	–	1,495,456
Unallocated liabilities				5,934,010
Total liabilities				**7,429,466**
Capital expenditure (Note 8)	882,139	58,455	–	940,594
Intangible assets acquisition (Note 9)	84,317	–	–	84,317
Depreciation and amortisation	226,076	58,721	–	284,797

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

7. Balances and Transactions with Related Parties

In accordance with IAS 24 "Related Party Disclosures", parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions or if parties are under common control (this includes parents, subsidiaries and fellow subsidiaries). In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form.

Related parties may enter into transactions which unrelated parties might not enter, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

The nature of the related party relationships for those related parties with whom the Group entered into transactions or had balances outstanding at 31 December 2007 and 2006 are detailed below.

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

Balances with related parties:

2007	Trade receivables Note 12	Short-term financial assets Note 14	Cash and cash equivalents Note 13 (c)	Trade payables, other payables and accruals – (a) Note 17
Other related parties[1]	–	5,111	168,836	6,990
Total	**–**	**5,111**	**168,836**	**6,990**

2006	Trade receivables Note 12	Short-term financial assets Note 14	Cash and cash equivalents Note 13 (c)	Trade payables, other payables and accruals – (b) Note 17
Other related parties[1]	18,974	30,264	124,632	824,723
Total	**18,974**	**30,264**	**124,632**	**824,723**

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

(b) This balance represented obligation for the voting shares of OJSC "TZMOI" originated from their acquisition in 2005 and 2006 which was fully paid in 2007.

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

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

Caption	Interest rate %		Maturity period	
	2007	2006	2007	2006
Current loans and deposits to related parties	2%	2%	3 months	1-12 months

Cash balances with related bank carry no interest. Cash equivalents represented by deposits with related bank carry 9% interest p.a.

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

Transactions with related parties included in the statement of operations:

Statement of operations caption	Relationship	2007	2006
Sales of medical equipment	Other related parties[1]	–	4,167
License fee (included in distribution costs) (A)	Other related parties[1]	24,522	18,686
Warehouse rental expenses (included in distribution costs) (B)	Other related parties[1]	30,532	19,915
Office rental expenses (included in general and administrative expenses) (B)	Other related parties[1]	14,473	9,494

(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.

(B) Rental expenses

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

Acquisition of intangible assets

In 2007, the Group acquired an intangible asset (trade mark) for RR 160,000 (2006: RR 84,317) from an other related party.

Sale of OJSC "Pharmstandard-Octyabr" buildings

In 2006, the Group terminated operations of "Pharmstandard-Octyabr" OJSC. As a result, buildings of "Pharmstandard-Octyabr" OJSC with the carrying value of RR 103,000 were sold to an other related party in 2006 for cash consideration equal to their carrying value.

Shareholder's loan for Masterlek acquisition

On 2 August 2006, the Group received a loan from the Company's shareholder in the amount of US$ 146,200 thousand (RR 3,912,385) for CJSC "Masterlek" acquisition (Note 5). The loan attracted interest rate of 12% per annum.

In December 2006 this shareholder's loan was refinanced by the syndicated borrowing organised by Citibank (Note 15). Total interest expense incurred in respect of the shareholder's loan was RR 176,057.

Compensation to key management personnel

Key management personnel comprise 3 persons as of 31 December 2007 and 2006. Total compensation to key management personnel, amounted to RR 82,257 for the year ended 31 December 2007 (2006: RR 16,129). Such compensation represented the following short-term employee benefits: (i) payroll and bonuses included in general and administrative expenses and (ii) one-off remuneration for achievement of the IPO-related targets (Notes 18 and 23) included in other expenses in the statement of operations.

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

8. Property, Plant and Equipment

Property, plant and equipment and related accumulated depreciation consist of the following:

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

(a) Impaired assets represented equipment for production of needles for syringes which was terminated by the Group due to low profitability. The impairment charge presented in the table equals to the carrying value of that equipment.

31 December 2006	Land	Buildings	Plant and machinery	Equipment and motor vehicles	Assets under construction	Total
Cost						
Balance at 31 December 2005	**49,101**	**1,591,342**	**1,162,705**	**55,521**	**689,091**	**3,547,760**
Additions	12,738	–	235,693	71,806	620,357	940,594
Acquisition through business combination (Note 5)	–	–	–	4,851	–	4,851
Transfers	–	456,593	590,275	27,869	(1,074,737)	–
Disposals	(24,185)	(234,585)	(55,459)	(13,516)	(6,543)	(334,288)
Balance at 31 December 2006	**37,654**	**1,813,350**	**1,933,214**	**146,531**	**228,168**	**4,158,917**
Accumulated Depreciation						
Balance at 31 December 2005	**–**	**71,929**	**109,759**	**17,144**	**–**	**198,832**
Depreciation charge	–	55,034	146,536	13,929	–	215,499
Transfers	–	79	(7,234)	7,155	–	–
Disposals	–	(15,717)	(20,938)	(7,340)	–	(43,995)
Balance at 31 December 2006	**–**	**111,325**	**228,123**	**30,888**	**–**	**370,336**
Net Book Value						
Balance at 31 December 2005	49,101	1,519,413	1,052,946	38,377	689,091	3,348,928
Balance at 31 December 2006	**37,654**	**1,702,025**	**1,705,091**	**115,643**	**228,168**	**3,788,581**

The Group did not use borrowings to finance capital expenditures, thus no interest expense was capitalized in 2007 and 2006.

The Group assets include only a minor portion of the land on which the Group's factories and buildings, comprising the Group's principal manufacturing facilities, are located, whilst the major portion of the land is held under operating lease agreements with the state municipal bodies (Note 4). The total amount of rental payments for the use of the land during 2007 was RR 8,382 (2006: RR 7,962). Such payments are assessed by the state authorities on an annual basis. No such assessment has been completed for 2008.

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

9. Intangible Assets

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

	Goodwill	Trademarks	Total
Cost			
Balance at 31 December 2005	**218,854**	**2,645**	**221,499**
Additions	–	84,317	84,317
Acquisition through business combination (Note 5)	961,615	3,278,151	4,239,766
Disposals	–	(2,645)	(2,645)
Balance at 31 December 2006	**1,180,469**	**3,362,468**	**4,542,937**
Accumulated Amortisation			
Balance at 31 December 2005	**–**	**–**	**–**
Amortisation expense	–	69,298	69,298
Balance at 31 December 2006	**–**	**69,298**	**69,298**
Net Book Value			
Balance at 31 December 2005	218,854	2,645	221,499
Balance at 31 December 2006	**1,180,469**	**3,293,170**	**4,473,639**

Impairment testing of goodwill

Goodwill acquired through business combinations before 2007 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	
	2007	2006	2007	2006	2007	2006
Carrying amount of goodwill	961,615	961,615	218,854	218,854	1,180,469	1,180,469

The recoverable amount of the cash-generating units has been determined based on a value in use calculation using cash flow projections based on financial budgets approved by management covering a five-year period and cash flows beyond the five-year period are extrapolated using a 20% and 5% growth rate that is the same as the mid-term average growth rate for Pharmaceuticals and Equipment groups of cash-generating units, respectively. The discount rate applied to cash flow projections is 13%.

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;
- Growth rate used to extrapolate cash flows beyond the budget period.

Discount rates - Discount rates reflect management's estimate of the risks specific to each group of units. This is the benchmark used by management to assess operating performance and to evaluate future investment proposals. In determining appropriate discount rates for each group of units, regard has been given to the inter-bank interest rate approved by Central Bank of Russian Federation at the beginning of the budgeted year.

Raw material price inflation – past actual raw materials price movements have been used as an indicator of future price movements.

Growth rate estimates – Rates are based on published industry research.

Sensitivity to changes in assumptions

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

10. Non-Current Assets Classified as Held for Sale

The Company's management approved a plan to dispose "TMK" LLC in 2007. "TMK" LLC represents a minor part of the medical equipment and disposables business segment with a total net assets (primarily property, plant and equipment) of RR 164,101. The fair value less the cost of sale of "TMK" LLC is estimated based on the selling price, preliminarily agreed with a third party, amounting to RR 140,000 (Note 28). A loss on non-current assets classified as held for sale amounting to RR 24,101 was recognised in the statement of operations (Note 23).

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

The remainder of the non-current Assets Classified as Held for Sale amounting to RR 18,855 represent some non-current assets located in St-Petersburg where the Group terminated production operations in 2006. The Group has approved plan for their disposal.

Non-current assets classified as held for sale reflected in the balance sheet as of 31 December 2006 amounting to RR 22,655 were sold in February 2007 for a cash consideration of US$ 1,311 thousand (RR 34,133).

11. Inventories

Inventories consist of the following:

	2007	2006
Raw materials - at cost	841,703	748,619
Work in progress - at cost	134,554	96,948
Finished goods:		
- at cost	851,052	596,992
- at net realisable value	783,938	561,385
	1,760,195	**1,406,952**

The amount of write-down of inventories recognised as an expense in 2007 is RR 43,224 (2006: RR 32,606). This expense is included in the cost of sales line item as a cost of materials and components, which is disclosed in Note 20.

12. Trade Receivables

	2007	2006
Trade receivables (net of allowance for impairment of receivables of RR 167,933 (2006: RR 79,308))	4,176,200	3,373,741
	4,176,200	**3,373,741**

At 31 December 2007 RR 129,304 of trade receivables were denominated in currencies other than Russian Roubles, primarily in US$ (2006: RR 68,549).

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

	2007	2006
Balance at 1 January	79,308	83,049
Additional allowance	95,483	10,596
Written off during the year	(6,858)	(14,337)
Balance at 31 December	**167,933**	**79,308**

13. Cash and Cash Equivalents

Cash and cash equivalents consist of the following:

	2007	2006
Cash in bank – Russian Roubles	119,126	158,239
Cash in bank – US$ and Euro	13,463	34,727
Short-term bank deposits with original maturity less than 90 days – Russian Roubles	60,000	–
	192,589	**192,966**

Short term deposits carry interest at 9% per annum.

14. Financial Assets

Short-term financial assets

	2007	2006
Promissory notes	81,300	34,466
Loans to related parties (Note 7)	5,111	30,264
Trading securities and other	25,488	40,136
	111,899	**104,866**

Long-term financial assets

	2007	2006
Non-listed shares	245,398	–
	245,398	**–**

In December 2007, the Group acquired 19.88% of "Dipaka Trading Limited", a company registered under the laws of Cyprus, for cash consideration of US$10 million (RR 245,398). This company is the sole shareholder of the Russian company "Mirpharm" which is involved in pharmaceutical production and distribution and researching. Also, "Dipaka Trading Limited" owns several medical patents and trade marks.

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

15. Borrowings and Loans

	2007	2006
Long-term borrowings and loans		
(a) Syndicated borrowing organised by Citibank ("Citibank loan")	3,256,151	3,844,341
(b) Other loans	8,799	31,071
Less: Current portion of long-term borrowings and loans	(1,310,374)	(351,415)
	1,954,576	**3,523,997**

Long-term debt is repayable as follows:

	2007
1 to 2 years	1,319,198
2 to 3 years	317,628
3 to 4 years	317,750
	1,954,576

As at 31 December 2007 and 2006 all the borrowings are US$ denominated. The foreign exchange risk in this respect is not covered by any derivative instruments.

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

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

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

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

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

In addition to interest, the Group is obliged to reimburse mandatory administrative costs, if any incurred by Citibank in connection with the Citibank loan.

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

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

In 2007, the Group repaid US$ 13,346 thousand (RR 329,726) of the Citibank loan.

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

16. Other Taxes Payable

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

	2007	2006
Value-added tax	157,585	112,482
Property and other taxes	55,221	35,977
	212,806	**148,459**

17. Trade and Other Payables and Accruals

	2007	2006
Trade payables	766,007	1,071,596
Other payables – related party (Note 7)	6,990	824,723
Other payables and accruals	273,523	196,563
	1,046,520	**2,092,882**

At 31 December 2007 RR 274,167 of trade payables were denominated in currencies other than Russian Rouble, primarily in US$ (2006: RR 414,022).

18. Share Capital

In accordance with its charter documents the share capital of the Company is RR 37,793. The authorised number of ordinary shares is 37,792,603 with par value of 1 (one) Russian Ruble. All authorised shares are issued and fully paid. There were no transactions with own shares during 2007.

As at 31 December 2007 and 2006 more than half of voting shares of OJSC "Pharmstandard" were held by "Augment Investments Limited" ("Augment"), a company registered under the laws of Cyprus. None of Augment participants held more than 50% interest in the Company and as a result no individual party ultimately controlled the Group as at 31 December 2007 and 2006 (Note 28).

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

In accordance with Russian legislation, dividends may only be declared from accumulated undistributed and unreserved earnings as shown in Russian statutory financial statements. The Company had approximately RR 3,782,223 of undistributed and unreserved earnings as at 31 December 2007 (2006: RR 2,114,304). In addition, the

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

Company's share in the undistributed and unreserved earnings of the subsidiaries was approximately RR 7,698,340 as at 31 December 2007 (2006: RR 5,938,296).

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

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

Earnings per Share

Earnings per share calculated retrospectively are as follows:

	2007	2006
Weighted average number of ordinary shares outstanding	37,793,603	37,793,603
Profit for the year attributable to the shareholders	3,227,895	1,897,671
Basic and diluted earnings per share, Russian Roubles	85.41	50.21

19. Revenue - Sale of Goods

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

Sales breakdown by product groups comprised the following:

Product group	2007	2006
Pharmaceutical products		
OTC		
Branded	7,547,567	5,340,643
Non-branded	687,630	690,844
	8,235,197	**6,031,487**
Prescription		
Branded	1,207,026	899,273
Non-branded	265,836	299,240
	1,472,862	**1,198,513**
Other	54,578	96,380
Total pharmaceutical products	**9,762,637**	**7,326,380**
Medical equipment and disposables	1,608,708	1,196,400
	11,371,345	**8,522,780**

20. Cost of Sales

The components of cost of sales were as follows:

	2007	2006
Materials and components	2,997,475	2,360,659
Production overheads	815,557	757,616
Depreciation and amortisation	481,309	260,285
Direct labour costs	225,408	202,677
	4,519,749	**3,581,237**

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

21. Selling and Distribution Costs

Selling and distribution costs were as follows:

	2007	2006
Advertising	753,580	665,108
Labour costs	397,082	215,607
Freight, communication and insurance of goods in transit	126,817	129,831
Utilities and other services	27,031	17,428
Certification expenses	29,092	32,300
Rent	35,211	39,593
Commission and license fee	105,681	75,922
Materials and maintenance	43,430	28,587
Travel and entertainment	43,986	23,397
Depreciation	27,920	10,485
Other expenses	36,211	29,902
	1,626,041	**1,268,160**

The Group entered into a number operating lease agreements for warehouses. Rental agreements are revised on an annual basis. Future minimum operating lease payments classified as selling and distribution costs will not substantially change in 2008 compared to 2007.

22. General and Administrative Expenses

General and administrative expenses were as follows:

	2007	2006
Labour costs	356,500	288,016
Utilities and services	48,050	87,637
Taxes other than income tax	17,589	18,362
Property insurance	13,481	15,772
Freight and communication	20,142	16,159
Depreciation	18,371	14,027
Rent	34,286	22,534
Materials and maintenance	19,745	11,005
Other	42,355	25,417
	570,519	**498,929**

The Group entered into a number operating lease agreements for office premises. Rental agreements are revised on annual basis. Future minimum operating lease payments classified as are general and administrative expense will not substantially change in 2008 compared to 2007.

23. Other Income and Other Expenses

Other income comprised the following:

	2007	2006
Gain from sale of non-current assets classified as held for sale (Note 10)	11,478	–
Gain from disposal of property, plant and equipment and investments property	3,566	
Foreign exchange gain	259,098	–
	274,142	**–**

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

Other expenses comprised the following:

	2007	2006
Impairment of equipment (Note 8)	42,403	–
Legal, audit, one-off management remuneration (Note 7) and other non-recurring expenses incurred in connection with IPO (Note 18)	110,016	–
Loss from disposal of property, plant and equipment	–	160,145
Charity	4,114	13,082
Other taxes	56,381	32,027
Write-off other short-term financial assets	13,657	–
Loss recognised on non-current assets classified as held for sale (Note 10)	24,101	–
Other	64,919	1,742
	315,591	**206,996**

24. Financial Income and Expense

Financial income and expense comprised the following:

	2007	2006
Interest income:		
Income from changes of fair value of financial assets recognised in the statement of operations	10,578	–
Income from Interest Rate Swap (Notes 15 and 27)	6,790	–
Interest income from loans and deposits	11,361	23,987
	28,729	**23,987**
Interest expense:		
Expense from changes in fair value of the Interest Rate Swap (Notes 15 and 27)	44,598	–
Interest expenses on finance lease	–	18,356
Interest expense on borrowings and loans	275,769	273,007
	320,367	**291,363**

25. Income Tax

	2007	2006
Income tax expense – current	1,106,218	811,991
Correction of prior periods after reconciliation with tax authorities (a)	(14,480)	–
Deferred tax expense – origination and reversal of temporary differences	(33,029)	(147,977)
Income tax expense	**1,058,709**	**664,014**

(a) The Group identified overpayment of income tax in prior periods as a result of routine reconciliation with tax authorities. As a result, the respective receivable from the budget was recognised.

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

	2007	2006
Profit before income tax	4,321,949	2,700,082
Theoretical tax charge at statutory rate of 24%	1,037,268	648,020
Correction of prior periods after reconciliation with tax authorities	(14,480)	–
Tax effect of items which are not deductible or assessable for taxation purposes:		
Interest rate swap	10,704	–
Non-deductible expenses and other	25,217	15,994
Income tax expense	**1,058,709**	**664,014**

Movements in deferred tax balances were as follows:

	31 December 2005	Differences recognition and reversal	Effect of business combination in 2006 (Note 5)	31 December 2006	Differences recognition and reversal	31 December 2007
Tax effects of deductible temporary differences – asset (liability):						
Property, plant and equipment (Note 8)	(375,982)	34,994	–	(340,988)	(19,371)	(360,359)
Intangible assets (Note 9)	–	64,990	(786,756)	(721,766)	24,740	(697,026)
Trade and other receivables	(51,646)	6,689	–	(44,957)	49,356	4,399
Inventories	(13,835)	17,522	(3,482)	205	(18,483)	(18,278)
Trade and other payables	–	18,628	2,896	21,524	(1,868)	19,656
Other	–	5,154	–	5,154	(1,345)	3,809
Total net deferred tax liability	**(441,463)**	**147,977**	**(787,342)**	**(1,080,828)**	**33,029**	**(1,047,799)**

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

The aggregate amount of temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognised was approximately RR 7,698,340 as at 31 December 2007 (2006: RR 5,938,296).

26. Contingencies, Commitments and Operating Risks

Operating environment of the group

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russian Federation 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.

Taxation

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

As at 31 December 2007 management believes that its interpretation of the relevant legislation is appropriate and that the Group's tax, currency and customs positions will be sustained.

Because of the uncertainties associated with the Russian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as of

31 December 2007. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Should the Russian tax authorities decide to issue a claim and prove successful in the court, they would be entitled to recover the amount claimed, together with fines amounting to 20% of such amount and interest at the rate of 1/300 of the Central Bank of Russian Federation rate for each day of delay for late payment of such amount. Management believes that it is not probable that the ultimate outcome of such matters would result in a liability. Therefore, no provision for these contingencies was recorded in the accompanying financial statements.

Insurance policies

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

27. Financial Instruments and Financial Risk Management Objectives and Policies

Fair values

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

	2007		2006	
	Fair value	Net carrying value	Fair value	Net carrying value
Financial assets				
Cash and cash equivalents (Note 13)	192,589	192,589	192,966	192,966
Short-term loans to related parties (Note 7)	5,111	5,111	30,264	30,264
Promissory notes (Note 14)	81,300	81,300	34,466	34,466
Other short-term investments (Note 14)	25,488	25,488	40,136	40,355
Long-term investment in non-listed shares (Note 14)	245,398	245,398	–	–
Financial liabilities				
Borrowings and loans (Note 15)	3,264,950	3,264,950	3,875,412	3,875,412
Derivative financial instruments	44,598	44,598	–	–
Other non-current liabilities	36,826	36,826	47,767	47,767

Fair values of long-term borrowings and loans are approximately equal to their carrying value as they are based on variable interest rates (LIBOR). Fair value of other non-current liabilities and derivative financial instruments (see below) has been calculated by discounting the expected future cash flows at prevailing interest rates.

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

Fair value of long-term investment in non-listed shares has been determined by reference to its recent purchase price (see Note 14). Fair values of other items above approximate their carrying amounts due to their short maturity.

Financial risk management objectives and policies

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

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

Interest rate risk

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

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

	Increase/decrease in basis points	Effect on statement of operations (interest expense), US$ thousand	Effect on statement of operations (due to fair value change), US$ thousand
As at 31 December 2007			
US Dollar	200	(2,653)	2,093
US Dollar	(200)	2,653	(3,288)
As at 31 December 2006			
US Dollar	200	(2,920)	–
US Dollar	(200)	2,920	–

Foreign exchange risk

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

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

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

	Increase/decrease in US$ rate	Effect on profit before tax, RR
As at 31 December 2007		
US$/Roubles exchange rate	+7%	(233,902)
US$/Roubles exchange rate	-7%	233,902
As at 31 December 2006		
US$/Roubles exchange rate	+7%	(291,473)
US$/Roubles exchange rate	-7%	291,473

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 payables which normally have maturity periods shorter than 90 days.

As at 31 December 2007	Total	Less than 3 months	3 to 6 months	6 to 12 months	1 to 5 years
Borrowings (a)	3,709,520	379,335	379,335	758,669	2,192,181
Other non-current liabilities	79,825	–	–	12,347	67,478
Total	**3,789,345**	**379,335**	**379,335**	**771,016**	**2,259,659**

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

As at 31 December 2006	Total	Less than 3 months	3 to 6 months	6 to 12 months	1 to 5 years
Borrowings (a)	4,525,693	67,427	67,427	486,268	3,904,571
Financial liabilities (b)	824,723	389,770	434,953	–	–
Other non-current liabilities	99,110	–	–	11,665	87,446
Total	**5,449,526**	**457,197**	**502,380**	**497,933**	**3,992,017**

(a) The Citibank loan received in 2006 (see Note 15 for details) is including contractual principal amount of a debt and interests at the LIBOR rate interest calculated at 31 December 2007 and 2006.

(b) This balance represents the obligation for the voting shares of OJSC "TZMOI" originated from their acquisition in 2005 and 2006 which was fully paid in 2007 (see Note 7).

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 regularly monitors sales and receivables conditions using effective internal control procedures.

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

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

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

	Total	Neither impaired nor past due	Not impaired but past due				
			less 1 month	1-2 months	2-3 months	3 to 6 months	> 6 months
31 December 2007	4,176,200	3,240,772	792,664	66,548	49,989	22,335	3,892
31 December 2006	3,373,741	2,682,810	340,278	109,186	60,650	156,240	24,577

Sales concentration to a small group of customers

The Group works with five distributors that together represent about 50% of the Group's revenue for 2007 and 2006. Given the Russian market structure limited number of large distributors is not unusual and due to the strong relationships with these distributors, management considers the related credit risk concentration as normal. The Group has no other significant concentrations of credit risk.

Capital Risk Management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt (while taking into consideration terms and conditions set by the Citibank Loan Agreement, Note 15).

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

	2007	2006
Borrowings and loans	3,264,950	3,875,412
Trade and other payables	1,046,520	2,092,882
Less: cash and cash equivalents	(192,589)	(192,966)
Net debt	4,118,881	5,775,328
Equity	9,041,814	5,876,699
Capital and net debt	13,160,695	11,652,027
Gearing ratio	**31%**	**50%**

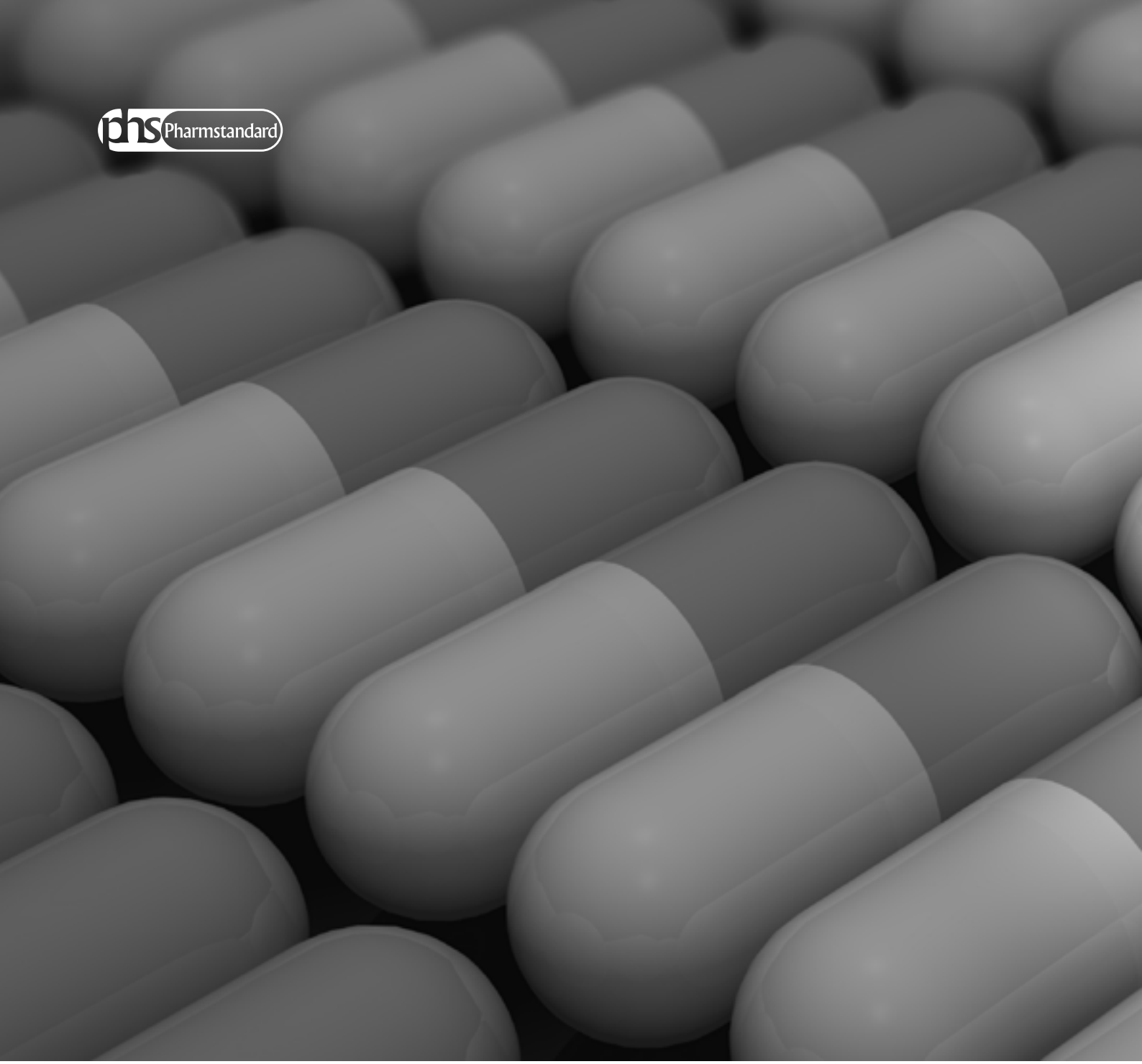
28. Post Balance Sheet Events

Ultimate controlling party

On 26 March 2008, Victor Kharitonin, a Russian citizen obtained control over more than a half of voting shares of the Company. Therefore he became the Group's ultimate controlling party since that date.

Sale of non-current assets

The non-current assets classified as held for sale carried in the balance sheet as at 31 December 2007 in the amount of RR 140,000 and represented by TMK LLC (Note 1), were sold in March 2008 for cash consideration of RR 140,000.



Our production capacity of 1,3 billion packs is one of the largest among domestic pharmaceutical companies in Russia. Each of our five modern manufacturing facilities is certified to be compliant with Russian good manufacturing practice (“GMP”) standards.

05 Contacts

On any questions, please, contact us by e-mail or by regular mail with the following details:

5 'B' Likhachevsky proezd, Dolgoprudny town, Moscow region, Russia, 141700, OJSC "Pharmstandard"

e-mail: ir@pharmstd.ru

phone: +7 (495) 970 00 30

fax: +7 (495) 970 00 32