Pharmstandard




# ANNUAL REPORT

2014

## Mission

Development and manufacture of advanceв pharmaceutical products, which meet healthcare requirements and patients' expectations

## Strategy

Raising share of high margin drugs in portfolio of the Company

Strengthening of the extent of drugs production localization within the joint projects with the leading international pharmaceutical companies

Expansion of Company's participation in the governmental import substitution program

Development and launch of new drugs, expansion of range of dosage forms and dosages of manufactured drugs for maximum satisfaction of market demands and customers' expectations

Automation of production planning processes with the view of raising efficiency of process management and strengthening of focus on cost control

# CEO Statement

## Dear shareholders, investors and partners!

I welcome the opportunity to present you the Company's Annual Report for 2014.

Last year was the year of challenges both for the country in general and the Company. Exceptional depreciation of Russian ruble in the second half of 2014 jeopardized the vector of further development of Russian economy.

Current market situation also had a significant effect to the financial position and operating results of the Company. On the one hand, a significant part of costs of sales was denominated in rubles. On the other hand, despite the state regulation of ceiling prices of VEDs (vital and essential drugs), which represent 52% share in the Company's revenues, to some extent we managed to compensate USD-denominated costs of sales and even improve our gross margin (+1%).

The revenues of the Company were RUB41.2bn (or RUB34.7bn without operating results of PAO "OTCPharm") in 2014. In this connection the business profitability improved: our EBITDA margin went up by 7% and reached 36.2%, net margin increased by more than 7% up to 27%. Net cash of the Group showed a growth by 11% and reached RUB10.9bn.

Proper cash management policy helped us to minimize currency risks. In the second half of 2014 we transferred a substantial portion of supply contracts to the settlements in rubles. In addition, during 2014 we accumulated considerable portion of US Dollars and Euro (by the end of 2014, 67% of available cash were denominated in foreign currency, while there were almost lack of accounts and deposits in foreign currency by the end of 2013). This resulted to a foreign currency gain in the amount of RUR 1.6 billion.

The geopolitical situation that developed in 2014 forced public authorities to raise a burning question of reduction of country's dependence on the imported goods. The Government declared their intention to reshape the pattern of national economy development and shift to substitution of imported technologies in strategically important sectors of economy, including pharmaceutical industry. According to our estimates, the substantial portion of consuption in pharmaceutical industry fell to the imported goods. We've already seen in our industry various governmental incentives aimed at promotion of local production. Moreover, a range of such incentives is rather large, varying between expansion of government procurement and investments in development of new plants and increasing of import custom duties on the finished products and decreasing of duties on some kinds of raw materials and components used for medicine manufacturing. We expect the import substitution policy to have a positive effect to the industry in general, just in the mid-term future.

In the near term, the import substitution will unleash the opportunity of production localization for the international companies. Pharmstandart, holding the unique manufacturing opportunities and facilities in Russia, can become a reliable partner in this area and is ready to provide a manufacturing site. We already develop the production localizing projects with some of our foreign colleagues, and negotiate several other promising projects now.

The changes in market conditions and spin-off of over-the-counter business require the search of new ways of Company's development. In this concern we began shaping the revised strategy of development (please, see the essentials of the strategy in Strategy section), which will be aimed at revenues raising through the increase in production of high-margin medicine, development of partner programs, i.e. manufacturing of third-parties medicine, expansion of participation in governmental procurement programs, production of new drugs, expansion of dosage forms and dosages line. In order to reach the above goals, the management team will be strengthened with the specialists in various fields. This strategy shall be implemented within the conditions of maintaining and increasing of production capacities. This year we continued investing in development and expansion of production capacities of our manufacturing plants. Our capital expenditure in 2014 amounted to RUB2.4bn and was mostly applied to the construction of new plant in Ufa, reconstruction of existing facilities in Tomsk and Kursk and procurement of new equipment. We also hope to go on with fruitful and mutually beneficial cooperation with PJSC "OTCPharm" for contract manufacturing.

At the end of 2014, I have been appointed as a General Director, and I would like to thank Igor Krylov, who managed Pharmastandart more than 8 year, and I appreciate his critical contribution to the development of our Company and his long service resulted in Company's leadership in Russian market.

The results of company's operations are its achievements – it's a hard day-to-day work of the team of professionals. Let me take this opportunity to thank every employee of the Company for his or her contribution to our development, for professionalism and concerned attitude to the work, without which one can hardly imagine the successful development of Pharmstandart.

**Vladimir Chupikov,**
Chief Executive Officer Pharmstandard OJSC

# Management Responsibility Statement

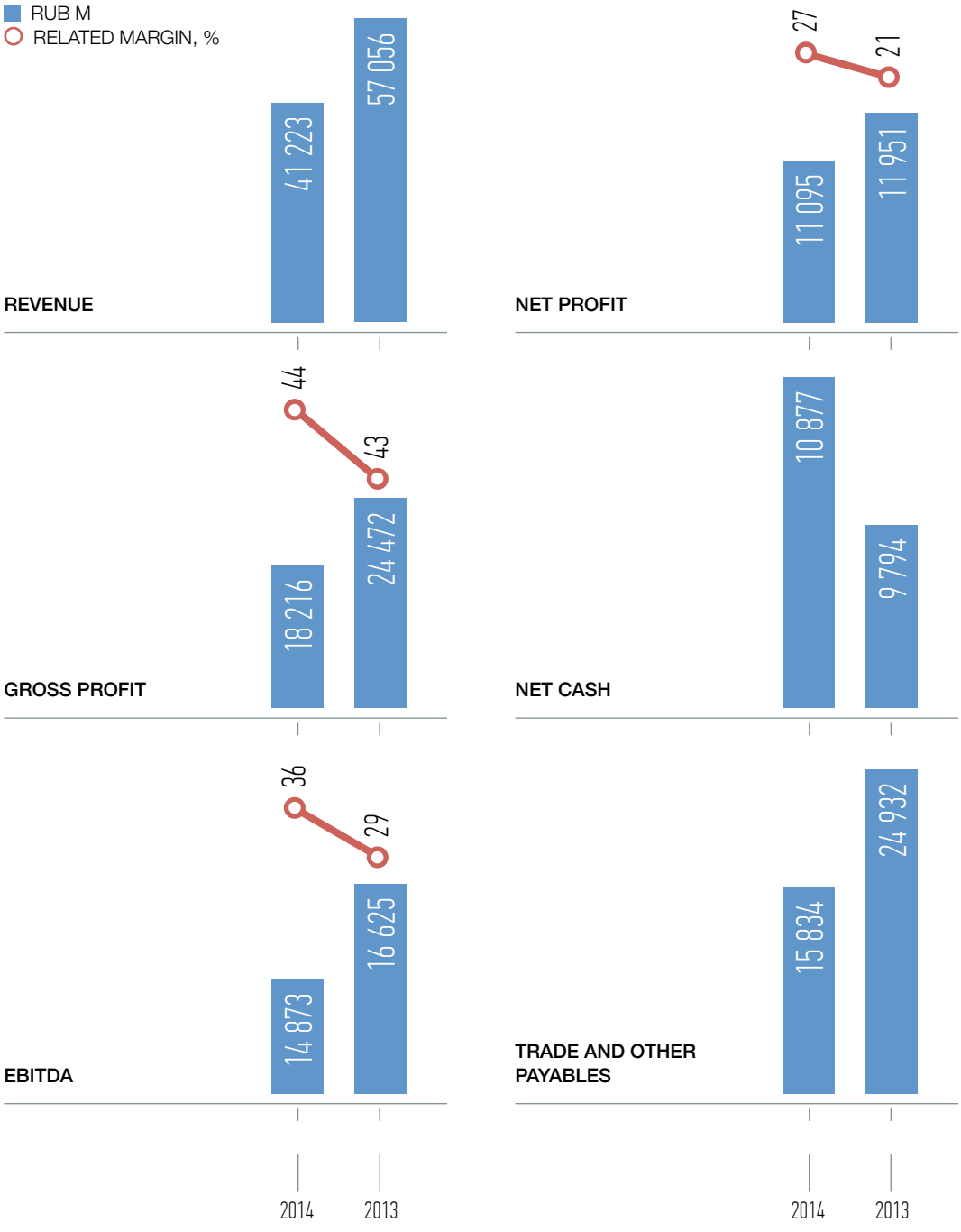
Directors are responsible for preparing this Annual Report of Pharmstandard OJSC ("Pharmstandard" or the "Company") including consolidated financial statements in accordance with applicable laws and regulations. Each of the current Directors whose names and functions are listed in the Corporate Governance Section of the 2014 Annual Report confirms that, to the best of his or her knowledge:

- the Company's IFRS consolidated financial statements provide a true and fair view of its assets, liabilities, financial position and earnings;
- Business Section of the Annual Report includes a fair review of the Company's business development and performance, its industry position as well as a description of key risks and uncertainties impacting the Company's business.

**Vladimir Chupikov,**
Chief Executive Officer Pharmstandard OJSC

# Performance Highlights

In 2014, despite a decrease in revenue following OTC business spin-off, Company's financial position is now highly sustainable: we increased profitability of the business with a simultaneous improvement of the liquidity position (cash and ST investments increased, while trade and financial liabilities decreased).



# Calendar of Major Events

## On 27 June 2014, the Annual General Meeting of shareholders was held

Based on the voting results, the AGM has passed the following resolutions:

1. To approve the annual report, annual financial accounts, statement of profit or loss of Pharmstandard OJSC, and the allocation of profit and loss of the Company based on 2013 FY results.

2. To forego the payment of 2013 dividends for common shares in Pharmstandard OJSC.

3. To elect the following members of the Board of Directors of Pharmstandard OJSC:
   - Arkhangelskaya Elena Vladimirovna
   - Dushelikhinsky Sergey Yurievich
   - Fedlyuk Viktor Pavlovich
   - Goryunov Roman Yurievich
   - Kharitonin Victor Vladimirovich
   - Krylov Igor Konstantinovich
   - Kulkov Egor Nikolaevich
   - Nosyrev Pavel Vladimirovich
   - Reus Andrey Georgeevich
   - Shuster Alexander Mikhaylovic
   - Tyryshkin Ivan Alexandrovich.

4. To elect the following members of the Audit Committee of Pharmstandard OJSC:
   - Gadelia Inna Vianorovna
   - Kropacheva Yulia Evgenyevna
   - Kuznetsov Andrey Vladimirovitch.

5. To appoint the auditors for Pharmstandard OJSC for 2014:
   - **Financial and Accounting Consultants LLC –** for accounts auditing under the Russian Accounting Standards (RAS)
   - **Ernst & Young LLC –** for accounts auditing under the International Financial Reporting Standards (IFRS).

6. To approve the restated Charter of Pharmstandard OJSC.

7. To approve the restated Regulations on Preparation and Holding of Annual General Meetings of Shareholders of Pharmstandard OJSC.

8. To approve the restated Regulations on the Board of Directors of Pharmstandard OJSC.

9. To approve the restated Regulations on the Chief Executive Officer of Pharmstandard OJSC.

## On 24 July 2014, Pharmstandard OJSC and Millhouse completed the acquisition of stakes in Biocad Holding Ltd.

Pharmstandard OJSC and Millhouse announced that they had completed individual acquisitions of stakes in Biocad Holding Ltd. – the majority shareholder in a Russian Biocad CJSC ("Biocad").

Biocad is engaged in the development, production and promotion of its proprietary and generic drugs in such therapeutic categories like urology, gynecology, dermatovenerology, oncology, hematology, autoimmune and infectious diseases.

Under the terms of the deal, Pharmstandard acquired a 20% stake in Biocad Holding Ltd., and a Millhouse affiliated entity purchased a 50% stake in Biocad Holding Ltd.

This acquisition was financed from Pharmstandard's internal funds.

## Merck and Pharmstandard announced the cooperation in local manufacturing of Rebif® – a MS treatment drug

Merck and Pharmstandard OJSC ("Pharmstandard") have entered into a number of partnership agreements aimed at the long-term cooperation in manufacturing, distribution and marketing of Merck's Rebif®. The medication will be manufactured at Pharmstandard-UfaVITA plant in Ufa.

Rebif® is used as a first-line MS therapy according to the international standards for MS treatment. The Ministry of Healthcare of the Russian Federation has been purchasing interferon beta-1a, including Rebif®, for MS patients under 7 High-Cost Nosologies Federal Program (a public drug benefit program) for a number of years. Currently about 15% of patients with relapsing-remitting MS indicated for medical treatment receive Rebif®. As a result of Rebif® manufacturing localization in Russia the drug will become more accessible for this socially significant category of patients.

**About Merck.** Merck is a leading company for innovative and top-quality high-tech products in pharmaceutical and chemical sectors. Around 39,000 employees work in 66 countries to improve the quality of life for patients, to further the success of our customers and to help meet global challenges. The group operates under the Merck name and brand. Holding c. 70% interest, the founding family remains the majority owner of the company to this day, the other 30% of the equity belong to the shareholders. In 1917, a US division of Merck & Co was expropriated and since then has been operating as an independent company.

## On 29 November 2014 Vladimir Chupikov appointed as CEO of the Company

Igor Krylov left the Company and resigned from his position as CEO of Pharmstandard OJSC effective 28 November 2014. Vladimir Chupikov appointed as CEO of Pharmstandard OJSC effective 29 November 2014.

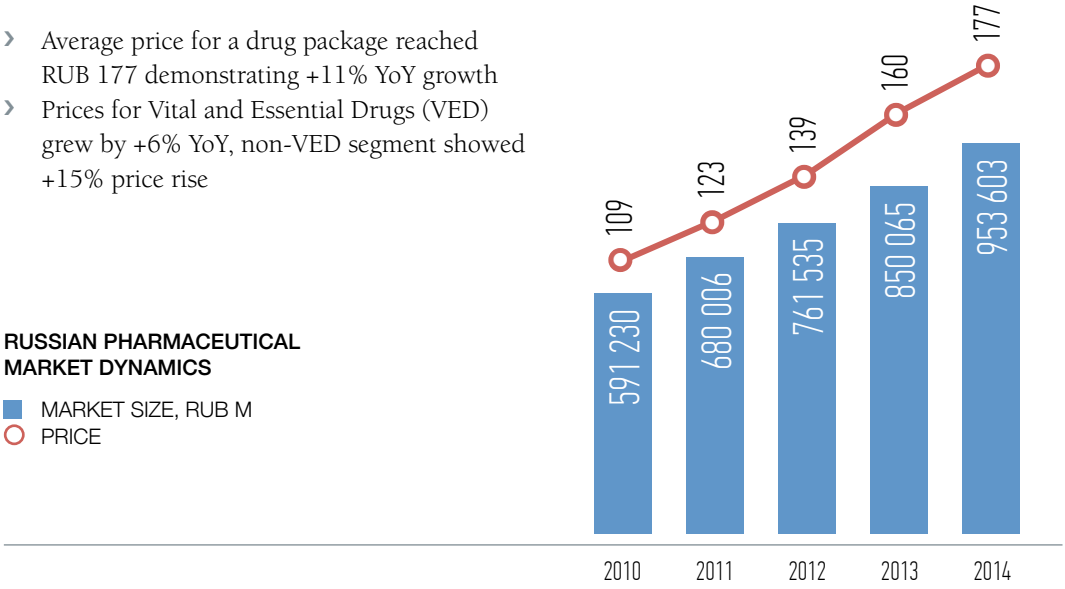
# Russian Pharmaceutical Market Overview

# Market Review 2014

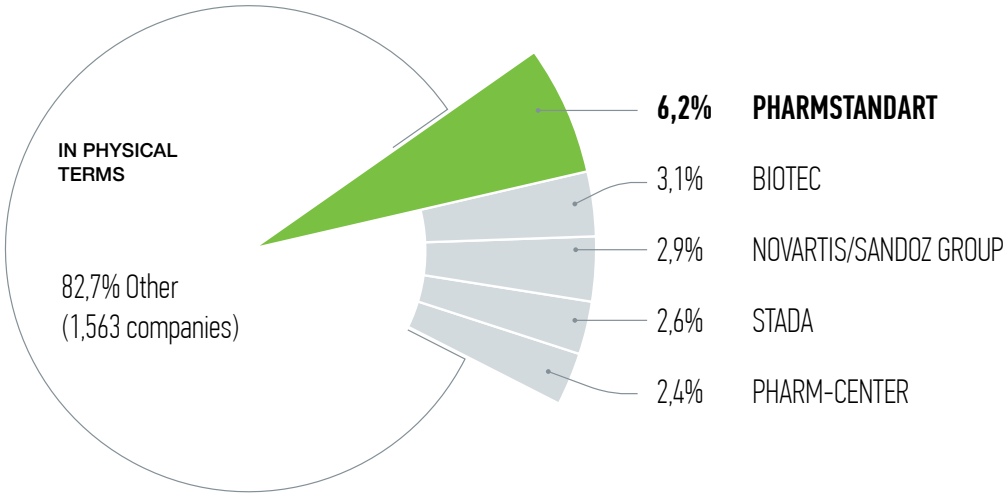
In 2014, the Russian drug and biologically active additive (BAA) market reached RUB 953 m (in consumer prices) and 5.4 bn packages

- Average price for a drug package reached RUB 177 demonstrating +11% YoY growth
- Prices for Vital and Essential Drugs (VED) grew by +6% YoY, non-VED segment showed +15% price rise

**RUSSIAN PHARMACEUTICAL MARKET DYNAMICS**




**RUSSIAN PHARMACEUTICAL MARKET STRUCTURE BY COMPANY**



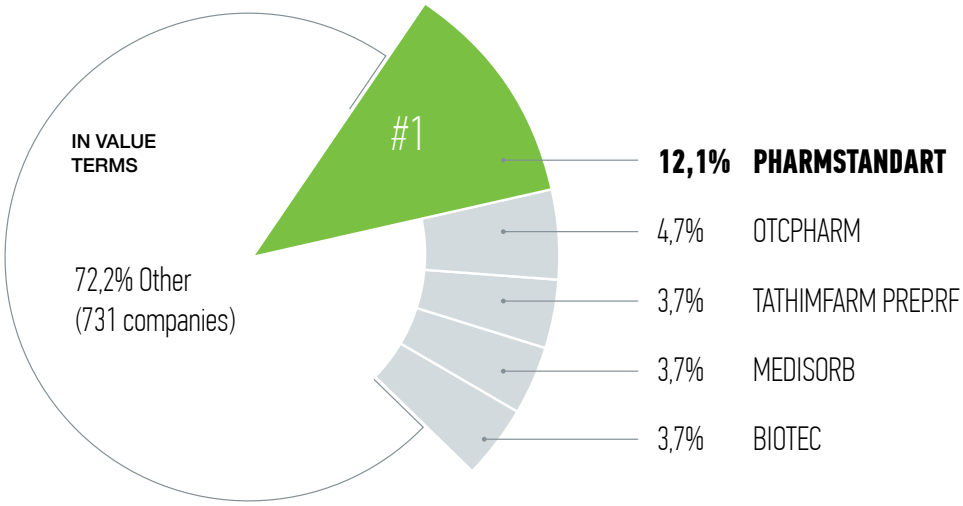

* Based on 2014 performance, Pharmstandard holds #1 position among all drug/BAA manufacturers with a market share of 6.2% (in physical terms)

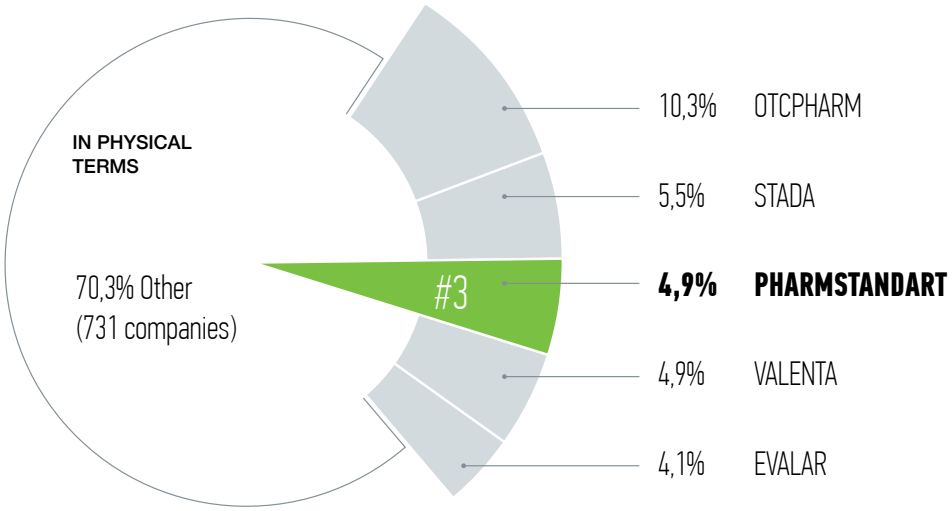
All information in the Section 'Russian Pharmaceutical Market Overview. Market Structure' is based on the IMS Health Russia's Research on the Russian retail drug and BAA market (commercial segment), the Research on hospital-related drug segment, FRP segment (the Federal Reimbursement Program), including government procurement under the Public Drug Benefit Program (PDBP) and 7 High-Cost Nosologies Federal Program (7 Nosologies), and the regional-level drug benefit channel.

The Russian pharmaceutical market comprises three major segments:

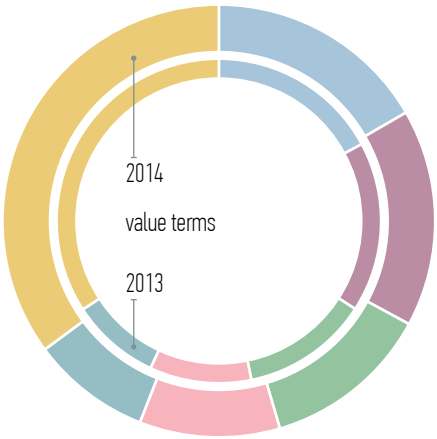
- Commercial segment (retail)
- Hospital segment
- FRP segment – the Federal Reimbursement Program, including government procurement under 7 High-Cost Nosologies Federal Program (7 Nosologies), the Public Drug Benefit Program (PDBP), and the regional-level drug benefit channel


Pharmstandard holds #1 position among Russian pharmaceutical companies in the segment in physical terms (12% of the segment) and #3 position in value terms with a share of 4.9 %

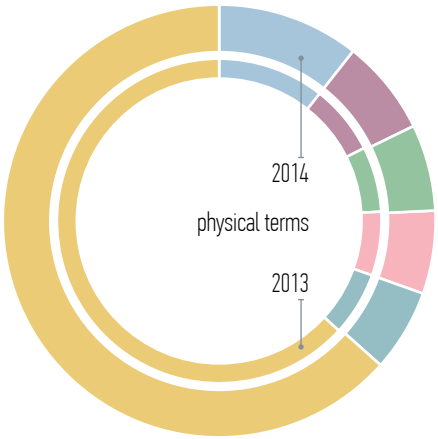


## RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY ATC CLASSIFICATION CATEGORIES




| RUB bn 2013 | RUB bn 2014 | | packs bn 2013 | packs bn 2014 |
|---|---|---|---|---|
| 911 | 898 | N - NERVOUS SYSTEM | 143 | 160 |
| 17% | 17% | | 17% | 17% |
| 902 | 877 | A - ALIMENTARY TRUCT AND METABOLISM | 94 | 107 |
| 17% | 16% | | 11% | 11% |
| 673 | 676 | R - RESPIRATORY SYSTEM | 87 | 97 |
| 13% | 13% | | 10% | 10% |
| 539 | 567 | C - CARDIOVASCULAR SYSTEM | 86 | 94 |
| 10% | 11% | | 10% | 10% |
| 473 | 482 | J - GENERAL ANTI-INFECTIVES SYSTEMIC | 86 | 93 |
| 9% | 9% | | 10% | 10% |
| 1 816 | 1 894 | VARIOUS 10 ATCs | 850 | 954 |
| 34% | 35% | | 42% | 42% |




## RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY SEGMENT,

RUB m (in value terms) Commercial Hospital FRP Regional-Level Benefit


## RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY SEGMENT,

packs m (in physical terms) Commercial Hospital FRP Regional-Level Benefit


## AVERAGE MANUFACTURER'S PRICE DYNAMICS IN THE RUSSIAN PHARMACEUTICAL MARKET BY SEGMENT, RUB/pack

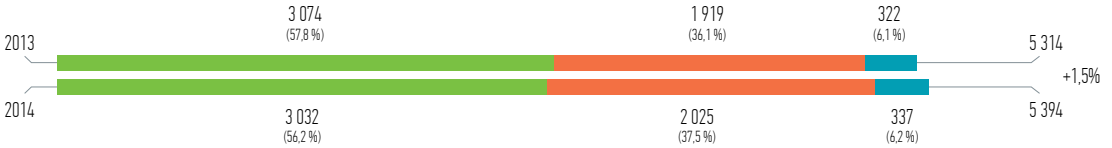
Commercial Hospital FRP Regional-Level Benefit

**RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY MANUFACTURER ORIGIN,** RUB m (in value terms) Import Local

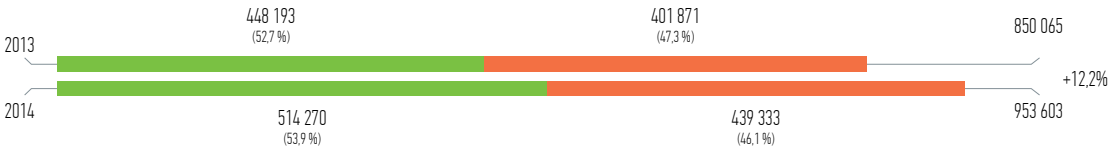

**RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY MANUFACTURER ORIGIN,** packs m (in physical terms) Import Local


**RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY DRUG STATUS,** RUB m (in value terms) Rx OTC BAA


**RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY DRUG STATUS,** packs m (in physical terms) Rx OTC BAA




**RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY PRODUCT INCLUSION IN THE VED LIST,** RUB m (in value terms) Non-VED listed Non-VED listed




**RUSSIAN PHARMACEUTICAL MARKET STRUCTURE AND DYNAMICS BY PRODUCT INCLUSION IN THE VED LIST,** packs m (in physical terms) Non-VED listed Non-VED listed


**AVERAGE MANUFACTURER'S PRICES IN THE RUSSIAN PHARMACEUTICAL MARKET FOR VEDS VS OTHER DRUGS,** RUB/pack Non-VED listed Non-VED listed

# Pharmaceutical Activity Regulation. Key Regulatory Changes

Pharmstandard extensively procures its medicinal products under federal and municipal orders funded through federal and regional public drug benefit programs.

In the Russian Federation, patients entitled to state-funded social care are procured with medications through the following public drug supply channels:

**1. Procurement of drugs and medical products, including health care products, for categories eligible for state-funded social care (federal and regional benefit recipients) funded through regional budgets and federal subventions.**

Federal level benefit recipients, i.e. individuals eligible for state-funded social support in the form of welfare services package in accordance with the Federal Law on State Social Assistance dated 17 July 1999 #178. This group of benefit recipients receives fully subsidized drugs under the Public Drug Benefit Program (PDBP) as per the list of drugs approved by the Order of the Ministry of Healthcare and Social Development of the Russian Federation dated 18 September 2006 #665.

Regional level benefit recipients, i.e. individuals included, based on the RF Government's Decree #890 dated 30 July 1994, in the list of categories eligible for fully subsidized drugs prescribed by physicians as per the approved list of drugs and medical products.

**2. Centralized procurement of high-cost nosologies for treatment of patients with haemophilia, mucoviscidosis, pituitary dwarfism, Gaucher disease, myeloleukemia, disseminated sclerosis, post organ and/ or tissue transplant patients, funded through the federal budget (the so called 7 Nosologies Federal Program).**

7 Nosologies Federal Program has been being implemented in the Russian Federation since 2008. Under the Program, medications for patients suffering from 7 rare and the most expensive to treat diseases are purchased on a centralized basis through the federal budget. The medications are handed over on an outpatient basis under the public drug benefit programs.

7 Nosologies drugs are purchased by the Russia's Ministry of Healthcare in accordance with the Rules of Procurement of Medications for Treatment of Patients with Malignancy of Lymphoid, Hematopoietic and Related Tissue, Haemophilia, Mucoviscidosis, Pituitary Dwarfism, Gaucher Disease, Disseminated Sclerosis, Post Organ and/ or Tissue Transplant Patients approved by the RF Government's Decree #1155 of 26 December 2011.

These Rules set out the procedure for purchasing the above medications by the Ministry of Healthcare and Social Development of the Russian Federation, the terms and procedure for their transfer to the federal healthcare institutions subordinated to Russia's Federal Medical and Biological Agency, as well as their transfer to the ownership of constituent entities of the Russian Federation for further transfer, on an as-needed basis, to the ownership of municipal structures.

The list of drugs purchased under 7 Nosologies Federal Program, approved by the RF Government's Ordinance #2053 r of 31 December 2008, included 18 INNs. By the RF Government's Ordinance #2782 r of 30 December 2014, the List was extended to 22 INNs effective from 01 March 2015.

In 2014, purchases under 7 Nosologies Federal Program reached RUB 44,251,240,139; the purchase plan for 2015 is RUB 44,118,959,801.

Effective from 1 January 2013, the Government's Decree of 27 December 2012 #1438 On Financing Purchases of Diagnostic and Antiviral Products for Prevention, Detection, Treatment Monitoring and Medical Care of HIV and Hepatitis B & C Infected Patients, marked the beginning of decentralization of drug purchases for treatment of socially significant diseases with the function transfer to regional authorities. In this segment in 2014, the Company achieved successful sales of Intelence, Prezista and Edurant brands produced in co-operation with Johnson & Johnson.

Specific government procurement laws regulate the procedure for drug procurement funded through the budget.

The Federal Law of 05 April 2013 #44-FZ On Contract System in Purchasing Goods, Works and Services for State and Municipal Needs (the "CS Law") took effect from 1 January 2014 to supersede the Federal Law of 21 July 2005 #94 FZ On Placing Orders for Delivery of Goods, Works and Services for State and Municipal Needs.

The CS Law was enacted with a view to improving the regulations in the sphere of government and municipal procurement and creating the contract-based procurement system. Firstly, the purchase procedure, as specified by the CS Law, regulates the entire workflow within the purchase process, including such key stages as planning, order placing, execution and oversight. The Law primarily focuses on the procurement result, which should be directly linked to the outset stage of a purchasing process, i.e. a three-year planning process. Secondly, the CS Law now regulates many areas not covered by Law #94-FZ, including procurement planning, anti-dumping and anti-corruption aspects, further, it provides for a detail procedure for determining the initial and ultimate price under a contract awarded (especially for VED listed medications), and also provides for a unilateral contract termination, etc.

The Order of the RF Ministry of Economic Development #155 dated 25 March 2014 On Admission Preconditions for Foreign Origin Goods with respect to Purchasing Goods, Works and Services for State and Municipal Needs, took effect from 21 May 2014. The Order sets out the admission terms for foreign products with respect to state and municipal order placing as well as preferential terms for Russian and Belorussian products.

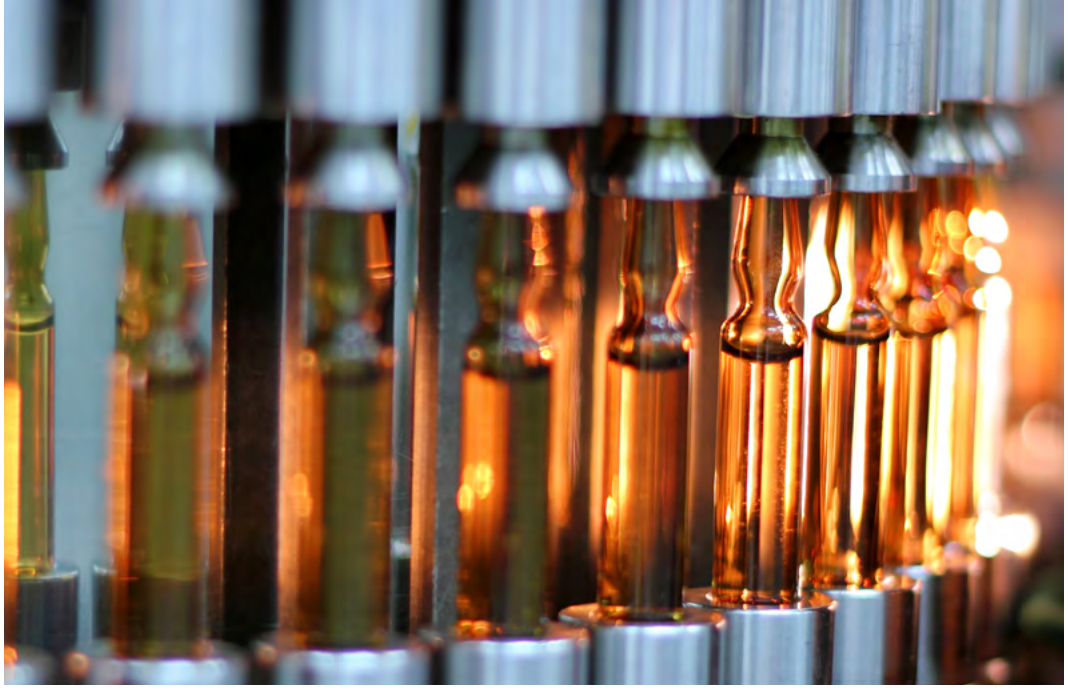
Pursuant to the Order, tenders or auctions for supply of goods for state and municipal purposes should prioritize bidders supplying Russian, Belorussian and/or Kazakhstan goods. As such, when foreign drugs are purchased through an auction a 15% discount is applied to the proposed contract price, while the Customs Union bidders have the discount relief.

Starting from 2014, the federal executive agencies, in implementing the Government's Import Substitution Strategy, have been taking active steps to further expand the preferences for Russian pharmaceutical companies. The "odd man out" concept decree being developed by the RF Government stipulates that foreign origin drugs will not be admitted to government procurement contracts in case of at least two proposals submitted by manufacturers from the Customs Union countries. The expected "odd-man-out" decree has had an immediate effect on the manufacturing market – catalyzing the operating companies which have free capacity and are ready to provide contract manufacturing services.

# Business report

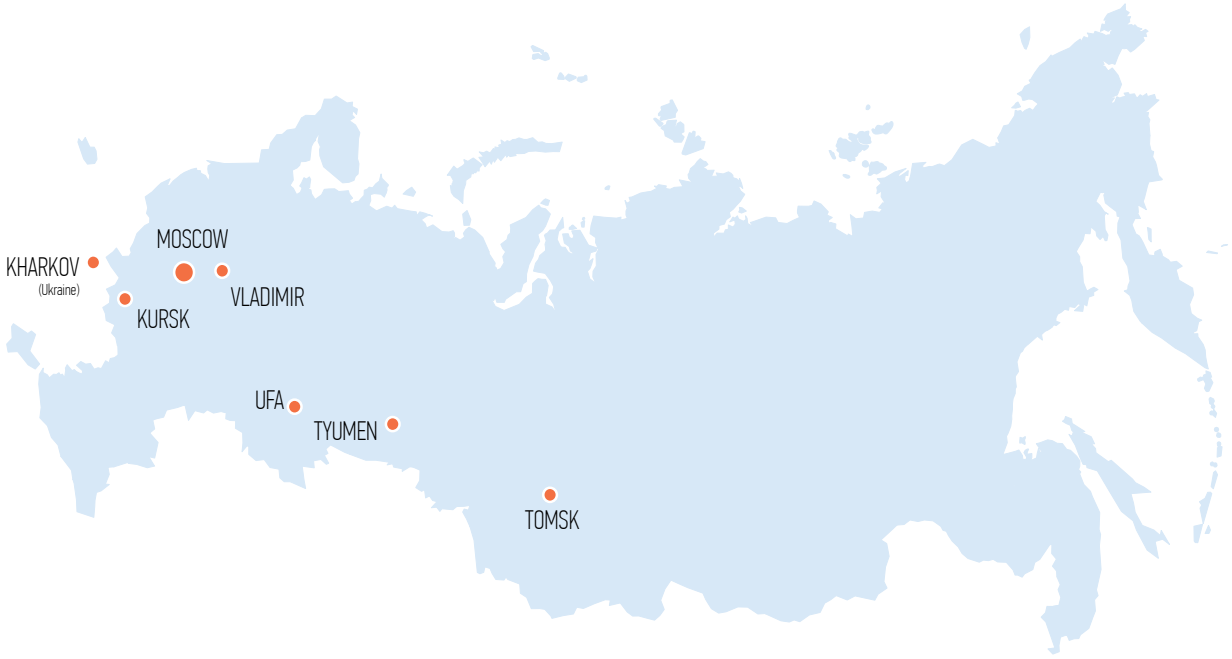
# Manufacturing Capacity

| Operating company | Finished dosage form | Number of shifts | Manufacturing capacity 2014, thous. packs | Capacity utilisation 2014, % | Addition of capacity, 2014 |
|---|---|---|---|---|---|
| Pharmstandard Leksredstva | Syrups and liquid dosage forms | 3 | 86,274 | 93% | March 2014 |
| | Tablets | 3 | 385,133 | 69% | |
| | Aerosols and sprays | 3 | 27,883 | 62% | |
| | Powders | 3 | 6,649 | 26% | |
| | Capsules | 3 | 71,150 | 54% | |
| | Vitamins (Ferrohematogen) | | 1,000 | 59% | October 2014 |
| Pharmstandard UfaVITA | Ampoules | 3 | 25,468 | 49% | |
| | Lyophilisates | 3 | 390 | 99% | |
| | Syrups and liquid dosage forms | 3 | - | 0% | |
| | Tablets | 3 | 122,090 | 60% | |
| | Vitamins (Ferrohematogen) | 3 | 37,700 | 62% | |
| | Insulin (human) | 3 | 2,648 | 45% | |
| Pharmstandard Tomskhimpharm | Syrups and liquid dosage forms | 3 | 5,400 | 5% | |
| | Tablets | 3 | 318,931 | 26% | |
| | Aerosols and sprays | 3 | 9,600 | 21% | |
| | Ointments | 3 | 2,178 | 31% | |
| Pharmstandard Biolek | Syrups and liquid dosage forms | 3 | 177 | 34% | |
| | Ampoules | 3 | 6,483 | 12% | |
| | Lyophilisates | 3 | 480 | 26% | |
| | Powders | 3 | 25 | 43% | |
| Lekko CJSC | Tablets | 3 | 6,734 | 12% | |
| | Capsules | 3 | 4,819 | 77% | June 2014 |
| | Syrups and liquid dosage forms | 3 | 56,300 | 45% | |
| | Powders | 3 | 12,238 | 55% | |
| | Aerosols and sprays | 3 | 15,435 | 6% | |
| | Lyophilisates | 3 | - | 0% | |
| Mechnikov Biomed OJSC | Tablets | 3 | 56 | 63% | |
| | Syrups and liquid dosage forms | 3 | 52 | 90% | |
| | Ampoules | 3 | 126 | 69% | |
| | Interferons | 3 | 436 | 75% | |
| **Total pharmaceutical products** | | | **1 205 855** | | |



| Operating company | Equipment | Numver of shifts | Manufacturing capacity 2014, units | Capacity utilisation 2014, % |
|---|---|---|---|---|
| TZMOI JSC | Steam sterilizers, up to 100 l | 3 | 10 | 31% |
| | Steam sterilizers, over 100 l | 3 | 420 | 13% |
| | Aqua distillers and water collectors | 3 | 7 | 40% |

| Operating company | Presentation | Number of shifts | Manufacturing capacity 2014, ml | Capacity utilisation 2014, % |
|---|---|---|---|---|
| Pharmapark CJSC | Interferon acetonitrile-free, API | 3 | 27,000 | 97% |
| | Interferon alfa, API | 3 | 205,000 | 99% |
| | Interferon methionine-free (IFN), API | 3 | 52,000 | 94% |
| | PEG-Interferon, API | 3 | 16,000 | 97% |
| | Erythropoietin, API | 3 | 11,160 | 11% |



# GMP and Quality Management

All Pharmstandard operations have a functional and constantly improving quality management system in place.

The system has been developed and implemented in full compliance with the EC Commission Directive 2003/94/EC, the Drug Manufacturing and Quality Control Rules approved by the RF Industry and Trade Ministry's Order #916 of 14 June 2013, Russian National Standards GOST R 52249-2009 (GMP) "Drug Manufacturing and Quality Control Rules" and GOST R ISO 9001-2008 (ISO 9001:2008) "Quality Management System. Requirements".
The quality management system operating at our Tyumen Medical Equipment and Tools Plant complies with EN ISO 13485 (EN ISO 13485:2012 + AC: 2012 – ISO 13485:2003 + Cor. 1:2009) "Medical Devices – Quality Management Systems – Regulatory Requirements" and EN ISO 9001 (ISO 9001:2008) "Quality Management Systems – Requirements".

In 2014, the RF Industry and Trade Ministry's Commission conducted its first inspections to check the compliance with the Drug Manufacturing and Quality Control Rules which were approved by the Ministry's Order #916 of 14 June 2013 and took effect on 19 November 2013. The inspections were conducted at:

- Pharmstandard-Leksredstva OJSC – in December 2013
- Pharmstandard-UfaVITA OJSC – in January 2014
- Pharmstandard-Tomskhimpharm OJSC – in January 2014
- Lekko CJSC – in May 2014
- Pharmapark LLC – in July 2014.

Based on the inspection results, the drug manufacturing and quality control processes in place at Pharmstandard operating companies were certified as compliant with the licence requirements, and Drug Manufacturing and Quality Control Management Rules approved by the RF Industry and Trade Ministry's Order #916 of 14 June 2013. The compliance of Pharmstandard companies' operations is confirmed by the Statements on Medicinal Product Manufacturer's Compliance with the Drug Manufacturing and Quality Control Rules rendered to Pharmstandard-UfaVITA OJSC and Pharmstandard-Leksredstva OJSC on 29 January 2015.

In 2014, the Russian Management System Certification Authority, namely All-Russia Research Certification Institute (VNIIS):

1. Re-inspected Pharmstandard-UfaVITA OJSC, Pharmstandard-Leksredstva OJSC, Pharmstandard-Tomskhimpharm OJSC, Lekko CJSC, Pharmapark LLC for their compliance with GOST ISO 9001-2011 (ISO 9001:2008) “Quality Management System. Requirements” and GOST R 52249-2009 “Drug Manufacturing and Quality Control Rules (GMP)” and rendered the statement confirming the validity of compliance certificates.

2. Re-inspected pharmacy depots of Pharmstandard OJSC and Pharmstandard LLC for their compliance with GOST ISO 9001-2011 “Quality Management System. Requirements” and GOST R 52249-2009 “Drug Manufacturing and Quality Control Rules” and rendered the statement confirming the validity of compliance certificates.

3. Certified Pharmstandard-Biolek PJSC operations as compliant with GOST ISO 9001-2011 (ISO 9001:2008) “Quality Management System. Requirements” and granted the compliance certificate.

PHARMSTANDARD’S COMMITMENT TO COMPLY WITH GXP PRACTICES IS THE KEY TO EXPANDING CO-OPERATION WITH EU MANUFACTURERS.

In December 2014, Latvian State Agency of Medicines inspected Pharmstandard-Leksredstva OJSC for GMP compliance as per Directive 2003/94/EC, and issued the GMP EC compliance certificate for 9 process flow segments (8 products).

During 2014, Pharmstandard-UfaVITA OJSC has undertaken extensive efforts to prepare its injection drug unit for the EU GMP compliance certification. The unit was inspected by Latvian State Agency of Medicines in February 2015.

EU GMP compliance certificates issued for Pharmstandard-Leksredstva OJSC production lines can be found in Eu-draGMP database at the following address: eudragmp.ema.europa.eu/inspections/gmpc/searchGMPCompliance.do.

In February 2014, Pharmstandard launched a major business project with a view to implement a computerized manufacturing management system. Under the project, we have opted to co-operate with SAP AG – a world-renowned German software company with its SAP ERP software. The project preparation stage involved the extensive work aimed to unify the organizational structure of the Group companies' Quality Management Service, align job titles and job descriptions, and distribute authorities within SAP ERP upon the system deployment; we have also performed the reconciliation of the process and validation documentation. Relevant specialists have prepared and reviewed all quality control and operating environment monitoring regulatory and reference information to be uploaded into the system. The Batch File format (the main product batch document) has been unified. The QM (quality management) module is split into two phases. In 2014, the following project solutions were developed and deployed as part of the 1st implementation phase:

- Intermediate product quality control
- Finished product quality control
- Operating environment monitoring
- Equipment validated status checks.

In 2014, the operating environment deployed in Pharmstandard-Leksredstva (Shop #2, Site #2) allowed the manufacturing facility to efficiently utilise the above solutions in its process flow.

In furtherance of the RF Industry and Trade Ministry's Order on the Approval of Drug Manufacturing and Quality Control Management Rules, and the Russian National Standard GOST R 52249-2009 (GMP) "Drug Manufacturing and Quality Control Rules" dated 14 June 2013 #916, Pharmstandard Group companies arranged for Authorized Persons' certification. In 2014, Pharmstandard-UfaVITA, Pharmstandard-Leksredstva, Pharmstandard-Tomskhimpharm, Lekko, Pharmapark employees have been successfully certified as Authorized Persons by the Russian Healthcare Ministry's Certification Commission.

All Pharmstandard companies undergo regular external inspections/audits both by the Russian regulators (Drug Licensing Division of Pharmaceutical and Medical Industry Development Department of the RF Industry and Trade Ministry; the Federal Healthcare Supervision Service), and independent European and Russian auditors.

Compliance certificates held by Pharmstandard OJSC operating companies:

## Pharmstandard-Leksredstva OJSC

- EU GMP compliance certificate (based on Directive 2003/94/EC (1)) #ZVA/LV/2015/002H issued on 19 February 2015, valid until 12 December 2017
- GOST R 52249-2009 (GMP) ("Drug Manufacturing and Quality Control Rules") compliance certificate GMPEU RU.001.P0007 issued on 27 May 2013, valid until 27 May 2016
- GOST ISO 9001-2011 (ISO 9001:2008) ("Quality Management System. Requirements") compliance certificate ROSS RU.IS11.K00893 issued on 27 May 2013, valid until 27 May 2016
- Ukrainian Decree ST-N MOZU 42-4.0:2011 ("Pharmaceuticals. Good Manufacturing Practice") compliance certificate 035/2013/SAUMP/GMP valid until 29 March 2016
- Statement on medicinal product manufacturer's compliance with the Drug Manufacturing and Quality Control Rules #GMP-0003-000003/15 issued on 29 January 2015

### Pharmstandard-UfaVITA OJSC

- GOST R 52249-2009 (GMP) ("Drug Manufacturing and Quality Control Rules") compliance certificate GMPEU RU.001.P00326 issued on 30 May 2013, valid until 30 May 2016
- GOST ISO 9001-2011 (ISO 9001:2008) ("Quality Management System. Requirements") compliance certificate ROSS RU.IS11.K00895 issued on 30 May 2013, valid until 30 May 2016
- Statement on medicinal product manufacturer's compliance with the Drug Manufacturing and Quality Control Rules #GMP-0002-000002/15 issued on 29 January 2015

### Pharmstandard-Tomskhimpharm OJSC

- GOST R 52249-2009 (GMP) ("Drug Manufacturing and Quality Control Rules") compliance certificate GMPEU RU.001.P000327 issued on 30 May 2013, valid until 30 May 2016
- GOST ISO 9001-2011 (ISO 9001:2008) ("Quality Management System. Requirements") compliance certificate ROSS RU.IS11.K00896 issued on 30 May 2013, valid until 30 May 2016
- Ukrainian Decree ST-N MOZU 42-4.0:2011 ("Pharmaceuticals. Good Manufacturing Practice") compliance certificate 068/2013/SAUMP/GMP valid until 19 July 2016

### Lekko CJSC

- GOST R 52249-2009 (GMP) ("Drug Manufacturing and Quality Control Rules") compliance certificate GMPEU RU.001.P0010 issued on 18 June 2013, valid until 18 June 2016;
- GOST ISO 9001-2011 (ISO 9001:2008) ("Quality Management System. Requirements") compliance certificate ROSS RU.IS11. K00866 issued on 11 March 2013, valid until 11 March 2016

### Pharmapark LLC

- GOST R 52249-2009 (GMP) ("Drug Manufacturing and Quality Control Rules") compliance certificate GMPEU RU.001.P0006 issued on 26 December 2012, valid until 26 December 2015
- GOST ISO 9001-2008 (ISO 9001:2008) ("Quality Management System. Requirements") compliance certificate ROSS RU.IS11.K00852 issued on 26 December 2012, valid until 26 December 2015
- Statement on medicinal product manufacturer's compliance with the Drug Manufacturing and Quality Control Rules #GMP-0010-000012/15 issued on 13 February 2015
- Statement on medicinal product manufacturer's compliance with the Drug Manufacturing and Quality Control Rules #GMP-0010-000011/15 issued on 13 February 2015

### Tyumen Medical Equipment and Tools Plant, OJSC

- EN ISO 13485 (EN ISO 13485:2012 + AC:2012 – ISO 13485:2003 + Cor. 1:2009) ("Medical Devices – Quality Management Systems – Regulatory requirements") compliance certificate #D1236900007 issued on 27 November 2013, valid until 20 October 2018
- EN ISO 9001 (ISO 9001:2008) ("Quality Management Systems – Requirements") compliance certificate #D1236900008 issued on 28 November 2013, valid until 27 October 2016

### Pharmstandard OJSC / Pharmstandard LLC pharmacy depots

- GOST R ISO 9001-2008 (“Quality Management System. Requirements”) compliance certificates:
  - ROSS RU.IS11.K00815 valid until 18 September 2015 granted to Pharmstandard OJSC
  - ROSS RU.IS11.K00814 valid until 18 September 2015 granted to Pharmstandard LLC
- GOST R 52249-2009 (“Drug Manufacturing and Quality Control Rules”) compliance certificates:
  - GMPPEU RU.001.#.0005 valid until 18 September 2015 granted to Pharmstandard OJSC
  - GMPPEU RU.001.#.0004 valid until 18 September 2015 granted to Pharmstandard LLC

## Validation Unit

Pharmstandard Group companies’ validation process is carried out in accordance with the Validation Master Plans based on the V-model approach with validators’ involvement from the very early stage of a validation object life cycle.

This includes development of User Requirement Specifications (URS) and continuous change control and management. Regular validators’ participation in FAT/SAT tests allows to comply with Good Engineering Practice requirements.

Control and monitoring of the cold chain conditions in thermo liable drugs manufacturing, storage and transportation is an important part of the validation process. Operating independently or jointly with international partners, Pharmstandard with its extensive expertise in this area is capable to successfully execute the most complex projects involving thermo liable drugs manufacturing, storage and transportation.

In their work Pharmstandard validators use advanced validation instrumentation supplied by international leading producers of such kind of equipment. The validation instrumentation undergoes regular calibrations and verifications in order to guarantee unequivocal information from validated objects and optimize labour input in the validation process.

Validators are actively involved in the development, introduction and validation of computerized manufacturing management and monitoring / electronic document flow systems deployed at Pharmstandard Group operating companies in line with the GAMP 5 requirements.

In Pharmstandard, we hold on to an open approach, and our validators are happy to share their expertise with counterparts from other pharmaceutical companies and institutions, assisting them in validation procedures and providing valuable advice.

Validators’s performance, both at the operating company and the holding company level, is supported by continuous training at the leading training centres in Russia and abroad as well as constant focus on the compliance with the best global validation practices.

# Pharmstandard growth plans

In accordance with the Company's growth plans a number of new production units/sites have been built to launch new products or expand the existing capacity, with some of them still under construction. The Company purchased new process and laboratory equipment for product manufacturing and quality control.

## Pharmstandard-Leksredstva OJSC

- continues the reconstruction of Shop #2 to launch manufacturing of metered dose aerosol preparations, scheduled for commissioning in July 2015
- completed the reconstruction of Site #43 and arranged manufacturing of chewable BAA pastilles (put in operation in November 2014)
- completed the reconstruction of Site 5 in Shop #3 undertaken to install HVAC system
- continues the reconstruction of the plant warehouse 1st floor to expand the storage space for packing materials (building extension, design engineering)
- replaced obsolete equipment to upgrade and outfit the existing facilities

## Pharmstandard-Tomskhimpharm OJSC

- completed the construction of the gas/ steam boiler house, scheduled for commissioning in May 2015
- prepared the construction design for central laboratory, including quality control, environmental protection and industrial sanitation divisions
- preparatory arrangements in progress to deploy SAP's Enterprise Resource Planning system
- purchased new equipment for manufacturing facilities, quality control division and central laboratory
- completed the reconstruction of tablet coating unit in the tablet shop (Site #1), arranged and equipped the film coating unit

## Pharmstandard-UfaVITA OJSC

- completed the construction of cytostatics shop (tablet unit and injection drug unit)
- purchased new process equipment for cytostatics shop
- obtained "Qualified" status for cytostatics shop's cleanroom, engineering system and process equipment
- continues the reconstruction of insulin shop manufacturing facilities, process equipment purchases are under way, completed the factory acceptance tests (FAT) of the cold chain block and labelling machine
- continues the construction and organization of prefilled syringe manufacturing: cleanroom qualification, engineering systems, equipment purchases and FATs are in progress
- continues the reconstruction of injection drug unit, including equipment replacement and small batch manufacturing organization
- continues the construction of eye drops unit
- continues the construction of a new building for finished drug products, central laboratory and quality control division
- purchased new process equipment as well as laboratory equipment for central laboratory and quality control division

# Addition of capacity in Pharmstandard Group's operating companies in 2014

## Pharmstandard-Leksredstva OJSC

In October 2014, a new pastilles (hematogens) manufacturing shop was put into operation. The shop's planned capacity is 5 m pastille packs per month. Investments in the new shop construction amounted to RUB 313.8 million.

In November 2014, the company commenced the manufacturing of new BAA product forms –Ferrohematogen for kids (25 g and 50 g) and Hematogen 25 g, and relocated the manufacturing of Ferrohematogen-Pharmstandard 50 g and Hematogen 50 g BAAs from Pharmstandard-UfaVITA OJSC.

In March 2014, a new syrup filling and packing line was put into operation, resulting into the capacity increase by 50%. In addition to 100 ml vial drugs, the new line set up the manufacturing of organic 200 ml vial drugs, as well as Eurespal® syrup in 150 ml and 250 ml dosage forms under the manufacturing contract with Servier.

A new metered dose aerosol line is planned to be put into operation in 2015. The intent is to utilise the new line for contract manufacturing of antasthmatic drugs.

In 2015, the company plans to construct a new coated tablet manufacturing unit, this will allow to double the manufacturing capacity from 330 m to 660 m tables per annum.

## Lekko CJSC

In June 2014, a new lyophile manufacturing unit was put into operation, resulting into the capacity increase by 50 %. The said unit manufactures Acipol® and Lactonorm® drugs.

## Pharmstandard-UfaVITA OJSC

At the end of 2014, the company completed construction and commissioned a new cytostatics shop. The drug manufacturing commenced in Q1 2015.

The following new manufacturing units are planned to be put into operation in 2015:
- pre-filled syringe manufacturing unit;
- small batch vial fill injectable drug manufacturing unit.

The Company also plans to perform the reconstruction of its injectable drug unit in order to commence manufacturing of Mabthera® drug.

# Contract Manufacturing and Business Partners

Pharmstandard closely co-operates with many pharmaceutical majors, including Abbott, AbbVie, Celgene, CHIESI, GE HelthCare, Genzyme, Grindeks, Johnson, Kemwell Biopharma, MARVEL BIOSCIENCE, Merck, Novartis, Roche, Servier in manufacturing, marketing and distribution, striving to achieve the maximum localization of strategically important drugs and make them more accessible for consumers.

The below secondary package and complete manufacturing cycle localization projects have been completed during 2014 in the following Pharmstandard Group operating companies:

1. **Celgene Logistics Sarl**
   At the manufacturing facilities of Pharmstandard-UfaVITA OJSC - secondary package
   - Vidaza, lyophilisate for suspension

2. **AbbVie LLC**
   At the manufacturing facilities of Pharmstandard-UfaVITA OJSC - secondary package
   - Synagis, lyophilisate for solution 100 mg
   - Synagis, lyophilisate for solution 50 mg

3. **Novartis Pharma LLC**
   At the manufacturing facilities of Pharmstandard-UfaVITA OJSC - secondary package
   - Tasigna, capsules150 mg
   - Tasigna, capsules 200 mg

4. **Johnson & Johnson LLC**
   At the manufacturing facilities of Pharmstandard-UfaVITA OJSC - secondary package
   - Prezista, film coated tablets 800 mg

5. **Merck Export GmbH**
   At the manufacturing facilities of Pharmstandard-UfaVITA OJSC - secondary package
   - Rebif, solution for hypodermic injection 22 mcg/ 0.5 ml, pre-filled syringe 0.5 ml
   - Rebif, solution for hypodermic injection 44 mcg/ 0.5 ml, pre-filled syringe 0.5 ml

6. **Genzyme Europe B.V.**
   At the manufacturing facilities of Pharmstandard-UfaVITA OJSC - secondary package
   - - Cerezyme, lyophilisate for infusion solution

7. **Servier CJSC**
   At the manufacturing facilities of Pharmstandard-Leksredstva OJSC - complete manufacturing cycle
   - Eurespal, syrup 2 mg/ml, 150 ml

# Pharmaceutical Portfolio

## Product Development & Research

In 2014, the Company completed the development of, obtained the Marketing Authorisations for and launch ed commercial manufacturing of 7 new products (generics, new compositions of existing INNs and formerly manufactured products with new consumer characteristics or dosage forms), including 2 prescription drugs (Rx), 2 over-the-counter drugs (OTC), 2 biologically active additives (BAA) and 1 cosmetic ointment (see the Table below).

### New products launched in 2014

| Product | Group | Therapeutic segment | Planned launch | Actual launch |
|---|---|---|---|---|
| Codelac® Neo Tablets (tablets) | OTC | Cold & flu | August 2014 | September 2014 |
| Arbidol capsules 200 mg | OTC | Cold & flu | November 2014 | November 2014 |
| Codelac-Pulmo (ointment) | OTC/ Cosmetic | Cold & flu | August 2014 | June 2014 |
| Ferrohematogen – Pharmstandard (pastilles 25 g, 30 g, 50 g) – manufacturing at the new site | BAA | Hematogenesis | October 2014 | November 2014 |
| Ferrohematogen for kids (pastilles 25 g, 50 g) – manufacturing at the new site | BAA | Hematogenesis | October 2014 | November 2014 |
| PEG Altevir (lyophilizate solution for injection 50 mcg, 80 mcg, 100 mcg, 120 mcg, 150 mcg) | RX | Viral hepatitis | August 2014 | September 2014 |
| Biosulin N, R (solution for injection in pre-filled syringe) | RX | Diabetes | August 2014 | January 2015 |
| Azithromycin (tablets) | RX | Antibiotics | September 2014 | October 2014* |

5 OTC products, 4 BAAs and 1 Rx product (listed in the Table below) previously targeted for launch in 2014 will be registered and released in 2015 due to changes in the registration scenarios for these products. Part of these products (asterisked *) will be launched upon the commissioning of the relevant capacities.

### Product launch extended for 2015

| Product | Group | Therapeutic segment | Planned launch | Actual launch |
|---|---|---|---|---|
| Magnelis® B6 Forte (coated tablets) | OTC | Multivitamins & minerals | September 2014 | August 2015 |
| Mycoderil cream 1% (15 g, 30 g for outward application) | OTC | Dermatology | November 2014 | May 2015 |
| Mycoderil solution 1% (10 ml, 20 ml, 30 ml for outward application) | OTC | Dermatology | November 2014 | March 2015 |
| Ibuprofen suspension 100 mg/ 5 ml | OTC | Anti-inflammatory | October 2014 | October 2015 |
| Corvalol (tablets) | OTC | Cardiovascular system | December 2014 | July 2015 |
| Complivit CHONDRO (coated tablets) (BAA) | BAA | Healthy joints | May 2014 | May 2015 |

| Product | Group | Therapeutic segment | Planned launch | Actual launch |
|---|---|---|---|---|
| Complivit Superenergy (coated tablets) | BAA | Multivitamins & minerals | October 2014 | October 2015 |
| Complivit Calcium D3 for women 45+ (tablets) | BAA | Women health | September 2014 | May 2015 |
| Complivit Hair Repair (capsules) | BAA | Beauty & health | December 2014 | July 2015 |
| Biosulin N, R (solution for injection in pre-filled syringe) | RX | Diabetes | August 2014 | January 2015 |

In 2015, we plan to launch 8 new products, including 5 Rx drugs, 2 OTC drugs and 1 biologically active additive.

The Company's organic products targeted for launch in 2015 are listed in the Table below.

## New products targeted for launch in 2015

| Product | INN | Group / type | Therapeutic segment | Planned launch |
|---|---|---|---|---|
| Escape (tablets120 mg) | Bismuthate tripotassium dicitrate | OTC | Gastroenterology | December 2015 |
| Arbidol® for kids (powder for suspension for oral administration, 25 mg/ 5 ml) | Umifenovir | OTC | Antiviral | 24 August 2015 |
| Glycine forte Pharmstandard (BAA) – tablets #20, 600 mg | BAA | BAA | Neurology | 09 March 2015 |
| Moxifloxacine (coated tablets 400 mg) | Moxifloxacine | RX | Antimicrobial | 10 August 2015 |
| Gliclazide MV (modified release tablets 30 mg, 60 mg) | Gliclazide | RX | Antihyperglycemic | 26 August 2015 |
| Clarithromycin (coated tablets 500 mg) | Clarithromycin | RX | Antimicrobial | 19 May 2015 |
| Clarithromycin (sustained- action tablets, coated 500 mg) | Clarithromycin | RX | Antimicrobial | 23 August 2015 |
| Levofloxacin (coated tablets 250 mg, 500 mg, 750 mg) | Levofloxacin | RX | | 27 May 2015 |

In 2014, the Company proceeded with the ongoing projects and started new joint manufacturing projects in cooperation with a number of international and national pharmaceutical companies.

We completed 11 secondary packaging and release quality control localization projects, and 2 complete cycle localization projects for manufacturing of medicines in the form of tablets, solution for injection, lyophilizate solution for injection on the Pharmstandard's operating platform.

For 2015 the Company plans to complete the localization of secondary packaging manufacturing process and release quality control for 15 products of ten international companies (including coated tables and syrups for digestive diseases; tables and hard gelatine capsules for HIV infections, impaired circulation, oncohematological diseases; and injectable preparations for severe viral upper respiratory tract infections and oncohematological diseases). We plan to set up the complete cycle manufacturing of more than 40 products of 6 international and 4 Russian pharmaceutical companies.

# Vital & Essential Drugs, 2014-2015

Price regulation with respect to products included in the List of Vital and Essential Drugs ("VED") in 2014 was based on the statutory rules and methodologies established in 2012, since then the applicable regulatory framework has not been changed. The basic regulatory documents for setting the wholesale manufacturer ceiling prices for the VED listed pharmaceuticals include:

- the Federal Law on the Circulation of Medicines dated 12 April 2010 #61-FZ;
- the Procedure for Setting the Wholesale Manufacturer Ceiling Prices for the VED Listed Pharmaceuticals (the "Procedure") (approved by the joint order of the Ministry of Healthcare and Social Development of the Russian Federation and the Federal Tariff Service dated 3 November 2010 #961n/ 527a, as amended by the joint order of the Ministry of Healthcare of the Russian Federation and the Federal Tariff Service dated 08 October 2012 #400n/ 663-a).

The VED List for 2014 was kept unchanged (as per the Ordinance of the RF Government dated 7 December 2011 # 2199-r).

## Re-registration of wholesale ceiling prices for the VED listed pharmaceuticals in 2014

In accordance with the law, Pharmstandard Group filed the appropriate dossiers with the Russia's Ministry of Healthcare seeking a 5% inflation rate adjustment with respect to 69 VED prices. The anticipated inflation rate of 5% for the ensuing financial year was established by the Federal Law on the Federal Budget for 2014 and the Planning Period of 2015 and 2016, #349-FZ. All applications submitted in 2014 for price reregistration based on inflation rate adjustment were accepted by the Federal Tariff Service that confirmed reregistration of 69 VED ceiling prices for 34 international non-proprietary names (INNs), i.e. 36 brand names, of which 44 were the inflation adjusted ceiling prices for organic VED listed products and 25 for third party VED listed products.

| # | INN | Brand name | Number of reregistered inflation rate adjusted prices in 2014 |
|---|---|---|---|
| 1 | - | Anatoxinum diphtherico-tetanicum purificatum (ADT-M Anatoxinum) | 1 |
| 2 | - | Anatoxinum tetanicum purificatum adsorptum fluidum (AT Anatoxinum) | 1 |
| 3 | Azithromycin | Azitrox | 5 |
| 4 | Activated Charcoal | Activated Charcoal | 2 |
| 5 | Aminophilline | Euphyllin | 1 |
| 6 | Ascorbic acid | Ascorbic acid | 1 |
| 7 | Acetylsalicylic acid | Acetylsalicylic acid | 2 |
| 8 | Darunavir | Prezista | 2 |
| 9 | Digoxin | Digoxin | 1 |
| 10 | Isosorbide dinitrate | Nitrosorbide | 1 |
| 11 | Interferon alfa | Interferon leukocytic human fluid | 2 |
| 12 | Potassium-magnesium asparaginate | Asparcam | 1 |
| 13 | Calcium gluconate | Calcium gluconate | 1 |
| 14 | Co-trimoxazole | Co-trimoxazole | 1 |
| 15 | Co-trimoxazole [Sulfamethoxazole + trimethoprim] | Co-trimoxazole | 1 |

| # | INN | Brand name | Number of rereg-istered inflation rate adjusted prices in 2014 |
|---|---|---|---|
| 16 | Lenalidomide | Revlimid | 3 |
| 17 | Lidocaine | Lidocaine | 1 |
| 18 | Losartan | Bloctran | 3 |
| 19 | Meldonium | Meldonium | 1 |
| 20 | Nitroglycerin | Nitroglycerin | 1 |
| | | Nitrospray | 1 |
| 21 | Oseltamyvir | Tamiflu | 9 |
| 22 | Pancreatin | Pancreatin | 1 |
| 23 | Paracetamol | Paracetamol | 4 |
| 24 | Propranolol | Anaprilin | 2 |
| 25 | Rituximab | Mabthera | 6 |
| 26 | Thioctic acid | Octolipen | 2 |
| 27 | Tocilizumab | Actemra | 3 |
| 28 | Trihexyphenidyl | Cyclodol | 1 |
| 29 | Formoterol | Atimos | 1 |
| 30 | Phospholipides + Glycyrrhizinic acid | Phosphogliv | 1 |
| | | Phosphogliv forte | 1 |
| 31 | Furosemide | Furosemide | 1 |
| 32 | Chloramphenicol | Levomycetin | 1 |
| 33 | Enalapril | Renipril | 2 |
| 34 | Etravirine | Intelence | 1 |
| **Total:** | | | **69** |

Breakdown by operating company looks as follows:

| Pharmstandard Group operating companies | Number of prices reregistered in 2014 |
|---|---|
| Pharmstandard-Leksredstva OJSC | 47 |
| Pharmstandard-UfaVITA OJSC | 14 |
| Pharmstandard-Tomskhimpharm OJSC | 4 |
| Biomed Mechnikov OJSC | 4 |
| **Total:** | **69** |

In 2014, we filed the documents with the Russia's Ministry of Healthcare seeking a re-registration of ceiling prices for Epostin® prefilled syringe solution for intravenous and hypodermic injections (2 prices for 2000 IU/ml and 10000 IU/ml dosage forms) manufactured by Pharmapark LLC, with a view to re-register a reduced the ceiling price for the VED listed product relative to the registered VED ceiling price. The request for VED price re-registration with respect to Epostin® solution for intravenous and hypodermic injections (2 prices) was denied on the grounds that the existing rules and regulations do not provide for a VED price re-registration in the event of a ceiling price reduction.

## Registration of wholesale ceiling prices for the VED listed pharmaceuticals in 2014

In 2014, 78 wholesale ceiling prices for VED brand names manufactured or owned by Pharmstandard Group companies were entered in the State Register (20 INNs / 20 brand names).

| # | INN | Brand name | Number of VED prices registered in 2014 |
|---|---|---|---|
| 1 | Azithromycin | Azithromycin | 4 |
| 2 | Bortezomib | Velcade | 1 |
| 3 | Vinorelbine | Vinorelbine | 6 |
| 4 | Darunavir | Prezista | 1 |
| 5 | Desmopressin | Nativa | 2 |
| 6 | Doxorubicin | Doxorubicin | 5 |
| 7 | Imiglucerase | Cerezyme | 2 |
| 8 | Insulin-isophan [human biosynthetic] | Biosulin | 2 |
| 9 | Interferon alfa-2b | Altevir | 10 |
| 10 | Interferon beta-1a | Rebif | 2 |
| 11 | Co-trimoxazole | Co-trimoxazole | 1 |
| 12 | Mitoxantron | Mitoxantron | 6 |
| 13 | Nilotinib | Tasigna | 4 |
| 14 | Paclitaxel | Paclitaxel | 5 |
| 15 | PegInterferon alfa-2B | PegaAltevir | 5 |
| 16 | Somatropin | Rastan | 2 |
| 17 | Fluorouracil | Fluorouracil | 1 |
| 18 | Epirubicin | Epirubicin | 8 |
| 19 | Epoietin beta | Epostin | 10 |
| 20 | Etravirine | Intelence | 1 |
| **Total:** | | | **78** |

Breakdown by operating company looks as follows:

| Type of manufacturer | Operating company | Number of VED prices registered in 2014 |
|---|---|---|
| **Russian manufacturers** | Pharmstandard-UfaVITA OJSC | 39 |
| | Pharmstandard-Leksredstva OJSC | 5 |
| | Manufacturing under order of Pharmapark LLC (complete manufacturing cycle at Pharmstandard-UfaVITA OJSC) | 25 |
| **Total – Russian manufacturers** | | **69** |
| **Foreign manufacturer not affiliated with Pharmstandard Group (Pharmstandard OJSC is the Marketing Authorisation Holder)** | Onko-Generiks LLC | 7 |
| **Foreign manufacturer affiliated with Pharmstandard Group** | Pharmstandard Biolek PJSC | 2 |
| **Total – foreign manufacturers** | | **9** |
| **Total:** | | **78** |

VED price registration in 2014 took place for the following reasons:

- price registration for newly launched products (21 prices);
- price registration due to new type of primary package included in the Marketing Authorisation (4 prices);
- price registration due to additional manufacturing site included in the Marketing Authorisation (production relocation within Pharmstandard Group manufacturing facilities) (34 prices);
- price registration due to additional manufacturing site included in the Marketing Authorisation (localization of secondary package manufacturing in Russia) (16 prices);
- price registration due to additional manufacturing site included in the Marketing Authorisation (localization of complete manufacturing cycle) (3 prices);

## VED products in Pharmstandard Group sales mix

As of 1 March 2015, Pharmstandard Group has 365 SKUs (both organic and TPPs) with VED ceiling prices registered for 95 INNs (for the entire range of product forms and dosages).

VED sales in 2014 reached RUB 26,983 m, accounting for 76% of Pharmstandard Group's total sales.

2014 saw a decline in VED sales by RUB 6,098 m or -18% YoY vs 2013. The decline is mainly attributed to TPP products, specifically Mabthera (Rituximab INN) with a decline by RUB 5,630.5 m.

As of 2014, VED organic sales reached RUB 4,969 m or 49% of Pharmstandard Group's total organic sales, demonstrating RUB 438 m or +10% YoY growth compared to 2013 VED organic sales.

In 2014, sales of third party VED listed products reached RUB 22,014 m or 87% of TPP sales.

Compared to 2013, sales of third party VED listed products decreased by RUB 6,536 m or -23% YoY.

The number of VED listed product names (including all product forms and dosages) sold by Pharmstandard in 2014 declined by -7% YoY to reach 172 items vs 185 items in 2013.

The number of VED listed organic products increased by 9 items while the number of TPPs decreased by 22 items. The TPP sales structure changed as a result of the withdrawal of Microgen's products (16 items) and Veropharm's products (3 items) from Pharmstandard Group sales mix.

Prescription products (Rx) hold the dominant position in Pharmstandard Group's VED sales. In 2014, Rx share increased from 82% to 88%.

| Product type | Marketing status (OTC/RX) | 2013 | | 2014 | | Change | |
|---|---|---|---|---|---|---|---|
| | | Number of products | % of total | Number of products | % of total | # of products | % |
| All types (organic + TPP) | OTC | 33 | 18% | 21 | 12% | -12 | -36% |
| | RX | 152 | 82% | 151 | 88% | -1 | -1% |
| **Total:** | | **185** | **100%** | **172** | **100%** | **-13** | **-7%** |
| Organic products | OTC | 18 | 18% | 16 | 15% | -2 | -11% |
| | RX | 83 | 82% | 94 | 85% | 11 | 13% |
| **Total:** | | **101** | **100%** | **110** | **100%** | **9** | **9%** |
| TPPs | OTC | 15 | 18% | 5 | 8% | -10 | -67% |
| | RX | 69 | 82% | 57 | 92% | -12 | -17% |
| **Total:** | | **84** | **100%** | **62** | **100%** | **-22** | **-26%** |

## Price changes in 2015

On the date of the Annual Report preparation, there were no changes in the regulatory framework in terms of registration/ reregistration of wholesale manufacturer ceiling prices for the VED listed pharmaceuticals, the regulatory framework was based on the statutory rules and methodologies enacted in 2012.

Re-registration of wholesale ceiling prices for the VED listed drugs in 2015

In accordance with the law, Pharmstandard Group companies filed the appropriate dossiers with the Russia's Ministry of Healthcare applying for the inflation rate adjustment (5.5%) with respect to 81 VED prices for 36 INNs / 37 brand names manufactured or owned by Pharmstandard Group companies. The anticipated inflation rate (5.5%) was established by the Federal Law on the Federal Budget for 2015 and the Planning Period of 2016 and 2017, #384-FZ.

As of 1 March 2015, Biomed Mechnikov's VED prices (3 prices) are pending approval by the Federal Tariff Service. 78 VED ceiling prices have been approved by the Federal Tariff Service which confirmed their reregistration. 33 (of total 78 VED prices) were the inflation rate adjusted ceiling prices for third party VED listed products, and 45 – refer to organic VED listed products.

| # | INN | Brand name | Number of re-registered inflation rate adjusted prices in 2015 |
|---|---|---|---|
| 1 | Azithromycin | Azitrox | 5 |
| 2 | Activated Charcoal* | Activated Charcoal | 2 |
| 3 | Aminophilline | Euphyllin | 1 |
| 4 | Ascorbic acid | Ascorbic acid | 1 |
| 5 | Atenolol | Atenolol | 2 |
| 6 | Acetylsalicylic acid | Acetylsalicylic acid | 1 |
| 7 | Beclometasone | Clenil | 1 |

| # | INN | Brand name | Number of re-registered inflation rate adjusted prices in 2015 |
|---|---|---|---|
| 8 | Glibenclamide | Glibenclamide | 1 |
| 9 | Darunavir | Prezista | 3 |
| 10 | Digoxin | Digoxin | 1 |
| 11 | Dornase alfa | Pulmozyme | 1 |
| 12 | Interferon alfa-2b | Altevir | 3 |
| 13 | Interferon beta-1a | Rebif | 2 |
| 14 | Potassium-magnesium asparaginate | Asparcam | 1 |
| 15 | Calcium gluconate | Calcium gluconate | 1 |
| 16 | Co-trimoxazole | Co-trimoxazole | 1 |
| 17 | Co-trimoxazole [Sulfamethoxazole + trimethoprim] | Co-trimoxazole | 1 |
| 18 | Lenalidomide | Revlimid | 3 |
| 19 | Lidocaine | Lidocaine | 1 |
| 20 | Losartan | Bloctran | 3 |
| 21 | Meldonium | Meldonium | 1 |
| 22 | Nilotinib | Tasigna | 4 |
| 23 | Nitroglycerin | Nitrospray | 1 |
| 24 | Oseltamyvir | Tamiflu | 9 |
| 25 | Pancreatin | Pancreatin | 1 |
| 26 | Paracetamol | Paracetamol | 4 |
| 27 | Propranolol | Anaprilin | 2 |
| 28 | Rituximab | Mabthera | 6 |
| 29 | Thioctic acid | Octolipen | 2 |
| 30 | Tocilizumab | Actemra | 2 |
| 31 | Trihexyphenidyl | Cyclodol | 1 |
| 32 | Filgrastim | Neupomax | 2 |
| 33 | Formoterol | Atimos | 1 |
| 34 | Phospholipides + Glycyrrhizinic acid | Phosphogliv | 3 |
| | | Phosphogliv forte | 1 |
| 35 | Enalapril | Renipril | 2 |
| 36 | Etravirine | Intelence | 1 |
| Total: | 78 | | |

* As of 1 March 2015, Activated Charcoal INN is excluded from the VED List.

In 2015 YTD, a larger number of VED ceiling prices has been reregistered compared to 2014 (by 4 trade names vs 2014).

The economic situation in and around Russia at the start of 2015 was supportive to the steady growth in foreign exchange rates and the resulting increase in production costs due to a significant FX component in raw materials, including those used in VED manufacturing. Levomycetin wholesale ceiling prices calculated in 2015 for VED listing purposes in accordance with the existing Procedure could not cover the Company's expenses on the main raw purchased in foreign currency.

Therefore, Pharmstandard Group has filed the documents seeking a registration of wholesale ceiling prices for Levomycetin above the allowable limits established in the State Register of wholesale ceiling prices, supporting our application with a detailed justification of the price advance due to a FX component in the raw material. The prices proposed for registration could have supported a breakeven manufacturing of the product. Pharmstandard's request for VED price registration was denied on the grounds that the proposed prices exceed the allowable limits for wholesale ceiling prices for similar drugs.

## Changes in the VED List in 2015

In pursuance of the RF Government ordinance #2782-r dated 30 December 2014, the VED list for 2015 was amended. The amendments to the VED List has come into force since 1 March 2015. Before 1 March 2015, the VED List approved by the RF Government order #2199-r dated 7 December 2011 was in effect.

Changes made to 2015 VED List, which took effect from 1 March 2015, refer both to products manufactured by Pharmstandard Group operating companies and to third party products marketed by Pharmstandard OJSC:

1. Drugs with Activated Charcoal INNs are excluded from the VED List.

2. New INNs included in the VED List: 4 INNs of the products manufactured by Pharmstandard Group operating companies, and 1 INN of a third party product being purchased by Pharmstandard OJSC for further distribution.

| INN | Brand name | Manufacturer |
|---|---|---|
| Bedaquiline | Sirturo | Pharmstandard-UfaVITA OJSC |
| Telaprevir | Insivo | Pharmstandard-UfaVITA OJSC |
| Azacitidine | Vidaza | Pharmstandard-UfaVITA OJSC |
| Palivizumab | Synagis | Pharmstandard-UfaVITA OJSC |
| Moroctocog alfa | Octofactor | Generium CJSC |

3. New dosage forms included in the VED List:

| Brand name | Dosage form | INN | Manufacturer |
|---|---|---|---|
| Velcade | Lyophilizate for solution for hypodermic injections | Bortezomib | Pharmstandard-UfaVITA OJSC |
| Mildronate | Solution for intramuscular, intravenous and parabulbar injections | Meldonium | Pharmstandard-UfaVITA OJSC |

Wholesale ceiling prices for all above VED listed pharmaceuticals as of 1 March 2015 have been registered and entered in the State Register.

# Government Procurement market

According IMS Health, in 2014 the government procurement market grew by c. 16% to reach RUB 280.7 bn.

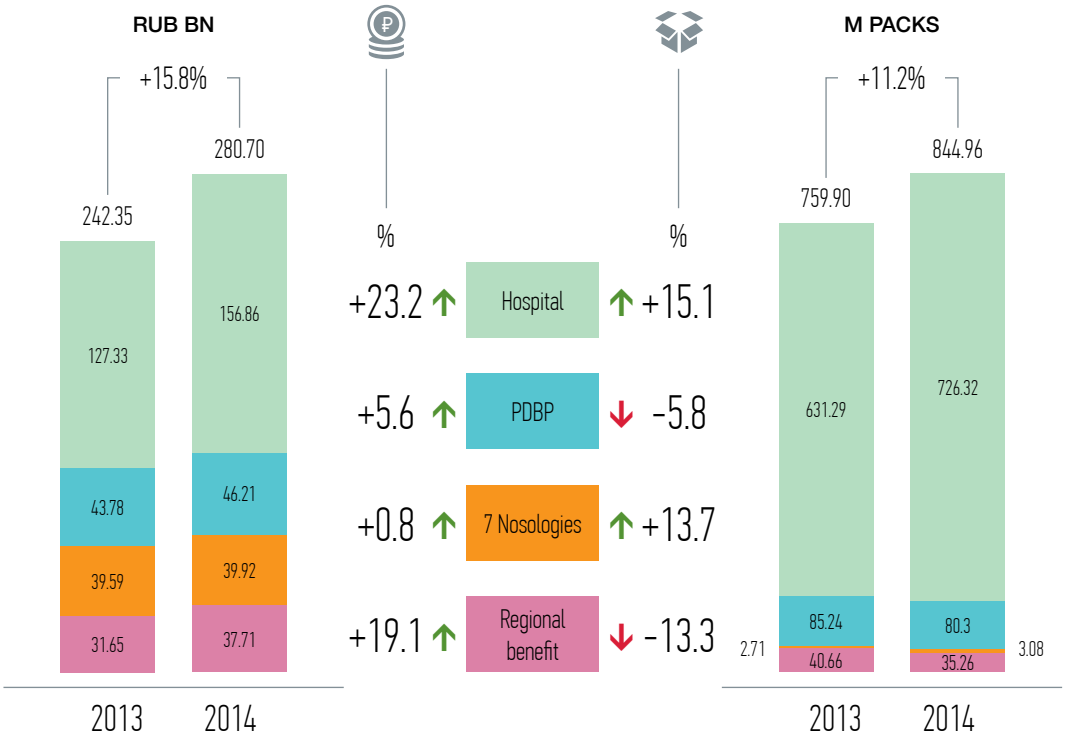
Hospital segment demonstrated the highest growth rate +23.2% YoY. A significant growth was also seen in the Regional Benefit segment +19.1% YoY. The PDBP funding showed a moderate increase by +5.6% YoY, while expenditure under the High-Cost Nosologies Federal Program remained nearly stable +0.8% YoY.

In physical terms, the government procurement market also demonstrated a +11.2% YoY growth, with the highest growth rate in Hospital and 7 Nosologies segments: +15.1% and +13.7% correspondingly, reflecting the generics pressure on the drug prices. Drug consumption in PDBP and Regional Benefit segments showed a negative growth -5.8% and -13.3% correspondingly.

The key players' rankings remained unchanged. In 2014, Top 5 majors on the RF government procurement market were represented by:

1. Roche
2. Sanofi-Aventis
3. Johnson & Jonson
4. Merck Sharp & Dohme
5. Teva

**GOVERNMENT PROCUREMENT MARKET 2013-2014**



Although most of the companies increased their sales (except for Teva), their market share decreased **(see Table #1)**. Johnson & Johnson was the only one who slightly improved its market position.

Table #1. RANKING OF KEY PHARMACEUTICAL PLAYERS ON GOVERNMENT PROCUREMENT MARKET

| | Year | | | | | |
|---|---|---|---|---|---|---|
| | Sales, *RUB m incl. VAT (wholesale)* | | Market share, *% (RUB)* | | Growth rate, *% (RUB)* | |
| Manufacturer | 2013 | 2014 | 2013 | 2014 | | 2014 |
| **ROCHE*** | 22,029.752 | 24,314.019 | 9.09% | 8.66% | ↑ | +10.4% |
| **SANOFI-AVENTIS** | 15,087.173 | 15,520.276 | 6.23% | 5.53% | ↑ | +2.9% |
| **JOHNSON & JOHNSON*** | 12,369.077 | 14,400.181 | 5.10% | 5.13% | ↑ | +16.4% |
| **MERCK SHARP DOHME*** | 8,564.799 | 9,210.112 | 3.53% | 3.28% | ↑ | +7.5% |
| **TEVA*** | 8,564.133 | 7,658.989 | 3.53% | 2.73% | ↓ | -10.6% |
| **OTHERS** | 175,743.699 | 209,598.463 | 72.51% | 74.67% | ↑ | +19.3% |

Table #2. MANUFACTURER / DRUG RANKINGS ON GOVERNMENT PROCUREMENT MARKET (W/O 7 NOSOLOGIES FEDERAL PROGRAM)

| | | Year | | | |
|---|---|---|---|---|---|
| | | Sales, *RUB m incl. VAT (wholesale)* | | Growth rate, *% (RUB)* | |
| Manufacturer | Brand name | 2013 | 2014 | | 2014 |
| **ABBVIE*** | KALETRA | 3,504.110 | 3,891.836 | ↑ | +11.1% |
| | HUMIRA | 938.448 | 1,580.804 | ↑ | +68.4% |
| | SEVORANE | 954.321 | 889.610 | ↓ | -6.8% |
| | SYNAGIS | 268.558 | 479.793 | ↑ | +78.7% |
| | ZEMPLAR | 89.719 | 118.198 | ↑ | +31.7% |
| **ABBVIE* - Total** | | **5,755.155** | **6,960.241** | ↑ | **+ 20.9%** |
| **ASTRAZENECA*** | SYMBICORT TURBUHALER | 1,718.272 | 1,905.435 | ↑ | +10.9% |
| | ZOLADEX | 1,028.107 | 1,235.391 | ↑ | +20.2% |
| | IRESSA | 703.043 | 837.107 | ↑ | +19.1% |
| | FASLODEX | 444.601 | 625.847 | ↑ | +40.8% |
| | MERONEM | 859.077 | 574.952 | ↓ | -33.1% |
| **ASTRAZENECA* - Total** | | **4,753.100** | **5,178.732** | ↑ | **+9.0%** |
| **ROCHE*** | HERCEPTIN | 3,885.513 | 5,129.620 | ↑ | +32.0% |
| | AVASTIN | 2,460.285 | 2,905.707 | ↑ | +18.1% |
| | PEGASYS | 1,630.271 | 1,554.484 | ↓ | -4.6% |
| | MABTHERA | 1,114.224 | 1,151.915 | ↑ | +3.4% |
| | VALCYTE | 786.657 | 706.873 | ↓ | -10.1% |
| **ROCHE* - Total** | | **9,876.950** | **11,448.599** | ↑ | **+15.9%** |

| Manufacturer | Brand name | Year: Sales, RUB m incl. VAT (wholesale) 2013 | 2014 | | Growth rate, % (RUB) 2014 |
|---|---|---|---|---|---|
| **MERCK SHARP DOHME*** | REMICADE | 2,552.005 | 2,934.745 | ↑ | +15.0% |
| | ISENTRESS | 1,212.734 | 1,552.278 | ↑ | +28.0% |
| | PEGINTRON | 969.278 | 738.897 | ↓ | -23.8% |
| | TEMODAL | 658.922 | 407.397 | ↓ | -38.2% |
| | TIENAM | 584.303 | 336.386 | ↓ | -42.4% |
| **MERCK SHARP DOHME* - Total** | | **5,977.243** | **5,969.703** | ↓ | **-0.1%** |
| **SANOFI-AVENTIS** | LANTUS SOLOSTAR | 3,299.857 | 4,303.300 | ↑ | +30.4% |
| | CLEXANE | 1,972.622 | 1,720.429 | ↓ | -12.8% |
| | TAXOTERE | 1,351.348 | 1,241.757 | ↓ | -8.1% |
| | ALDURAZYME | 615.351 | 612.687 | ↓ | -0.4% |
| | LANTUS | 697.713 | 598.671 | ↓ | -14.2% |
| **SANOFI-AVENTIS - Total** | | **7,936.890** | **8,476.843** | ↑ | **+6.8%** |

Table #3. MANUFACTURER / DRUG RANKINGS UNDER 7 NOSOLOGIES FEDERAL PROGRAM

| Manufacturer | Brand name | Year: Sales, RUB m incl. VAT (wholesale) 2013 | 2014 | | Growth rate, % (RUB) 2014 |
|---|---|---|---|---|---|
| **ROCHE*** | MABTHERA | 7,282.108 | 7,980.298 | ↑ | +9.6% |
| | PULMOZYME | 1,188.013 | 1,182.653 | ↓ | -0.5% |
| | CELLCEPT | 109.360 | 27.760 | ↓ | -74.6% |
| **ROCHE* - Total** | | **8,579.481** | **9,190.711** | ↑ | **+7.1%** |
| **JOHNSON & JOHNSON*** | VELCADE | 5,864.248 | 6,821.721 | ↑ | +16.3% |
| **JOHNSON & JOHNSON* - Total** | | **5,864.248** | **6,821.721** | ↑ | **+16.3%** |
| **TEVA*** | COPAXONE-TEVA | 4,781.156 | 5,044.517 | ↑ | +5.5% |
| | TACROLIMUS-TEVA | 356.624 | 228.798 | ↓ | -35.8% |
| | EQUORAL | 125.111 | 92.709 | ↓ | -25.9% |
| | MYCOPHENOLATE-TEVA | 56.923 | 3.607 | ↓ | -93.7% |
| **TEVA* - Total** | | **5,319.813** | **5,369.631** | ↑ | **+0.9%** |
| **BAXTER INT** | HEMOFIL M | 1,201.125 | 1,500.595 | ↑ | +24.9% |
| | RECOMBINATE | 858.565 | 1,393.674 | ↑ | +62.3% |
| | IMMUNATE | 946.283 | 672.476 | ↓ | -28.9% |
| | IMMUNINE | 497.761 | 499.512 | ↑ | +0.4% |
| **BAXTER INT - Total** | | **3,503.733** | **4,066.258** | ↑ | **+16.1%** |
| **LABORATORIO TUTEUR** | GENFAXON | 2,394.502 | 1,658.350 | ↓ | -30.7% |
| | GENFATINIB | 1,855.693 | 471.996 | ↓ | -74.6% |
| | FLUTOTERA | 86.905 | 109.114 | ↑ | +25.6% |
| **LABORATORIO TUTEUR - Total** | | **4,337.100** | **2,239.460** | ↓ | **-48.4%** |

# Key pharmaceutical players on Russian government procurement market, 2014

### GOVERNMENT PROCUREMENT, W/O 7 NOSOLOGIES FEDERAL PROGRAM

| Supplier | Ultimate cost, *RUB incl. VAT* | Market share, *%* |
|---|---|---|
| R-Pharm CJSC | 30,578,254,978 | 15.5% |
| Pharmaceuticals import/ export (Pharmimpex) OJSC | 7,668,423,530 | 3.9% |
| Euroservice | 6,803,141,028 | 3.5% |
| PHARMSTANDARD | 5,290,544,058 | 2.7% |
| LANCET | 5,061,176,897 | 2.6% |
| OTHER SUPPLIERS | 141,475,979,686 | 71.9% |
| **TOTAL:** | **196,877,520,177** | **100.0%** |

### 7 NOSOLOGIES FEDERAL PROGRAM

| Supplier | Ultimate cost, *RUB incl. VAT* | Market share, *%* |
|---|---|---|
| Pharmaceuticals import/ export (Pharmimpex) OJSC | 9,377,691,880 | 21.2% |
| Teva LLC | 6,274,378,196 | 14.2% |
| Irvin 2 LLC | 6,199,273,632 | 14.0% |
| Biocad-Pharm LLC | 5,978,380,136 | 13.5% |
| PHARMSTANDARD* | 4,344,260,290 | 9.8% |
| BIOTEC | 3,322,099,205 | 7.5% |
| NATIONAL IMMUNOBIOLOGICAL COMPANY OJSC | 2,362,379,446 | 5.3% |
| R-Pharm CJSC | 2,089,938,818 | 4.7% |
| Medipal-ONCO LLC | 2,043,897,389 | 4.6% |
| NPK Katren CJSC | 1,351,299,487 | 3.1% |
| ROSTA CJSC | 617,164,391 | 1.4% |
| CORAL-MED CJSC | 218,089,039 | 0.5% |
| Russian Medical Company CJSC | 72,527,605 | 0.2% |
| **TOTAL:** | **44,251,379,514** | **100.0%** |

In 2014, the aggregate market share of Somatropin, Interferon beta-1b, Dornase alfa, Eptacog alfa, Bortezomib, Rituximab brands manufactured by Pharmstandard OJSC, Generium CJSC and Biocad LLC reached 39.4% of total government procurements.

This share is expected to grow in 2015 through the rollout of such new localized or entirely local drugs like Lenalidomide and Moroctocog alfa.

# Government procurement – 2014 performance

| | | 2013 | | 2014 | | | |
|---|---|---|---|---|---|---|---|
| | | Revenue, *less VAT (RUB)* | Share, *% (RUB)* | Revenue, *less VAT (RUB)* | Share, *% (RUB)* | | Growth rate, *% (RUB)* |
| **Sanofi-Aventis** | Lantus | 3,946,934,277 | 13.62% | 4,707,692,839 | 21.50% | ↑ | +19.3% |
| | Insuman Basal | 355,865,998 | 1.23% | 487,281,181 | 2.23% | ↑ | +36.9% |
| | Insuman Rapid | 277,193,275 | 0.96% | 306,959,953 | 1.40% | ↑ | +10.7% |
| | Apidra | 233,723,415 | 0.81% | 297,440,700 | 1.36% | ↑ | +27.3% |
| **Sanofi-Aventis - Total** | | **4,813,716,965** | **16.61%** | **5,799,374,673** | **26.49%** | ↑ | **+20.5%** |
| **Johnson & Johnson** | Velcade | 6,336,670,483 | 21.87% | 2,554,447,800 | 11.67% | ↓ | -59.7% |
| | Prezista | 1,923,600,568 | 6.64% | 2,041,011,911 | 9.32% | ↑ | +6.1% |
| | Intelence | 691,664,141 | 2.39% | 771,601,532 | 3.52% | ↑ | +11.6% |
| | Insivo | 327,828,334 | 1.13% | 278,283,215 | 1.27% | ↓ | -15.1% |
| | Edurant | 17,473,240 | 0.06% | 92,089,945 | 0.42% | ↑ | +427.0% |
| | Sovriad | | 0.00% | 39,101,063 | 0.18% | | |
| | Eviplera | | 0.00% | 16,565,306 | 0.08% | | |
| **Johnson & Johnson - Total** | | **9 297 236 767** | **32,09%** | **5 793 100 771** | **26,46%** | ↓ | **-37.7%** |
| **Roche** | Mabthera | 8,937,781,300 | 30.85% | 3,280,611,013 | 14.98% | ↓ | -63.3% |
| | Pulmozyme | 1,135,012,460 | 3.92% | 878,714,192 | 4.01% | ↓ | -22.6% |
| | Actemra | 272,212,054 | 0.94% | 335,709,535 | 1.53% | ↑ | +23.3% |
| **Roche - Total** | | **10,345,005,814** | **35.70%** | **4,495,034,740** | **20.53%** | ↓ | **-56.5%** |
| **Generium** | Coagil | 2,724,395,383 | 9.40% | 2,061,097,175 | 9.41% | ↓ | -24.3% |
| | Diaskintest | 261,918,543 | 0.90% | 429,090,637 | 1.96% | ↑ | +63.8% |
| | Sirturo | | 0.00% | 60,072,833 | 0.27% | | |
| | Infibeta | 202,512,867 | 0.70% | 9,413,640 | 0.04% | ↓ | -95.4% |
| | Octofactor | 126,500 | 0.00% | 3,056,125 | 0.01% | ↑ | +2315.9% |
| | Rebif | | 0.00% | 3,573,357 | 0.02% | | |
| **Generium - Total** | | **3,188,953,293** | **11.01%** | **2,566,303,766** | **11.72%** | ↓ | **-19.5%** |
| **Celgene** | Revlimid | 775,801,912 | 2.68% | 973,471,355 | 4.45% | ↑ | +25.5% |
| | Vidaza | 100,542,612 | 0.35% | 210,863,733 | 0.96% | ↑ | +109.7% |
| Celgene - Total | | 876,344,524 | 3.02% | 1,184,335,088 | 5.41% | ↑ | +35.1% |
| **Genzyme** | Cerezyme | | 0.00% | 984,368,551 | 4.50% | | |
| **Genzyme - Total** | | | **0.00%** | **984,368,551** | **4.50%** | | |
| **AVVA** | Micrasim | 181,367,941 | 0.63% | 323,059,107 | 1.48% | ↑ | +78.1% |
| | Ursoliv | 36,150,456 | 0.12% | 22,190,273 | 0.10% | | -38.6% |
| **AVVA - Total** | | **217,518,397** | **0.75%** | **345,249,380** | **1.58%** | ↑ | **+58.7%** |

| | | 2013 | | 2014 | | | |
|---|---|---|---|---|---|---|---|
| | | Revenue, *less VAT (RUB)* | Share, *% (RUB)* | Revenue, *less VAT (RUB)* | Share, *% (RUB)* | | Growth rate, *% (RUB)* |
| **Chiesi** | Foster | 75,431,070 | 0.26% | 127,327,261 | 0.58% | ↑ | +68.8% |
| | Atimos | 98,316,718 | 0.34% | 89,354,911 | 0.41% | | -9.1% |
| | Clenil | 61,369,089 | 0.21% | 72,843,007 | 0.33% | ↑ | +18.7% |
| **Chiesi - Total** | | **235,116,877** | **0.81%** | **289,525,180** | **1.32%** | ↑ | **+23.1%** |
| **Novartis** | Tasigna | | 0.00% | 264,799,695 | 1.21% | | |
| **Novartis - Total** | | | **0.00%** | **264,799,695** | **1.21%** | | |
| **Abbvie** | Synagis | | 0.00% | 137,907,741 | 0.63% | | |
| **Abbvie - Total** | | | **0.00%** | **137,907,741** | **0.63%** | | |
| **Pharmasyntez** | Kemeruvir | | 0.00% | 34,477,613 | 0.16% | | |
| **Pharmasyntez - Total** | | | **0.00%** | **34,477,613** | **0.16%** | | |
| **TOTAL:** | | **28,973,892,637** | **100.00%** | **21,894,477,197** | **100.00%** | ↓ | **-24.4%** |

Slump in Mabthera® and Velcade® sales is driven by the launch of generics. Decline in sales in Generium's group of products is a result of direct supplies by Generium CJSC (Coagil, Infibeta) under some Federal auctions in 2014.

# Medical equipment: 2014 performance, sales, developments – overview and prospects

In 2014, medical equipment segment demonstrated a 6.3% YoY growth in sales compared to 2013.

The growth was primarily driven by the expansion of Pharmstandard-Medtechnika's market presence through developing a new business line in the segment of expendables for disinfection and sterilization equipment.

DURING THE FIRST YEAR, EXPENDABLE PRODUCT SALES REACHED RUB 151 MILLION.

Tentatively speaking, expendables for disinfection and sterilization equipment may be split into two sub-groups: indicators for disinfection and sterilization processes and packing materials.

According to expert estimates, in 2014 Pharmstandard-Medtechnika's market share was 4.9% in indicators segment and 22.85% in packing materials segment. This is the evidence of a significant upside potential, which will be realised in the upcoming periods.

In 2014, Pharmstandard-Medtechnika's market share (calculated as the ratio of the contracts awarded to the Company to the total number of tenders held in this medical equipment segment)

reached 25%. The awarded contracts not only supported the sales volumes in 2014, but also partially formed the sales orders for 2015. Thus, the procurement orders awarded in 2014 will account for c. RUB 116 m of 2015 sales.

This was made possible due to the following:

- In 2014, we continued to pursue the new sales growth strategy focused on regional sales allowing to expand the Company's presence on the Russian regional markets
- Increased the Company's presence in the segment of medical waste disposal equipment facilitated by the extensive upgrade of medical waste disposal equipment production line at Tyumen Medical Equipment and Tools Plant JSC
- Made a number of material engineering changes in the existing equipment models to better meet the market requirements
- Higher quality of equipment maintenance services as a result of the service business development strategy focused on regional expansion, higher flexibility, service rate and quality of maintenance services.

In 2015, Pharmstandard-Medtechnika LLC will continue its business expansion to provide higher growth rates, this will be possible assuming the following factors:

- In 2014, Tyumen Medical Equipment and Tools Plant JSC has undergone an extensive upgrade with the ultimate objective to substantially renew the range of equipment produced. Currently, the reconstruction is 99% complete. The entire product line has been upgraded and now meets all quality and ergonomic requirements in line with the best standards in the market segment
- In 2015, Tyumen Medical Equipment and Tools Plant JSC will be capable to offer almost the entire product line in disinfection and sterilization segment: from steam sterilizers to disinfecting washing machines. This, coupled with active implementation of the National Strategy for Development of Medical Industry in the Russian Federation until 2020, would position the Company as one of the market leaders
- In 2015, the Company has set its sights on further development of equipment sales both in the Russian Federation, the CIS, and overseas planning to significantly expand its exports to Asia, Africa and Latin America
- In parallel, in 2015 we will continue to improve our maintenance service through increased flexibility, service rate and quality of maintenance services.

| **Product group** | **Sales,** *units* | **Revenue,** *RUB m* |
|---|---|---|
| Steam sterilizers, over 100 l capacity | 749 | 407 |
| Steam sterilizers, up to 100 l capacity | 1,672 | 158 |
| Plasma sterilizers | 18 | 38 |
| Disinfection and medical waste disposal equipment | 135 | 145 |
| Disinfecting washing machines | 64 | 53 |
| Disinfecting washing machines for endoscopes | 29 | 19 |
| Ultrasonic washing installations | 13 | 10 |
| Aqua distillers and water collectors | 2,627 | 55 |
| Other | 639 | 45 |
| Spare parts | 29,065 | 37 |
| Expendable material items | 36,700,392 | 151 |
| Component parts for equipment | 729 | 24 |
| Blood banking equipment | 52 | 2 |
| **Total:** | **36,736,184** | **1,145** |

# Overseas Sales

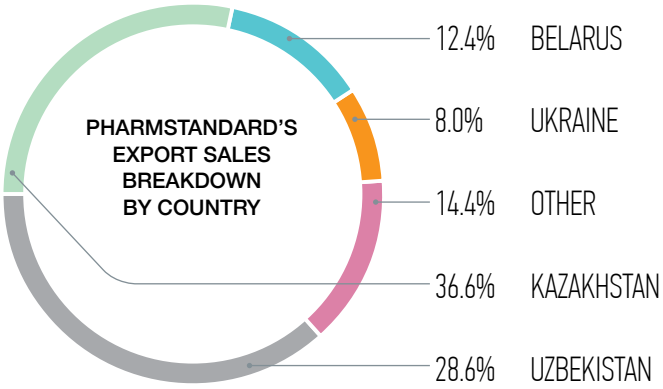
Pharmstandard exports its pharmaceutical products to 14 countries, predominantly to the CIS and the neighbouring FSU countries.

In 2014, export sales revenue decreased by 21.9% YoY vs 2013 and amounted to RUB 668.6 m[1] in money terms. Such decrease in export sales is driven by:

- the spin-off of the Group's branded OTC business into OTCPharm PJSC;
- political unrest and economic downturn in Ukraine;
- economic situation in a number of the CIS countries;
- changes in the requirements for pharmaceutical product marketing authorization in the export markets, and some other factors.

The major part of our export sales in 2014 is accounted for by pharma markets in Kazakhstan (36.6%), Uzbekistan (28.6%), Belarus (12.4%), Ukraine (8%).

As of 2014, export share reached 1.6% of the Company's total sales.



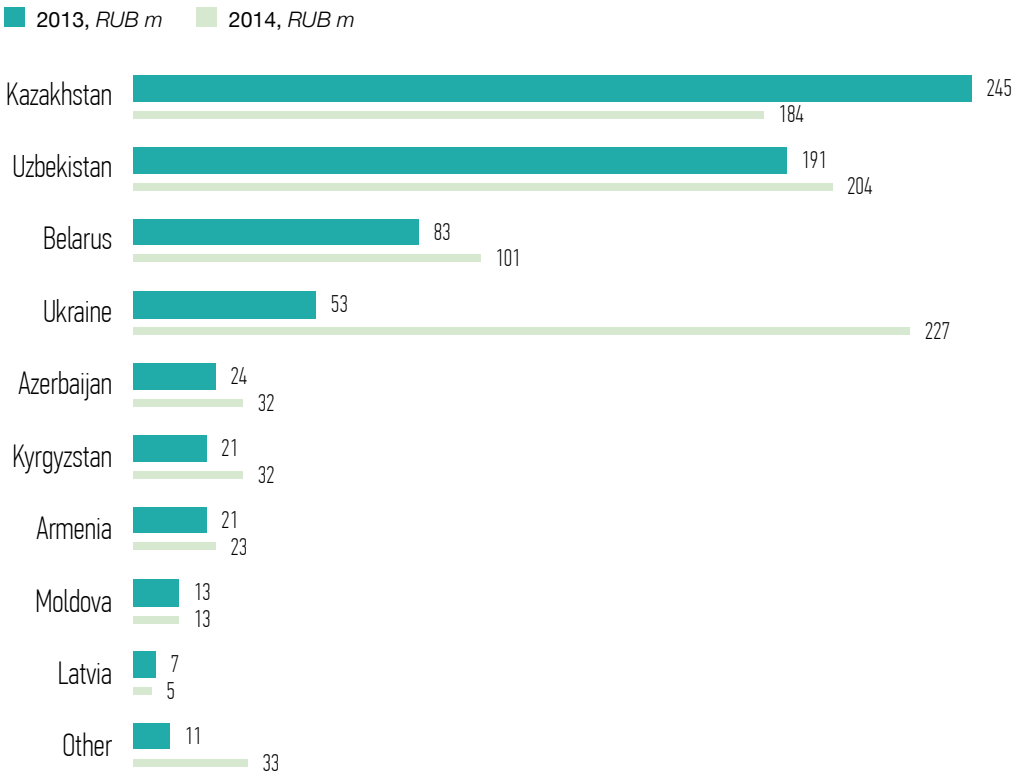

Pharmstandard strives to grow and expand its export business outside the CIS – both in the near abroad and far-abroad countries.

**EXPORT SALES AND YOY GROWTH BY COUNTRY (2013-2014)**

| Country | 2014, *RUB m* | 2014, *share %* | 2013, *RUB m* | 2013, *share %* | Growth 14/13, *RUB* | Growth 14/13, *%* |
|---|---|---|---|---|---|---|
| Kazakhstan | 245.0 | 36.6% | 184.3 | 21.5% | 60.66 | 32.9% |
| Uzbekistan | 191.2 | 28.6% | 204.1 | 23.9% | -12.94 | -6.3% |
| Belarus | 83.0 | 12.4% | 101.4 | 11.9% | -18.44 | -18.2% |
| Ukraine | 53.5 | 8.0% | 227.2 | 26.5% | -173.75 | -76.5% |
| Azerbaijan | 23.8 | 3.6% | 32.1 | 3.8% | -8.34 | -26.0% |
| Kyrgyzstan | 20.9 | 3.1% | 31.9 | 3.7% | -10.95 | -34.4% |
| Armenia | 20.9 | 3.1% | 23.4 | 2.7% | -2.54 | -10.8% |
| Moldova | 13.2 | 2.0% | 13.1 | 1.5% | 0.12 | 0.9% |
| Latvia | 6.7 | 1.0% | 5.2 | 0.6% | 1.47 | 28.2% |
| Other | 10.5 | 1.6% | 33.0 | 3.9% | -22.51 | -68.2% |
| **Total** | **668.6** | **100.0%** | **855.8** | **100.0%** | **-187.20** | **-21.9%** |

1 OTCPharm's pharmaceutical products are exported under the agency agreement, the agency fee figures are not included in the annual report's data.

**EXPORT STRUCTURE BY COUNTRY (2013-2014)**




## Key trends in the major CIS markets

**Kazakhstan and Belarus** together with Russia are members of the Single Economic Area's Customs Union. Armenia and Kyrgyzstan will be integrating in the Customs Union since 2015.

**Ukraine** demonstrated a pharmaceutical market decline driven by:

- population reduction associated with the out migration, separation of Crimea, the hostilities in the Luhansk and Donetsk People's Republics;
- political and economic crisis;
- devaluation of the national currency;
- a 7% VAT imposed on medicines and health care products imported and supplied to the territory of Ukraine, effective of April 2014;
- a ban on television sales of medicines and medical equipment prescribed by Law #1322VII On Amendments to the Law of Ukraine on Advertising.

**Kazakhstan's** pharmaceutical market reached US$ 1.35 bn in 2014

- Kazakhstan adheres to GMP standards. The National Pharmaceutical Sector Development Program pursued by the Government since 2010, requires that all companies should operate in compliance with GMP standards by 2014.
- Kazakhstan represents one of the biggest hospital markets in the CIS that accounts for about 45–50% of the entire national pharmaceutical market. Purchases are made through SK-Pharmacia, a state-owned company.
- Kazakhstan actively develops national pharmaceutical industry attracting investors to the construction of greenfield facilities and the expansion of existing capacity.
- Since 2014, registration dossiers are filled in electronic format in accordance with the regulatory requirements.

# Corporate Governance

# Pharmstandard Governance Structure and Policies

## Corporate Policy

The Company's corporate policy is based on the principle of respect for the rights and legitimate interests of its shareholders and is conducive to smooth and effective functioning of the Company including equity value growth, new job creation, financial stability and profitability.

The Company's successful operations and attractive investment case are supported by trust-based environment at all levels of corporate relations. The Company's corporate policy is focused on building trust-based relationships pertaining to the Company management.

## Dividend Policy

The dividend policy regulates the process of the Company's profit distribution among its shareholders. The dividend policy is determined by the Board of Directors. The Company may decide to reinvest its profit, retain it as undistributed corporate earnings or pay out as dividends, proceeding from the Company's objectives, current state of affairs and outlooks. The dividend policy is an integral part of the corporate financial policy and is aimed to strike the right balance between distributed and capitalized profit to maximize the Company's capitalisation.

The decision with regard to the 2014 dividend payment will be taken by the annual general meeting of shareholders to be held in May 2015. The Board of Directors is likely to recommend to the AGM to forgo the 2014 dividend payment on the Company's ordinary shares. This will allow to retain earnings for eventual M&A transactions and development of biotech projects.

## General Meeting of Shareholders

AGM is the Company's highest governance body. Based on the Board decision the Company announces AGM date and venue in a special press release. AGM takes place within the period from 2 to 6 months after the relevant financial year end. Holders (or a single holder) of at least 2% of the Company's voting shares are entitled to include items on AGM agenda and nominate candidates to the Board of Directors and the Audit Committee.

Extraordinary General Meetings of shareholders ("EGMs") are held by a decision of the Board based on the Board initiative, a request from the Audit Committee or the Company's auditor or a holder (holders) of at least 10% of the Company's voting shares as of the date of request.

Notice of a General Meeting ("GM") should be provided at least 30 days (or in some cases according to regulatory requirements, 70 days) prior to the scheduled date. The GM authorities and decision-making procedure are established by applicable laws and the Company's Charter.

## Board of Directors

The Board of Directors is responsible for the overall conduct of the Company's business. The Board determines the Company's priorities and approves business plans and feasibility studies for the Company's investment projects.

The Board of Directors consists of 11 members; two of them are independent.

The current Board of Directors for 2014-2015:

1. **Elena Arkhangelskaya –** has served as Chief Financial Officer since 2006, and Chief Operating Officer from February 2014 until December 2014, she was elected to the Board of Directors in June 2008. Elena has 15 years' experience in pharmaceutical companies. Previously, she held senior positions in Eli Lilly Vostok S.A. Representative Office. Elena Arkhangelskaya is a graduate of Finance Academy under the Government of the Russian Federation.

2. **Roman Goryunov –** has been the Board Member since June 2008. Previously, he held executive positions in RTS JSC, and from August 2007 to December 2011 he Chaired the Management Board of RTS Stock Exchange. Since December 2011, he has been Senior Managing Director and First Deputy Chairman of the Board of JSC MMVB-RTS. Since July 2012, President of Non-profit Partnership for the Development of Financial Market, RTS. Roman Goryunov is a graduate of St. Petersburg Technical University.

3. **Sergey Dushelikhinsky –** has served as our Chief Commercial Officer since 2006, he was elected to the Board of Directors in June 2008. He has 13 years' of experience in pharmaceutical sales. Previously, Sergey Dushelikhinsky worked in Veropharm CJSC and FTK Vremya. Sergey is a graduate of Moscow Technical University.

4. **Irog Krylov –** was CEO of Pharmstandard OJSC from 2006 to November 2014, and has been the Board Member since 2006. Over 18 years in his carrier, Irog Krylov spent in pharmaceutical industry. Previously, he held executive positions in representative offices of Eli Lilly Vostok S.A and Aventis Pharma International S.A. Igor Krylov graduated with honours from Kirov Military Medical Academy.

5. **Yegor Kulkov –** has been the Board Member since May 2006. Yegor Kulkov has held senior financial positions in various companies, and currently serves as General Director of Gloverton LLC. Yegor Kulkov is a graduate of Novosibirsk State University.

6. **Pavel Nosyrev –** has been the Board Member since 2014. From 2008 he headed New Products Development Department, and since 2009 served Deputy CEO for New Products Development. Pavel Nosyrev is a graduate of Lomonosov Moscow State University.

7. **Andrei Reus –** has been an Independent Director since 2010. From 2008 to 2012, he was Chief Executive Officer of Oboronprom United Industrial Corporation and also Chief Executive Officer of United Engine-Building Corporation Managing Company. Since 2012, he is CEO of the Eurasian Integration and Communication Research Centre, and CEO of Constanta Group LLC.

8. **Ivan Tyryshkin –** has been an Independent Director since October 2006. From 2006, he served Managing Director and Chief Executive Officer of ATON LLC. Currently, Ivan Tyryshkin is President and the Board member of Rusgrain Holding OJSC. Ivan Tyryshkin is a graduate of Russian Academy of Economics.

9. **Viktor Fedlyuk –** Head of Legal since 2006, and a member of the Board of Directors since 2008. Viktor Fedlyuk graduated from Ukraine National Law Academy. He has over 18 years' experience in law practice. From 1996 to 2003 Viktor Fedlyuk worked for Sibneft OJSC.

10. **Viktor Kharitonin –** has served as the Board Chairman since May 2006. He is an Executive Director of Pharmstandard OJSC. Viktor Kharitonin is a graduate of Novosibirsk State University.

11. **Alexander Shuster –** has been a member of the Board of Directors since June 2011. Currently, he is Scientific Director of Masterclone CJSC. Alexander Shuster is a graduate of Chernivtsi National University.

## Management Board

The Management Board is a collective executive body acting for the benefit of the Company's shareholders under the guidance of the General Meeting of Shareholders and the Company's Board of Directors. The Management Board is responsible for implementing the Company's objectives, growth strategy and policies, and administering the Company's day-to-day operations. The Management Board powers are set out in the Company's Charter.

The key role of the Management Board is to:
- protect the Company shareholders' rights and legitimate interests;
- develop the Company growth strategy solutions;
- implement the financial and operating policy, deliver solutions on critical issues relating to the Company's day-to-day operations, and co-ordinate the operation of its business units;
- take measures to improve the efficiency of internal control and risk monitoring systems;
- ensure high returns on the Company's assets and maximize the Company's operating profit.

The Management Board is headed by the Chief Executive Officer and includes the following members:

1. **Vladimir Chupikov –** Chairman of the Management Board and Chief Executive Officer of Pharmstantard OJSC since November 2014. From April 2007, Vladimir Chupikov served as Chief Executive Officer of Pharmstantard LLC. Vladimir Chupikov is a graduate of Novosibirsk State University.

2. **Marina Markova –** served as Chief Accountant since June 2011, and Head of Finance Department since 2013, in February 2014 she was appointed Deputy CEO for Finance. Marina Markova is a graduate of Moscow Aviation Institute (a state technical university).

3. **Pavel Nosyrev –** has been the Board Member since 2014. From 2008 he headed New Products Development Department, and since 2009 served Deputy CEO for New Products Development. Pavel Nosyrev is a graduate of Lomonosov Moscow State University.

## Audit Committee

Members of the Audit Committee appointed in 2014:
1. **Roman Goryunov**
2. **Andrei Reus**
3. **Ivan Tyryshkin, Chairman**

The key function of the Audit Committee is to develop and submit to the Board of Directors its recommendations relating to:
- evaluation of candidates for the position of the Company auditor;
- review of auditor reports;
- assessment of internal controls efficiency and elaboration of measures for further improvements.

## Remuneration and Nomination Committee

Members of the Remuneration and Nomination Committee elected in 2014:
1. **Yegor Kulkov**
2. **Ivan Tyryshkin**
3. **Alexander Shuster**

The Remuneration and Nomination Committee has been established to provide preliminary review and deliver recommendations for the Board of Directors on issues within the Board competence. Exclusive responsibilities of the Remuneration and Nomination Committee include:
- development of principles and criteria to determine the level of remuneration for Directors, management and a person authorized to act as the issuer's sole executive body;
- delivery of recommendations in relation to essential terms and conditions of the contracts with Directors, management and a person authorized to act as the issuer's sole executive body;
- of selection criteria with respect to nominations to the Board of Directors, the Management Board and the position of a person authorized to act as the issuer's sole executive body, as well as preliminary evaluation of such candidates;
- regular performance evaluation of the person authorized to act as the sole executive body (a Managing Body, a Manager) and the Company Management Board members; and recommendations for the Board with regard to their re-appointment.
- determination of priorities in terms of the Company's HR policy and remuneration of its governance and supervision bodies and top management. Top management includes executives reporting directly to the Company CEO as per their job descriptions.

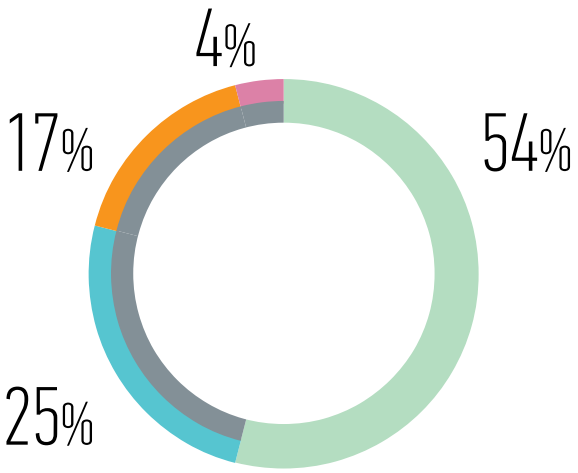
# Information for Shareholders and Investors

## Shareholder Structure as at 31 December 2014

- Augment Investments Limited (ordinary shares and GDRs*): 20,528,380
- Free float: 41.8792% including
  - LSE listed (GDRs*) 9,448,151
  - MOEX listed (ordinary shares) 6,379,152
  - Treasury shares 1,436,920

Total ordinary shares outstanding 37,792,603

1 ordinary share = 4 GDRs*




* GDRs – Global Depository Receipts

# Share price performance in 2014

**LONDON STOCK EXCHANGE:** PHARMSTANDARD GDRS


**MOSCOW EXCHANGE:** PHARMSTANDARD ORDINARY SHARES


In March 2007, the Company's shares were successfully floated on the Russian Trading System (RTS), and in May 2007 Pharmstandard conducted the Initial Public Offering (IPO) of its shares (in the form of Global Depository Receipts (GDRs)) on the London Stock Exchange (LSE).

On 27 September 2013, the extraordinary general meeting of Pharmstandard shareholders made a strategic decision to reorganize its business by spinning-off the branded OTC business into a separate entity – OTCPharm PJSC. In fulfilment of the reorganisation procedure and the buyout obligations with respect to ordinary shares held by certain shareholders, at the end of December the Company bought out 670,787 ordinary shares and 3,064,532 GDRs representing 3.8021% of Pharmstandard's authorised capital. In 2H 2014, the said number of shares was sold to our subsidiary Pharmstandard-Leksredstva OJSC.

# Employees and Social Responsibility

# Human resource

Human capital is arguably the most valuable asset to Pharmstandard Group. As of 31 December 2014, the total headcount of Pharmstandard Group operating companies was 6,655 employees, of which 36.7% were the trade union members.

Table below shows Pharmstandard Group headcount evolution in 2010 – 2014 by key business segments:

| | Headcount (employees) | | | | | Relative change (in people) 2014/2013 | Relative change (in %) 2014/2013 |
|---|---|---|---|---|---|---|---|
| **Business segment** | **2010** | **2011** | **2012** | **2013** | **2014** | | |
| Operations / Logistics | 3,750 | 3,909 | 4,993 | 4,626 | 4,711 | 85 | 1.8% |
| Research & Development | 144 | 162 | 254 | 266 | 273 | 7 | 2.6% |
| Marketing & Promotion | 987 | 1046 | 929 | 1048 | 460 | -588 | -56.1% |
| Administrative personnel | 700 | 777 | 1,028 | 1,041 | 1,211 | 170 | 16.3% |
| **TOTAL** | **5,581** | **5,894** | **7,204** | **6,981** | **6,655** | **-326** | **-4.7%** |

During the fiscal year, the Company's headcount slightly decreased by -4.7% vs 2013. A significant headcount decrease in the marketing and promotion functions (by -56.1% YoY) was due to 567 specialists' transfer to OTCPharm PJSC, as part of Pharmstandard OJCS reorganization with the spin-off of OTCPharm PJSC.

Table below shows the headcount for each operating company of Pharmstandard Group as of 31 December 2014:

| **Headcount in Pharmstandard Group operating companies as of 31 December 2014** | **Operations / Logistics** | **Research & Development** | **Marketing & Promotion** | **Administrative personnel** | **TOTAL** |
|---|---|---|---|---|---|
| Pharmstandard | 287 | 106 | 452 | 403 | **1,248** |
| Leksredstva | 1,448 | 33 | | 118 | **1,599** |
| UfaVita | 1,391 | 39 | | 140 | **1,570** |
| Tomskhimpharm | 520 | 33 | | 103 | **656** |
| Tyumen Medical Equipment Plat | 201 | | | 47 | **248** |
| Lekko | 202 | | | 54 | **256** |
| Mechnikov Biomed | 127 | | | 79 | **206** |
| Selera Pharm | 17 | 12 | | 19 | **48** |
| Med Technika | 96 | 2 | 7 | 39 | **144** |
| Pharma Park | 107 | 40 | | 57 | **204** |
| Boilek | 276 | 8 | 1 | 133 | **418** |
| Other | 39 | 0 | 0 | 19 | **58** |
| **TOTAL** | **4,711** | **273** | **460** | **1,211** | **6,655** |

The Group-wide and operating companies' average headcount dynamics, absence of collective employment disputes or discontinued operations initiated by trade unions, and a low personnel turnover in the operating companies suggest the competent human resource policy and sustainable development of the Company.

## PHARMSTANDARD GROUP'S WORKFORCE IS A TEAM OF PROFESSIONALS.

An average age of the Company's employees is 37 years. The benefits of well-balanced expertise of our skilled professionals and innovation of the younger staff, along with the personnel continuity, contributes largely to the efficient business process management in Pharmstandard Group.

The superior staff competence is a key success factor for achieving the Company's objectives in high-quality product manufacturing.

80.4% of Pharmstandard OJCS employees have higher education; over 20 employees with various industry-specific academic degrees serve in Pharmstandard Group.

Pharmstandard Group operating companies have the established continuous professional training and skill improvement system instrumental for maintaining a high level of personnel competence. The key areas of advanced professional training include: high-tech process line operation and maintenance skills, and GMP rules and regulations.

In 2014, Pharmstandard Group spent over RUB 20 million for personnel training.

Only motivated employees can work successfully to further the achievement of the Company's ambitious goals. The incentive and compensation system existing in Pharmstandard Group encourages people to do their best to achieve the Company's business objectives.

The Company is committed to maintain and provide:

- a competitive compensation level on the labour markets in the regions of the Company's operations;
- regular timely payroll payments and a reasonable wage increase;
- social benefits.

Pharmstandard Group employee's compensation includes fixed (70%) and variable (30%) components. The variable component is based on the employee motivation mechanisms providing for clear and transparent target bonus setting and calculation based on the key collective and individual performance indicators. Performance-linked monthly/ quarterly bonus payment is directly linked with the operating companies' performance in the respective accounting period.

In 2014, the average payroll salary in Pharmstandard Group operating companies increased by 14.5 % YoY vs 2013.

Pharmstandard Group's headcount is mainly represented by operations and logistics staff (4,711 employees).

With respect to the employees involved in core and support operations, the unified wage rate scale is applied which is an effective tool for rate setting and labour compensation. It is based on wage grades and corresponding multipliers used to set wage level for any employee depending on his/ her qualification.

In 2014, the average blue-collar compensation in core and support operations of Pharmstandard operating companies equalled to 5.0x of the minimum statutory monthly pay (MROT).

# Social responsibility

Pharmstandard is a socially responsible company. The management of Pharmstandard Group recognises the high level of our social responsibility to the employees, consumers and society.

## Corporate social responsibility to employees

The social package for Pharmstandard Group employees includes private medical insurance, life insurance, travel insurance of trips in Russia and abroad, payment for children recreation camp vouchers, health resort treatment, and a targeted welfare assistance.

## Corporate social responsibility to consumers

Pharmstandard Group's mission is to develop and manufacture advanced high-quality medicines meeting the healthcare requirements and patients' expectations. In performing this mission, we aim to further public health and procure patients with high quality, effective and accessible medicines.

The Group's aggregate capacity procures for manufacturing of over 1.7 billion drug packages per year.

The Company highly appreciates the physicians' and patients' loyalty to the medicines marketed under Pharmstandard trade name.

To ensure high quality of our pharmaceutical products, Pharmstandard consistently improves the manufacturing processes, expands and upgrades its manufacturing capacity.

In furtherance of the Federal Pharmaceutical Support Programme focused on the replacement of expensive imported medicines with affordable cost functionally equivalent pharmaceuticals produced locally in line with the best international standards, Pharmstandard OJCS participates in the Generium biotechnological project involving the development and manufacturing of socially significant medicines.

## Corporate social responsibility to society

Pharmstandard Group operating companies are bona fide taxpayers. In 2014 FY, Pharmstandard Group operating companies in the aggregate paid over RUB 5 billion to the budgets of various levels.

Pharmstandard OJCS, and five major operating companies of the Group (Pharmstandard-Leksredstva OJSC, Pharmstandard-UfaVITA OJSC, PharmstandardTomskhimpharm OJSC, Lekko CJSC, Tyumen Medical Equipment and Tools Plant CJSC) are amongst the largest taxpayers in the regions of their operations.

# Financial Review

# Management Discussions and Analysis

Further discussions of the Company's financial position and operating/ financial perf ormance should be considered in combination with the consolidated financial statements, notes thereon, and other information disclosed in this annual report.

## The Company performance

The core business of Pharmstandard operating companies (Pharmstandard Group) lies in the manufacturing and marketing of finished pharmaceutical products, active pharmaceutical ingredients (APIs) and medical equipment. Pharmstandard Group revenue structure in 2014 FY looks as follows (in % of total sales; the aggregate % of sales may differ from 100% due to rounding of intermediate values):

- Pharmaceutical products sales: 79.5%
- Contract manufacturing income: 3.6%
- Agency fee income: 4.4%
- Sale of raw material and finished product balances attributable to OTCPharm PJSC: 9.7%
- Medical equipment sales: 2.7%.

Drugs and medical equipment are primarily marketed under direct contracts with wholesale distributors and/or healthcare institutions, and procurement contracts awarded under public government tenders.

The table below shows 2013 vs 2014 comparative performance (as of 31 December) in absolute terms (RUB m) and as percentage of sales.

| | PHARMSTANDART CONSOLIDATED | | | | | |
|---|---|---|---|---|---|---|
| 2014-2013 | 2014 | % of sales | 2013 [1] | % of sales | Variance, *RUB m* | Variance, *%* |
| **Revenue** | **41,223** | **100.0%** | **57,056** | **100.0%** | **(15,833)** | **(27.7%)** |
| Pharmaceutical products | 32,772 | 79.5% | 54,859 | 96.1% | (22,087) | (40.3%) |
| Rx products | 6,931 | 16.8% | 6,776 | 11.9% | 155 | 2.3% |
| Branded | 5,924 | 14.4% | 5,974 | 10.5% | (50) | (0.8%) |
| Non-branded | 1,006 | 2.4% | 801 | 1.4% | 205 | 25.6% |
| Over-the-counter (OTC) products | 5,548 | 13.5% | 16,458 | 28.8% | (10,910) | (66.3%) |
| Branded | 2,766 | 6.7% | 13,708 | 24.0% | (10,942) | (79.8%) |
| Non-branded | 2,782 | 6.7% | 2,750 | 4.8% | 32 | 1.2% |
| Third party products (TPPs) | 19,025 | 46.2% | 30,451 | 53.4% | (11,426) | (37.5%) |
| Other sales – APIs | 1,269 | 3.1% | 1,174 | 2.1% | 95 | 8.1% |
| Contract manufacturing | 1,504 | 3.6% | 111 | 0.2% | 1,393 | 1258.6% |
| Agency fee | 1,829 | 4.4% | 1,038 | 1.8% | 791 | 76.2% |
| Sale of balances attributable to OTCPharm PJSC | 3,998 | 9.7% | 0 | 0.0% | 3,998 | 0.0% |
| Medical equipment | 1,120 | 2.7% | 1,048 | 1.8% | 72 | 6.9% |
| **Cost of sales** | **(23,007)** | **(55.8%)** | **(32,585)** | **(57.1%)** | **9,578** | **(29.4%)** |
| **Gross profit** | **18,216** | **44.2%** | **24,472** | **42.9%** | **(6,255)** | **(25.6%)** |
| Selling and distribution costs (S&D) | (4,134) | (10.0%) | (6,194) | (10.9%) | 2,060 | (33.3%) |
| General and administrative expenses (G&A) | (2,300) | (5.6%) | (1,930) | (3.4%) | 370 | (19.2%) |
| Other (expense) income | 2,146 | 5.2% | (649) | (1.1%) | 2,794 | (430.8%) |
| Interest (expense) income | (109) | (0.2%) | 163 | 0.3% | (272) | (166.9%) |
| **EBITDA [2]** | **14,873** | **36.1%** | **16,652** | **29.2%** | **(1,779)** | **(10.7%)** |
| **Profit before income tax** | **13,820** | **33.5%** | **15,863** | **27.8%** | **(2,043)** | **(12.9%)** |
| Income tax | (2,724) | 6.6% | (3,942) | (6.9%) | 1,218 | (30.9%) |
| **Net income** | **11,095** | **26.9%** | **11,920** | **20.9%** | **(825)** | **(6.9%)** |
| Depreciation and amortization (D&A) | (945) | (2.3%) | (953) | (1.7%) | 8 | (0.9%) |
| Foreign exchange (gain) loss | 1.641 | 4.0% | 157 | 0.3% | 1.484 | 948.0% |

For the purpose of comparative analysis and the previous year data comparability, the relevant 2013 FY figures were restated accordingly. The above changes in the Group companies' portfolio structure do not effect the bottom-line consolidated financial results of the Company. Further analysis is performed based on the said 2013 FY figures restatement.

Third party product ("TPP") sales are shown separately in the Table to reflect the Company business specifics in more detail. This approach to product portfolio structuring does not impact pharmaceutical sales results.

1 Note that the Company's subsidiaries provide toll manufacturing services in respect of certain products (hereinafter – contract manufacturing). Since 2014, contract manufacturing income (primarily attributed to the products manufactured for OTCPharm PJSC) is reclassified from other income accounted previously on net basis to revenue and cost of sales. Likewise, since 2014, agency fee is reflected by the Company in revenue as regular income.

2 EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) equals to the amount of earnings before deduction of tax, interest, D&A expense.

# Consolidated revenue

In 2014, Pharmstandard consolidated revenue amounted to RUB 41,223 m versus RUB 57,056 m in 2013. A 27.7% YoY (or RUB 15,833 m) decrease vs 2013 is driven by the spin-off of the Group's branded OTC business into a newly founded separate legal entity OTCPharm PJSC which started its independent operations from Q2 2014, and the decrease in TPP segment sales.

## Pharmaceutical products

Sales data under this category include fill-finish pharmaceutical products manufactured on Pharmstandard Group's manufacturing platform, products purchased from third parties for re-sale, and products manufactured by third parties based on the Company's orders, excluding third party-manufactured products distributed by the Company under the government procurement tenders and 7 High-Cost Nosologies Federal Program.

Pharmaceutical sales in 2014 decreased by 40.3% down to RUB 32,772 m vs RUB 54,859 m in 2013, with organic sales accounting for 38%, TPPs for 58% and APIs for 4% of the pharmaceutical sales mix.

Organic pharmaceutical sales in 2014 amounted to RUB 13,748 m (-44% YoY) vs RUB 24,408 m in 2013. The decrease is mainly attributed to OTC products with the majority of them being moved to OTCPharm PJSC and a resulting change in the structure of sales with 44% accounted for by OTC products and 56% by Rx products.

Organic prescription product (Rx) sales in 2014 grew by RUB 155 m (+2% YoY) to reach RUB 6.931 m. The key growth drivers were Phosphoglive® (+17.3%), Octolipen® (+21.8%) and Artrozan® (+23.4%).

Organic over-the-counter (OTC) product sales in 2014 went down to RUB 5,548 m and demonstrated a 66% YoY decline resulting from the transfer of the majority of the OTC product portfolio to OTCPharm PJSC. Thermopsol (+70%), Andripal (+127.4%), Ferrohematogen (+33.8%) and Validol (+26.6%) were the growth leaders in Pharmstandard Group's product portfolio.

2014 FY TPP segment sales amounted to RUB 19,025 m showing a decrease by RUB 11,426 m (or 38% YoY) vs RUB 30,451 m in 2013. The decline in sales was associated with the expiration of Velcade® and Mabthera® patent protection and the launch of alternative generics.

Sales of other products and APIs grew in 2014 by RUB 95 m (or +8% YoY) to reach RUB 1,269 m from RUB 1,174 m in 2013.

## Contract manufacturing

2014 FY contract manufacturing revenue reached RUB 1,504 m and added up RUB 1,393 m vs 2013. The revenue growth in contact manufacturing is attributable to toll material manufacturing, including for OTCPharm PJSC.

### Agency fees

2014 FY Agency Fee income rose to RUB 1,829 m (+76% YoY vs 2013). The increase in agency fee income primarily relates to the distribution agency contracts for OTCPharm's products.

Sale of finished product and raw material balances attributable to OTCPharm PJSC

In 2014, finished product and raw material balances were sold to OTCPharm PJSC as part of the spin-off of the Group's branded OTC business into the NewCo. Total revenue under these transactions amounted to RUB 3,998 m.

### Medical equipment

2014 FY medical equipment sales increased by RUB 72 m (+7% YoY) to reach RUB 1,120 m vs RUB 1,048 m in 2013.

## Third Party Products. Sales results

For a better visibility we move TPP sales into a separate section splitting the revenue into 2 parts – government procurement and commercial sales.

### Government Procurement Market. 7 High-Cost Nosologies Federal Program[1]

FY 2013 sales growth leaders in this segment – Velcade® and Mabthera® have decreased their share to 12% and 14% of total 2014 TPP revenue compared respectively to 19% and 29% of TPP revenue in 2013. In 2014, Velcade® and Mabthera® sales amounted to RUB 2,192 m and RUB 2,716 m vs RUB 5,670 m and RUB 8,770 m in 2013. 2014 saw a sharp decline in Velcade® and Mabthera® sales by RUB 3,479 m (61.3% YoY) and RUB 6,054 m (-69% YoY) vs 2013. The slump in sales is attributed to the expiration of the drugs' patent protection and the launch of alternative generics.

As of 2014, the highest increase in the segment sales was demonstrated by Revlimid® (+30.9%), Diaskintest (+66.8%), Prezista® (+6.1%) and Intelence® (+9.6%).

| | | 2014 | | 2013 | | Variance | |
|---|---|---|---|---|---|---|---|
| **Brand name** | **Marketing status (OTC/Rx)** | **Sales,** *RUB m* | **% of TPP sales** | **Sales,** *RUB m* | **% of TPP sales** | *RUB m* | *%* |
| Mabthera® | Rx | 2,716 | 14.3% | 8,770 | 28.8% | (6,054) | (69.0%) |
| Velcade® | Rx | 2,192 | 11.5% | 5,670 | 18.6% | (3,479) | (61.3%) |
| Coagil | Rx | 2,021 | 10.6% | 2,652 | 8.7% | (630) | (23.8%) |
| Prezista® | Rx | 1,997 | 10.5% | 1,882 | 6.2% | 114 | 6.1% |
| Revlimid | Rx | 924 | 4.9% | 706 | 2.3% | 218 | 30.9% |
| Pulmozyme | Rx | 875 | 4.6% | 1,132 | 3.7% | (257) | (22.7%) |
| Intelence® | Rx | 743 | 3.9% | 678 | 2.2% | 65 | 9.6% |
| Diaskintest | Rx | 416 | 2.2% | 250 | 0.8% | 167 | 66.8% |
| Other TPPs | Rx | 309 | 1.6% | 1,597 | 5.2% | (1,287) | (80.6%) |
| **Total for the group** | **Rx** | **12,194** | **64.1%** | **23,337** | **76.6%** | **(11,144)** | **(47.8%)** |
| **Total TPPs** | **OTC, Rx** | **19,025** | **100.0%** | **30,451** | **100.0%** | **(11,426)** | **(37.5%)** |

1 Described in more detail in the section 'Government Procurement. Third Party Products' of this annual report.

Due to the patent protection expiration and the launch of generic versions of Velcade® and Mabthera®, 2014 total sales in government procurement segment decreased by -47.8% YoY (or by RUB 11,144 m in round figures) amounting to RUB 12,194 m.

### Commercial Market

Commercial TPP sales in 2014 decreased to RUB 6,831 m (-4% YoY vs 2013) driven by the decline in Reduxin® and Tamiflu® sales.

IRS®19 and Imudon® jointly accounting for 7% of commercial TPP sales, Mildronate® accounting for 6% and Cerezyme® accounting for 5% of commercial TPP sales are the largest contributors to commercial TPP sales.

| | | 2014 | | 2013 | | Variance | |
|---|---|---|---|---|---|---|---|
| Brand name | Marketing status (OTC/Rx) | Sales, RUB m | % of TPP sales | Sales, RUB m | % of TPP sales | RUB m | % |
| IRS® 19, Imudon® | OTC, Rx | 1,342 | 7.1% | 1,254 | 4.1% | 87 | 7.0% |
| Mildronate® | Rx | 1,188 | 6.2% | 1,085 | 3.6% | 103 | 9.5% |
| Cerezyme® | Rx | 984 | 5.2% | - | 0.0% | 984 | |
| Reduxin® | OTC, Rx | 507 | 2.7% | 1,665 | 5.5% | (1,158) | (69.6%) |
| Emoxipine® | Rx | 417 | 2.2% | 338 | 1.1% | 78 | 23.2% |
| Other TPPs | OTC, Rx | 2,394 | 12.6% | 2,772 | 9.1% | (378) | (13.6%) |
| **Total for the group** | **OTC, Rx** | **6,831** | **35.9%** | **7,114** | **23.4%** | **(283)** | **(4.0%)** |
| **Total TPPs** | **OTC, Rx** | **19,025** | **100.0%** | **30,451** | **100.0%** | **(11,426)** | **(37.5%)** |

Since 2014, the Company has added Cerezyme®, Tasigna® and Rinvir to its commercial TPP portfolio. The new products sales reached RUB 984 m, RUB 250 m and RUB 177 m respectively.

## Cost of sales Goods Sold (COGS)

Cost of Goods Sold (COGS) includes raw material/ component costs, TPP purchase costs, manufacturing overheads, direct labour costs, brand name depreciation, plant & equipment amortization and depreciation, and contract manufacturing related expenditure.

| Item | 2014 | % of sales | 2013 | % of sales | Variance, RUB m | Variance, % |
|---|---|---|---|---|---|---|
| Revenue | 41,223 | 100.0% | 57,056 | 100.0% | (15,833) | (27.7%) |
| COGS | 23,007 | 55.8% | 32,585 | 57.1% | (9,578) | (29.4%) |
| Raw materials | 5,553 | 13.5% | 6,464 | 11.3% | (911) | (14.1%) |
| Third party products | 13,571 | 32.9% | 23,163 | 40.6% | (9,592) | (41.4%) |
| Manufacturing overheads | 1,651 | 4.0% | 1,562 | 2.7% | 89 | 5.7%, |
| Depreciation and amortisation | 747 | 1.8% | 789 | 1.4% | (42) | (5.4%) |
| Direct labour costs | 403 | 1.0% | 532 | 0.9% | (129) | (24.3%) |
| Contract manufacturing expenses | 1,083 | 2.6% | 75 | 0.1% | 1,008 | 1,347.5%, |
| **Gross profit** | **18,216** | **44.2%** | **24,472** | **42.9%** | **(6,255)** | **(25.6%)** |

In 2014, COGS decreased by RUB 9,578 m (or -29% YoY vs 2013) and amounted to RUB 23,007 m compared to RUB 32,585 m in 2013. The decline in COGS in absolute terms is attributed to a general decline in sales.

The main expenditure items – Raw Materials and TPP Costs have decreased their aggregate share from 91% of total COGS in 2013 to 86% of total COGS in 2014, among other factors due to the sales mix changes and COGS decrease in TPP segment.

As a result of a downturn in sales, the COGS structure has changed as follows:

1. **Raw Materials costs** in absolute terms declined from RUB 6,516 m in 2013 to RUB 6,150 m in 2014 (-5.6% YoY). The cost reduction by RUB 311 m is referred to the branded OTC business spin-off into OTCPharm PJSC. However, Raw Materials increased their share from 20.0% of total COGS in 2013 up to 26.7% of total COGS in 2014 due to the increased material-output ratio;
2. **TPP Costs** decreased by RUB 9,592 m in absolute terms – from RUB 23,163 m in 2013 to RUB 13,571 m in 2014. TPP Costs decreased their share from 71.1% of total COGS in 2013 down to 59.0% of total COGS in 2014 as a result of a decline in TPP sales, i.e. traditionally lower profit margin products;
3. **Manufacturing overheads** increased from RUB 1,575 m in 2013 to RUB 2,040 m in 2014 driven by a substantial increase of contract manufacturing services.
4. **Depreciation and amortization** decreased from RUB 789 m in 2013 to RUB 747 m in 2014.
5. **Direct Labour Costs** declined from RUB 542 m in 2013 to RUB 500 m in 2014 ( 7.9% YoY) due to manufacturing cutbacks;

The Table below shows the revenue and COGS evolution by the following segments: Organic Pharmaceutical Products (including OTCPharm's sales and COGS), Third Party Products, Medical Equipment, Contract Manufacturing and Agency Fees.

| | 2014 | | | 2013 | | | Variance, RUB m | | | Variance, % | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Segment | Revenue | COGS | Gross profit | Revenue | COGS | Gross profit | Revenue | COGS | Gross profit | Revenue | COGS | Gross profit |
| Pharmaceutical products | 17,746 | 7,651 | 10,094 | 24,408 | 8,641 | 15,767 | (6,663) | (990) | (5,673) | (27.3%) | (11.5%) | (36.0%) |
| TPPs | 19,025 | 13,571 | 5,454 | 30,451 | 23,163 | 7,288 | (11,426) | (9,592) | (1,834) | (37.5%) | (41.4%) | (25.2%) |
| Medical equipment | 1,120 | 702 | 418 | 1,048 | 706 | 342 | 72 | (4) | 76 | 6.9% | (0.5%) | 22.1% |
| Contract manufacturing and agency fees | 3,333 | 1,083 | 2,250 | 1,149 | 75 | 1,074 | 2,184 | 1,008 | 1,176 | 190.2% | 1347.5% | 109.6% |
| Total | 41,223 | 23,007 | 18,216 | 57,056 | 32,585 | 24,472 | (15,833) | (9,578) | (6,255) | (27.7%) | (29.4%) | (25.6%) |

## Organic pharmaceutical products

In 2014, organic COGS in absolute terms decreased by RUB 990 m (or 11.5% YoY) vs 2013 and amounted to RUB 7,651 m amid a 27.3% reduction in total organic sales.

This organic COGS decline was primarily driven by:

1. a 15.7% YoY reduction in **Raw Materials** costs from RUB 5,796 m in 2013 to RUB 4,888 m in 2014;
2. a 24% YoY reduction in **Direct Labour Costs** from RUB 532 m in 2013 to RUB 403 m in 2014 due to manufacturing cutbacks.

### Third party products

TPP COGS decreased by RUB 9,592 m (-41% YoY) from RUB 23,163 m in 2013 to RUB 13,571 m in 2014 due to the overall downturn in TPP sales (-38% YoY), not least because of the expiration of Velcade® and Mabthera® patent protection and the decline in Rebif® and Reduxin® sales.

### Contract manufacturing and agency fees

In 2014, COGS in contract manufacturing grew by RUB 1,008 m vs 2013 reaching RUB 1,083 m mainly driven by the concluded contracts for product manufacturing for OTCPharm PJSC.

### Medical equipment

COGS in medical equipment segment slightly decreased compared to 2013 (-1% YoY) and reached RUB 702 m amid a 6.9% increase in the segment sales.

## Gross profit

Gross profit is calculated as sales revenue less COGS.

| Item | 2014 | % of sales | 2013 | % of sales | Variance, RUB m | Variance, % |
|---|---|---|---|---|---|---|
| Revenue | 41,223, | 100.0% | 57,056, | 100.0% | (15,833) | (27.7%) |
| COGS | 23,007, | 55.8% | 32,585, | 57.1% | (9,578) | (29.4%) |
| **Gross profit** | **18,216,** | **44.2%** | **24,472,** | **42.9%** | **(6,255)** | **(25.6%)** |

As of 2014, the Company's gross profit declined by -25.6% YoY down to RUB 18,216 m from RUB 24,471 m in 2013. This YoY decline in gross profit is primarily attributed to a 27.7% decline in sales. Gross profit margin increased to 44.2% in 2014 vs 42.9% in 2013. Profit margin growth was influenced by the structural changes in sales and increased profitability in TPP segment.

The Table below shows Pharmstandard Group's gross profit evolution in 2013-2014, excluding OTCPharm results.

| Item | 2014 | % of sales | 2013 | % of sales | Variance, RUB m | Variance, % |
|---|---|---|---|---|---|---|
| Revenue | 34,715, | 100.0% | 43,043, | 100.0% | (8,328) | (19.3%) |
| COGS | 19,862, | 57.2% | 28,276, | 65.7% | (8,414) | (29.8%) |
| **Gross profit** | **14,853,** | **42.8%** | **14,767,** | **34.3%** | **86** | **0.6%** |

In 2014, Pharmstandard Group's gross profit (net of OTCPharm product sales) rose to RUB 14,853 m vs RUB 14,767 m in 2013 (+0.6% YoY). Group's gross profit margin also increased to 42.8% in 2014 from 34.3% in 2013. Profit margin growth was driven by increased profitability in TPP segment (due to changes in sales mix) and increased share of high margin contract manufacturing and agency fee income in the Company's revenue structure.

## Selling and distribution costs

Selling and distribution costs (S&D) include expenses mainly related to product advertising and promotion.

In absolute terms selling and distribution costs showed a 33.3% YoY decline (-RUB 2,060 m) from RUB 6,194 m in 2013 to RUB 4,134 m in 2014. As percentage of sales, S&D costs changed slightly and remained at a level of 10% in 2014. S&D costs include direct costs attributed to OTCPharm products, which amounted to RUB 1,182 m in 2014.

The decrease in sales, following the spin-off of OTCPharm PJSC, impacted S&D costs attributable to advertising and promotion which went down from RUB 3,537 m in 2013 to RUB 1,573 m in 2014 (-55.5% YoY), given that direct costs attributable to OTCPharm product advertising and promotion account for the major share of 2014 S&D costs.

Other commercial expenses (transportation and insurance, quality control and finished product certification, communications, travel, rental, stationary and office supplies, etc.) decreased from RUB 1,086 m in 2013 to RUB 1,057 m in 2014 (2.7% YoY).

## General and administrative expenses

General and administrative expenses (G&A) include administrative personnel payroll expenses, information and consultancy service fees, and other expenses.

The Company's overall general and administrative expenses increased by RUB 370 m (+19.2% YoY) from RUB 1,930 m in 2013 up to RUB 2,300 m in 2014. As of 2014, G&A share in total sales reached 5.6% vs 3.4% in 2013.

This YoY growth was mainly driven by:
1. increase in payroll expenses from RUB 1,278 m in 2013 to RUB 1,404 m in 2014 (+9.8% YoY) resulting mainly from administrative personnel wage indexation in Pharmstandard Group operating companies;
2. increase in information and consultancy costs from RUB 116 m in 2013 to RUB 306 m in 2014 (+164% YoY) associated with increased number of M&A transactions (including the acquisition of a stake in Biocad) and the resulting consultancy costs growth; as well as with SAP software deployment and maintenance.

## Net other income

In 2014, net other income increased by RUB 2,795 m to reached RUB 2,146 m.

This change in other net income is primarily associated with:
1. FX difference gain of RUB 1,641 m generated due to the efficient liquidity management;
2. income from promissory note transactions amounting to RUB 80 m;
3. return on investments in joint ventures and related companies, specifically Biocad and Argos, amounting to RUB 235 m in 2014, compared to a RUB 98 m expense in 2013;
4. decrease in fines and penalties assessed to RUB 130 m in 2014 compared to RUB 411 m in 2013;
5. decrease in write-offs of research and development expenditures attributed to Biolek, NTS+, Biomed, Selltera down to RUB 37 m in 2014 vs RUB 169 m in 2013;

## Financial income and expense

Financial income to a large extent consists of gains from short-term financial instruments, interest income from bank deposits and interest income from loans provided, including to related parties. In 2014, financial income grew by RUB 33 m (+12% YoY) and reached RUB 323 m vs RUB 290 m in 2013.

Financial expenses are mostly connected with interest payments under debt raised. In 2014, financial expenses grew by RUB 305 m (+241% YoY) reaching RUB 432 m vs RUB 127 m in 2013.

## EBITDA

EBITDA (Earnings before Interest, Taxes, Depreciation and Amortization) equals to the amount of earnings before deduction of tax, interest, and D&A assessed. In 2014, EBITDA demonstrated a -10.7% YoY decline from RUB 16,652 m in 2013 to RUB 14,873 m in 2014, with EBITDA margin reaching 36.1% vs 29.2% in 2013. A 6.9% increase in EBITDA margin was driven by the decreased COGS and S&D share in revenues, and other income, specifically FX difference gain.

## Income tax expense

Accrued income tax for 2014 was RUB 2,724 m vs RUB 3,942 m in 2013 with effective tax rate of 19.7% in 2014 vs 24.9% in 2013. Higher tax rate in 2013 mostly refers to tax effect recognition with respect to the Company's shares disposal in exchange to Bever acquisition.

## Net income

The Company's net income decreased by 6.9% YoY from RUB 11,095 m in 2013 to RUB 11,128 m in 2014. Net income margin demonstrated a 6.0% growth and reached 26.9% in 2014 vs 20.9% in 2013.

# Risk Management

In conducting its day-to-day operations the Group is exposed to various risks that may have a significant impact on its operating and financial performance, goodwill and shareholder value.

The Group's management employs a comprehensive approach to mitigate or eliminate risks, which includes monitoring, development of specific policies regulating the interaction with various external contractors, contract work for the benefit of the Group. A duty to develop the risk management policy lies with Audit Committee of the Board of Directors, Internal Audit Commission, Controlling and Auditing Function and Internal Audit and Control Department within their relative competences.

## Quantitative and qualitative information with respect to the market risks

## Country risk

### **Country risk.** Description

Economic reforms are still under way in Russia, along with legal, tax and regulatory base development in line with the market economy standards. Future strength of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy is vulnerable to market downturns and global economic slowdowns.

2014 added up a new exposure associated with the exacerbation of the political situation in Ukraine, the subsequent economic sanctions against Russia, the downgrade of Russia's sovereign credit ratings. All this created the uncertainties with respect to further economic growth, access to capital markets and cost of capital.

The Group has assets and operations in Ukraine. During 2014, the economic and political instability in Ukraine increased significantly. Political and social destabilization in conjunction with the tense situation in parts of Ukraine led to the separation of the Autonomous Republic of Crimea and its accession to the Russian Federation, the full-scale armed conflicts in certain areas of the Donetsk and Luhansk regions, and, eventually, a significant deterioration in the political and economic relations between Ukraine and the Russian Federation. All this resulted in a decline of leading economic indicators, increased government budget deficit, decrease in foreign exchange reserves of the National Bank of Ukraine (NBU), and the consequent downgrade of Ukraine's credit ratings. From 1 January 2014 to the date of this annual report, the Ukrainian Hryvnia experienced c. 194% devaluation versus leading foreign currencies based on the NBU's official exchange rate of the Ukrainian hryvnia against the US dollar.

### **Country risk.** Impact

The core business of Pharmstandard Group, with its four major Russia-based manufacturing assets, is located in Russia, Russia is also the primary market for our products, yet one of the Group's companies operates in Ukraine.

The existing crisis and tension in and around Russia and Ukraine may adversely affect Pharmstandard's financial position, performance and business prospects.

### **Country risk.** Mitigants

The Group's management continues to monitor the developments in the situation to take measures, as required, in order to minimize any negative effects to the extent possible. Further negative developments in political, macroeconomic and/or international commerce environment may continue to affect adversely the Company's financial standing and performance to the extent that cannot be assessed at this time.

Nevertheless, the Company's management believes that all necessary measures to ensure its strong economic performance in the present circumstances are being taken.

## Credit risk

### **Credit risk.** Description

In accordance with Pharmstandard's business conduct guidelines, almost all of our commercial sales are done on credit. Credit terms are customer-specific and aligned with our credit and marketing policy.

### **Credit risk.** Impact

Our key credit exposure is associated with a potential distributor's default on its contractual payment obligations.

### **Credit risk.** Mitigants

Our approach to credit risks is based on the policy providing for the product deliveries only to the customers with a sound credit history. We also conduct daily monitoring of sales and receivables with effective internal control procedures and take appropriate actions based on internal analysis. Our Credit Committee represented by Chief Executive Officer, Chief Financial Officer and Chief Commercial Officer establish the corporate credit policy which may be revised depending on a particular situation.

Under the corporate credit policy, our customers are split into two groups: (i) customers supplied on a prepaid basis, and (ii) customers supplied on a deferred payment basis within a contractor-specific credit limit. For some contractors, credit limits are provided subject to the performance security with respect to payment obligations, e.g. in the form of a bank guarantee covering the relevant credit limit, surety or a letter of credit.

In 2014, about 30% of our commercial sales were accounted for by 5 to 6 key distributors, while in 2013 the sales concentration attributable to key distributors was 50-60%. The distribution structure movements resulted in the diversification of the Group's commercial and credit risks.

Receivables carrying value less impairment reserves represents the maximum credit risk exposure. We believe that apart from 5 to 6 customers' concentration we have no material credit risk concentration. Though receivables collection can be driven by various economic factors, the Company's management expects no substantial loss risks with respect to existing contracts.

Given sustainability and sufficiency of public healthcare financing in Russia we see no major risks for this sales channel. The Group has not encountered any problems with settlements by government customers, the accounts receivable turnover in this sales channel is about one month.

## Currency risk

### **Currency risk.** Description

Certain portion of our accounts payable, cash and accounts receivable, and some of our financial investments can be denominated in currencies other that the Russian Rouble (the functional currency of Russian enterprises and reporting currency).

### **Currency risk.** Impact

We bear currency risks in transacting business in any currency other than our functional currency. Generally, our foreign currency operations include: a certain part of key raw material purchases for Pharmstandard, subsidiary acquisitions, intangible asset acquisitions, minority stake acquisitions and investments in associated companies, as well as certain 2013 long-term and short-term financial investments denominated in US dollars or Euro.

Thus, cost of sales and operating expenses shown in our consolidated financial statements as well as financial investments and accounts payable reflected in the Company's balance sheet can be subject to FX movements.

### **Currency risk.** Mitigants

Currency risks are mitigated by FX monitoring focused on currencies the Company's cash, accounts payable, loans and borrowings are denominated in. To minimize currency risks we use advanced forecasting methodologies and individual control over every foreign currency deal. Our efficient budgeting system supports the management in making timely decisions for all companies within the Group.

## Liquidity risk

### **Liquidity risk.** Description

Insufficient liquidity could result in a temporary impossibility for the Group to fulfil its obligations to suppliers or credit institutions.

### **Liquidity risk.** Impact

The management believes that currently Pharmstandard has ample funds both in free cash and in bank deposits to maintain a sufficient liquidity level.

### **Liquidity risk.** Mitigants

Our liquidity risk mitigation policy is focused on maintaining sufficient cash and cash equivalent amounts or ensuring available financing through external debt required to cover our operating and financial liabilities. We conduct continuous monitoring of cash deficiency risk along with maturity schedule control. We also provide daily cash flow planning and control.

## Interest rate risk

### **Interest rate risk.** Description

On 16-17 December 2014, Russia's Central Bank made a drastic interest rate move overnight, raising its key rate by 6.5 percentage points from 10.5% to 17% per annum. According to the Central Bank, the decision to rise the key rate by 6.5 percentage points was driven by the economic uncertainty associated with unstable external environment and increased volatility in financial markets. The decision was aimed at limiting substantially increased Rouble depreciation risks and inflation risks to maintain financial stability. Commercial banks accommodated with the Central Bank's short-term loans at the key rate rather quickly passed on the increased rates to the customers, both corporate and private. In January and February 2015, commercial loan interest rates could reach 20-22% per annum, depending on the financial strength of a borrower and the loan agreement terms and conditions. However, starting from February 2015, the Central Bank began to steady reduce the key rate, as of the date of this annual report the key rate was 14%.

### **Interest rate risk.** Impact

As of now, we believe the Company is not subject to serious interest rate risks since all our financial instruments as of 31 December 2014 had fixed interest rates and short-term nature.

### **Interest rate risk.** Mitigants

We currently have no reasons to expect any material short-term changes of effective market interest rates on deposits and debt financing. However, to minimize this risk, given a significant level of internal funds the Group's management may choose to use equity financing for its current operations and investment activities. Furthermore, the Group's credit policy is aimed to raise debt financing at fixed interest rates.

## Capital management

The Company's capital management policy is targeted at providing conditions for sustainable operations to create shareholder value and maintain optimal capital structure supportive of lower cost of capital. The Company manages and controls its capital structure depending on external economic environment. To maintain or change capital structure, the Company may adjust the amount of dividends or investments towards retained earnings, offer the capital repayment to shareholders, issue new shares or dispose of assets in order to reduce debt.

The Company's approach to capital monitoring is based on debt to equity ratio which is calculated as net debt divided by the sum of total capital and net debt. Under the Company's policy, this ratio may not exceed 60%. Net debt includes loans, borrowings and accounts payable less cash and cash equivalents. Capital means the parent company shareholder equity.

# Liquidity and capital

## General overview

Our liquidity requirements are primarily driven by the Group's working capital needs, capex financing, operational upgrades, compliance with GMP requirements, product portfolio diversification and profitability growth based on targeted acquisition of tangible and intangible assets.

In 2014, the Group acquired a 20% stake in Biocad Group. This asset has generated income before tax of RUB 836 m during the Group's holding period (for more details please refer to the relevant disclosure in the 'Group IFRS Consolidated Financial Statements' section).

In 2013-2014, we financed our operational and investment activity through free cash flows and short-term (generally up to 1-month maturity) borrowings. Going forward we intend to continue financing new acquisitions and joint projects with other pharmaceutical companies from internal funds, and external loans, if required.

The table below shows summary cash flow statements for 2013-2014:

| Cash flows | Year ended 31 December 2014, *RUB m* | Year ended 31 December 2013, *RUB m* |
|---|---|---|
| Net cash inflow from operating activities | 9,166 | 13,529 |
| Net cash outflow from investment activities | -9,887 | -2,186 |
| Net cash outflow from financing activities | -6,554 | -4,439 |
| Cash and cash equivalents as of YE | 8,542 | 15,365 |

## Net cash flow from operating activities

In general, our cash flow from operating activities for the periods covered by the Group consolidated financial statements, was generated through the sale of pharmaceutical products and medical equipment as well as agency fees for our partners' pharmaceutical product distribution.

Standard commercial contracts with distributors usually provide for 90 to 120 day payment deferral from the delivery date, though we also offer individual credit terms for each of our distributors. For supplies under public tender contracts, payment deferral is 0 to 90 days from the date of the Group's fulfilment of its obligations under a specific government contract. For supplies under joint commercial projects with third party manufacturers, payment deferral is set individually for each contract ranging from 60 to150 days from the delivery date.

In 2013, our net cash flow from operating activities reached RUB 9,166 m.

In 2014, the Group experience a decline in revenue driven by the spin-off of its branded OTC business into a newly founded sister company OTCPharm PJSC.

However, the decline in revenue was partially offset by:

1. Increased sales of Phosphoglive® (RUB 238 m), Revlimid® (RUB 218 m), Diaskintest (RUB 167 m), Minirin® (RUB 162 m), Prezista® (RUB 114 m), and the addition of new drugs like Cerezyme®, Tasigna®, Rinvir, Synagis®, Tuberkulin, Sirturo to Pharmstandard Group product portfolio;
2. Increased sales and distribution volumes under joint projects with third party manufacturers of IRS®19, Imudon®, Mildronate®; and
3. Significant rise in revenue from agency and contract manufacturing services, specifically toll manufacturing for OTCPharm PJSC on Pharmstandard Group's manufacturing platform.

Cash inflow from the reduction in accounts receivable reached RUB 4,765 m in 2014. This is primarily associated with decreased sales volumes.

The level of accounts payable decreased, along with AP structure changes:

- The Group also reduced its debt to raw material suppliers which resulted in additional discounts granted to us and associated growth in the Group's revenue;
- significant impact of FX difference loss (gain) on cash flow.

Cash inflow associated with the Company's inventory amounted to RUB 360 m in 2014 compared to cash inflow of RUB 858 m in 2013

The Group's inventory changes were mixed with:

- Decreased trade inventory following the spin-off of OTC branded business into OTCPharm PJSC, decreased OTC finished product inventory, and decreased inventory of raw materials for manufacturing of such products, and
- Increased cost of finished products associated with growing manufacturing cost of inventories purchased in foreign currency driven by the sharp devaluation of Russian Rouble.

The Group's income tax payments in 2014 reached RUB 2,308 m versus RUB 4,087 m in 2013. This change is attributed to FX difference loss associated with raw material purchases in foreign currency, and to absence of unusual operations, which took place in 2013.

## Net cash flow from investment activities

In 2014 and 2013, net cash outflow from investment activities amounted to RUB 9,887 m and RUB 2,186 m respectively.

Major investment activities in these years were associated with:

- acquisition of a 20% stake in an associated company Biocad Holding Limited (Cyprus);
- operations with long-term and short-term financial assets, predominantly free cash bank deposits and loan extensions to related parties inter alia;
- production asset acquisition, construction of new and upgrade of existing capacity, equipment purchase, in particular with respect to compliance with GMP requirements (for RUB 2,381 m in 2014 and RUB 1,475 m in 2013).

These investments were made predominantly as part of the Group's production and logistics capacity development to ensure compliance with GMP standards, including but not limited to:

- Pharmstandard-UfaVITA OJSC (Ufa) – the new biochemical laboratory construction (commissioned in June 2014), the pill manufacturing shop, new boiler house construction and the power station reconstruction (in progress);
- Pharmstandard-Leksredstva OJSC (Kursk) – the reconstruction of building $43 to launch chewable BAA pastilles manufacturing (the project work completed, the new shop was put into operation in November 2014), the reconstruction of Shop #2 to launch manufacturing of metered dose aerosol preparations, the reconstruction of Site 5 in Shop #3 to install HVAC system;
- Continuous replacement of deteriorated equipment for all operating companies of the Group, including for the purposes of GMP compliance in Russia and Ukraine;
- Pharmstandard OJSC – the acquisition of a car fleet for subsequent operational leasing by OTCPharm PJSC.

In 2014, the Group paid RUB 3,504 m for a 20% stake in Biocad Group (with the Cyprus based parent company). Biocad Group's operations are primarily located in the Russian Federation.

In 2014, the Company participated in the IPO of Argos Therapeutics, Inc. (a US Delaware based associated company of the Group). In the IPO, the Company paid RUB 354 m (US$ 10.2 m) for a 30.4% stake in Argos. In addition, the Company made investments in US based research companies of RUB 576 m (US$ 17 m) in total.

In 2014, the Group granted RUB 6,554 m loans to its related parties and RUB 1,864 m loans to third parties. Described in more detail in Note 11 of the consolidated financial statements.

In 2014, cash inflow from return of cash previously deposited with banks reached RUB 704 m.

## Net cash flow from financing activities

In 2014 and 2013, cash outflow related to the Group's financing activities reached RUB 3,053 m and RUB 4,439 m respectively.

In 2014, the Group fully repaid previously borrowed short-term loans of RUB 7,021 m and raised short-term debt financing of RUB 4,000 m. Also the Group discharged a RUB 3,501 m debt to OTCPharm PJSC arisen as a result of the OTC business spin-off in 2013.

# Consolidated financial statements

## For the year ended 31 December 2014

# Independent auditor's report

To the Shareholders and Management of OJSC "Pharmstandard"

We have audited the accompanying consolidated financial statements of OJSC "Pharmstandard" and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2014, and consolidated statement of comprehensive income, consolidated cash flow statement and consolidated statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information.

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

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

## Auditor's responsibility

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

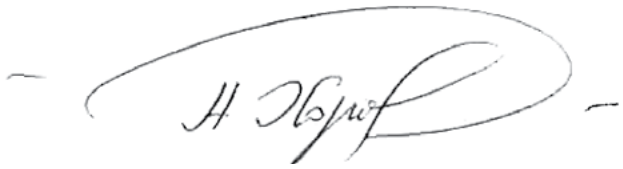
We conducted our audit in accordance with the federal standards on auditing effective in the Russian Federation and International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated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

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

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

## Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of OJSC "Pharmstandard" and its subsidiaries as at 31 December 2014, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.



**A.B. Khorovitch**
Partner
Ernst & Young LLC

27 April 2015

### Details of the audited entity

Name: OJSC "Pharmstandard"

Record made in the State Register of Legal Entities on 5 May 2006, State Registration Number 02№005162109.

Address: 141701, Russia, Moscow region, Dolgoprudny, Likhachevsky drive, 5 "b".

### Details of the auditor

Name: Ernst & Young LLC

Record made in the State Register of Legal Entities on 5 December 2002, State Registration Number 1027739707203.

Address: Russia 115035, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.

Ernst & Young LLC is a member of self-regulatory organization of auditors Non Profit partnership "Russian Audit Chamber" ("SRO NP APR"). Ernst & Young LLC is included in the control copy of the register of auditors and audit organizations, main registration number 10201017420.

# Consolidated statement of financial position

As at 31 December 2014 (in thousands of Russian Roubles)

| | Notes | 2014 | 2013 (reclassified, Note 2) |
|---|---|---|---|
| **Assets** | | | |
| Non-current assets | | | |
| Property, plant and equipment | 13 | 9,817,331 | 8,403,238 |
| Intangible assets | 14 | 3,122,597 | 3,202,517 |
| Long-term financial assets | 19 | 1,283,079 | 537,458 |
| Investments in associates and joint venture | 8, 9 | 6,319,310 | 1,478,561 |
| Deferred tax asset | 31 | 480,330 | 258,050 |
| | | **21,022,647** | **13,879,824** |
| **Current assets** | | | |
| Inventories | 15 | 7,049,775 | 7,486,754 |
| Trade and other receivables | 16 | 19,432,066 | 23,969,063 |
| VAT recoverable | | 116,304 | 337,772 |
| Prepayments | | 319,287 | 373,745 |
| Short-term financial assets | 18 | 6,338,846 | 1,453,322 |
| Cash and short term deposits | 17 | 8,541,548 | 15,364,875 |
| | | **41,797,826** | **48,985,531** |
| **Total assets** | | **62,820,473** | **62,865,355** |
| **Equity and liabilities** | | | |
| Equity attributable to equity holders of the parent | | | |
| Share capital | 24 | 37,793 | 37,793 |
| Treasury shares | | (1,437) | (1,437) |
| Foreign currency translation reserve | | 729,560 | 24,846 |
| Retained earnings | | 38,408,477 | 27,567,243 |
| | | **39,174,393** | **27,628,445** |
| Non-controlling interests | | 1,645,947 | 1,445,848 |
| **Total equity** | | **40,820,340** | **29,074,293** |
| Non-current liabilities | | | |
| Deferred tax liability | 31 | 606,773 | 444,145 |
| Other non-current liabilities | 23 | 92,472 | 150,762 |
| | | **699,245** | **594,907** |
| **Current liabilities** | | | |
| Trade and other payables | 22 | 15,834,351 | 24,931,724 |
| Short-term borrowings and loans | 20 | 4,002,941 | 7,024,080 |
| Income tax payable | | 807,972 | 332,068 |
| Taxes payable other than income tax | 21 | 655,624 | 908,283 |
| | | **21,300,888** | **33,196,155** |
| **Total liabilities** | | **22,000,133** | **33,791,062** |
| **Total equity and liabilities** | | **62,820,473** | **62,865,355** |

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

Chief Executive Officer **V.M. Chupikov**

Chief Financial Officer **M.A. Markova**

27 April 2015

# Consolidated statement of comprehensive income

For the year ended 31 December 2014 (in thousands of Russian Roubles)

| | Notes | 2014 | 2013 (reclassified, Note 2) |
|---|---|---|---|
| Revenue | 25 | 41,223,435 | 57,056,181 |
| Cost of sales | 26 | (23,007,040) | (32,584,628) |
| **Gross profit** | | **18,216,395** | **24,471,553** |
| Selling and distribution costs | 27 | (4,133,517) | (6,193,581) |
| General and administrative expenses | 28 | (2,300,426) | (1,930,313) |
| Other income | 29 | 2,943,445 | 517,301 |
| Other expenses | 30 | (1,032,936) | (1,068,144) |
| Interest income | | 323,446 | 290,074 |
| Interest expense | | (431,739) | (126,632) |
| Share in profit/(loss) of equity accounted investments, net | 8, 9 | 235,062 | (97,728) |
| **Profit before income tax** | | **13,819,730** | **15,862,530** |
| Income tax expense | 31 | (2,724,267) | (3,942,091) |
| **Profit for the year** | | **11,095,463** | **11,920,439** |
| **Other comprehensive income to be reclassified to profit or loss in subsequent periods** | | | |
| Exchange differences on translation of foreign operations | | 682,853 | 30,247 |
| Other comprehensive income/(loss) for the year | | 682,853 | 30,247 |
| **Total comprehensive income for the year** | | **11,778,316** | **11,950,686** |
| **Profit for the year** | | | |
| Attributable to: | | | |
| Equity holders of the parent | | 10,841,234 | 11,805,787 |
| Non-controlling interests | | 254,229 | 114,652 |
| | | **11,095,463** | **11,920,439** |
| **Total comprehensive income for the year** | | | |
| Attributable to: | | | |
| Equity holders of the parent | | 11,545,948 | 11,835,761 |
| Non-controlling interests | | 232,368 | 114,925 |
| | | **11,778,316** | **11,950,686** |
| Earnings per share (in Russian roubles) | | | |
| - basic and diluted, based on profit for the year attributable to equity holders of the parent | 24 | 298.2 | 340.92 |

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

Chief Executive Officer **V.M. Chupikov**

Chief Financial Officer **M.A. Markova**

27 April 2015

The accompanying notes on pages 87–124 are an integral part of these consolidated financial statements.

# Consolidated cash flow statement

For the year ended 31 December 2014 (in thousands of Russian Roubles)

| | Notes | 2014 | 2013 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Profit before income tax | | 13,819,730 | 15,862,530 |
| *Adjustments for:* | | | |
| Depreciation and amortisation | 13, 14 | 944,670 | 953,083 |
| (Gain)/loss from impairment of trade and other receivables, net | 16 | (17,648) | 136,928 |
| Write-down of inventories to net realisable value, net | 15 | 77,399 | 187,701 |
| Impairment charge – property, plant and equipment | 14, 29, 30 | 53,250 | 457 |
| Reversal of impairment – financial assets | 29 | (61,213) | – |
| Write-off of cash restricted in Cyprus bank | | – | 9,269 |
| Impairment charge – intangible assets | 14, 30 | – | 100,000 |
| Gain from disposal of property, plant and equipment | 13, 29 | (39,418) | (47,912) |
| Share in net (profit)/loss of joint ventures and associate | | (235,062) | 97,728 |
| Foreign exchange gain | | (1,913,390) | (157,827) |
| Gain from transactions with promissory notes | 29 | (80,112) | - |
| Interest income | | (323,446) | (290,074) |
| Interest expense | | 431,739 | 126,633 |
| **Operating cash flows before working capital changes** | | **12,656,499** | **16,978,516** |
| Increase in trade and other receivables | 16 | 4,764,839 | (9,156,760) |
| Decrease in inventories | 15 | 359,580 | 858,269 |
| Decrease/(increase) in VAT recoverable | | 221,468 | (4,254) |
| Decrease/(increase) in prepayments | | 54,458 | (97,493) |
| Increase in trade and other payables | 22 | (5,562,023) | 8,997,618 |
| Decrease in taxes payable other than income tax | 21 | (252,659) | (177,736) |
| **Cash generated from operations** | | **12,242,162** | **17,398,160** |
| Income tax paid | 31 | (2,308,015) | (4,086,713) |
| Interest paid | | (456,799) | (111,784) |
| Interest received | | 138,587 | 329,084 |
| **Net cash from operating activities** | | **9,615,935** | **13,528,747** |
| **Cash flows from investing activities** | | | |
| Purchase of property, plant and equipment | 13 | (2,380,677) | (1,475,004) |
| Payments for development expenditures | 14 | (45,627) | (98,740) |
| Cash paid for acquisition of share in associates | 9 | (3,858,103) | (1,206,457) |
| Acquisition of intangible assets | 7, 14 | (48,065) | (2,409,854) |
| Cash in new subsidiary (joint venture prior to 1 January 2013) | 8.1 | – | 259,125 |
| Proceeds from government grants | 23 | – | 64,100 |
| Cash received from sale property, plant and equipment | | 113,764 | 64,148 |
| Cash paid for long-term bank deposit | 19 | (42,900) | (400,000) |
| Cash received from return of deposit | 19 | 400,000 | – |
| Cash paid for acquisition of financial assets available for sale | 19 | (575,824) | (65,458) |
| Cash received from return of short-term financial assets | 18 | 303,575 | 2,951,958 |
| Short-term bank deposit placed | 18 | (66,166) | (675,257) |
| Loans provided to third parties | 18, 19 | (1,864,349) | – |
| Loans provided to related parties | 18 | (3,335,159) | (1,945,978) |
| Loans repaid by related parties | | 1,432,735 | 2,751,469 |
| Cash paid for purchase of promissory notes | 12 | (3,420,978) | - |
| Cash received from transactions with promissory notes | 12 | 3,501,090 | - |

| | Notes | 2014 | 2013 |
|---|---|---|---|
| **Net cash used in investing activities** | | **(9,886,684)** | **(2,185,948)** |
| **Cash flows from financing activities** | | | |
| Proceeds from loans and borrowings | 20 | 4,000,000 | 7,721,700 |
| Repayment of loans and borrowings | 20 | (7,021,139) | (700,000) |
| Cash distribution to OTCpharm | 6, 22 | (3,500,650) | - |
| Cash paid for acquisition of non-controlling interests | 10 | – | (360,730) |
| Cash paid for acquisition of treasury shares | | – | (11,076,520) |
| Dividends paid by a subsidiary to non-controlling shareholders | 34 | (32,269) | (23,498) |
| **Net cash used in financing activities** | | **(6,554,058)** | **(4,439,048)** |
| **Net increase in cash and cash equivalents** | | **(6,824,807)** | **6,903,751** |
| Net foreign exchange differences | | 1,480 | (1,858) |
| Cash and cash equivalents at the beginning of the year | 17 | 15,364,875 | 8,462,982 |
| **Cash and cash equivalents at the end of the year** | **17** | **8,541,548** | **15,364,875** |

The accompanying notes on pages 87–124 are an integral part of these consolidated financial statements.

# Consolidated statement of changes in equity

For the year ended 31 December 2014 (in thousands of Russian Roubles)

| | Equity attributable to equity holders of the parent | | | | | | |
|---|---|---|---|---|---|---|---|
| | Share capital | Treasury shares | Foreign currency translation reserve | Retained earnings | Total | Non-controlling Interests | Total equity |
| **Balance at 1 January 2013** | **37,793** | **(3,190)** | **(1,922)** | **37,533,953** | **37,566,634** | **1,651,138** | **39,217,772** |
| Profit for the year | – | – | – | 11,805,787 | 11,805,787 | 114,652 | 11,920,439 |
| Other comprehensive income for the year | – | – | 29,974 | – | 29,974 | 273 | 30,247 |
| **Total comprehensive income for the year** | **–** | **–** | **29,974** | **11,805,787** | **11,835,761** | **114,925** | **11,950,686** |
| Incorporation of subsidiary | – | – | – | – | – | 250 | 250 |
| Acquisition of subsidiary | – | – | – | – | – | 21,643 | 21,643 |
| Acquisition of non-controlling interests (Note 10) | – | – | – | (42,120) | (42,120) | (318,610) | (360,730) |
| Dividends paid by a subsidiary (Note 34) | – | – | – | – | – | (23,498) | (23,498) |
| Effect of spin-off of OTC business (Note 6) | – | – | (3,206) | (23,005,391) | (23,008,597) | | (23,008,597) |
| Acquisition of treasury shares | – | (5,329) | – | (11,071,191) | (11,076,520) | – | (11,076,520) |
| Treasury shares exchange for intangible asset (Note 7) | – | 7,082 | – | 12,346,205 | 12,353,287 | – | 12,353,287 |
| **Balance at 31 December 2013** | **37,793** | **(1,437)** | **24,846** | **27,567,243** | **27,628,445** | **1,445,848** | **29,074,293** |
| Profit for the year | – | – | – | 10,841,234 | 10,841,234 | 254,229 | 11,095,463 |
| Other comprehensive income for the year | – | – | 704,714 | – | 704,714 | (21,861) | 682,853 |
| Total comprehensive income for the year | – | – | 704,714 | 10,841,234 | 11,545,948 | 232,368 | 11,778,316 |
| Dividends paid by a subsidiary (Note 34) | – | – | – | – | – | (32,269) | (32,269) |
| **Balance at 31 December 2014** | **37,793** | **(1,437)** | **729,560** | **38,408,477** | **39,174,393** | **1,645,947** | **40,820,340** |

The accompanying notes on pages 87–124 are an integral part of these consolidated financial statements.

# Notes to the consolidated financial statements

## 1. Corporate information

The principal activity of OJSC "Pharmstandard" ("the Company") and its subsidiaries ("the Group") are production and wholesale distribution of pharmaceutical products and medical equipment. The Company was incorporated in the Russian Federation. Since May 2007, the Company's shares are publicly traded (Note 24). The Group's corporate office is in Dolgoprudny, Likhachevsky proezd, 5B, Moscow region, Russian Federation and its manufacturing facilities are based in Moscow region, Vladimir region, Kursk, Tomsk, Ufa, Tyumen (all Russian Federation) and Kharkov (Ukraine). The Company held interest in the following subsidiaries, associates and joint ventures as at 31 December 2014 and 2013:

| Entity | Country of incorporation | Activity | 2014 effective share | 2013 effective share |
|---|---|---|---|---|
| **Subsidiaries** | | | | |
| 1. "Pharmstandard" LLC | Russian Federation | Central procurement | 100 | 100 |
| 2. "Pharmstandard-Leksredstva" OJSC | Russian Federation | Manufacturing of pharmaceutical products | 100 | 100 |
| 3. "Pharmstandard-Tomskhimpharm" OJSC | Russian Federation | Manufacturing of pharmaceutical products | 91 | 91 |
| 4. "Pharmstandard-Ufavita" OJSC | Russian Federation | Manufacturing of pharmaceutical products | 100 | 100 |
| 5. "Pharmstandard-Biolik" PJSC | Ukraine | Manufacturing of pharmaceutical products | 96.93 | 96.93 |
| 6. "TZMOI" OJSC | Russian Federation | Manufacturing of medical equipment | 100 | 100 |
| 7. MDR Pharmaceuticals | Cyprus | Finance and holding company | 50.05 | 50.05 |
| 8. Bigpearl Trading Limited* | Cyprus | Intermediary holding company | 50.005 | 50.005 |
| 9. "Pharmapark" LLC* | Russian Federation | Manufacturing of pharmaceutical products | 50.005 | 50.005 |
| 10. "Biomed named after I.I. Mechnikov" OJSC* | Russian Federation | Manufacturing of pharmaceutical products | 49.845 | 49.845 |
| 11. "Pharmatsevticheskiye innovatsii"* | Russian Federation | Assets holder | 50.005 | 50.005 |
| 12. "PKB named after I.I. Mechnikov" CJSC* (a) | Russian Federation | Assets holder | – | 49.845 |
| 13. "EKK" OJSC* | Russian Federation | Sundry activity | 35.29 | 35.29 |
| 14. "Lekko" CJSC | Russian Federation | Manufacturing of pharmaceutical products | 100 | 100 |
| 15. Moldildo Trading Limited | Cyprus | Intermediary holding company | 75 | 75 |
| 16. "Pharmstandard-Medtechnika" LLC | Russian Federation | Distribution of medical equipment | 75 | 75 |
| 17. Pharmstandard International S.A. | Luxembourg | Venture investments | 100 | 100 |
| 18. "Sellthera Pharm" LLC | Russian Federation | Development and manufacturing Company | 75 | 75 |
| **Joint ventures and associates** | | | | |
| 19. "NauchTechStroy Plus" LLC (NTS +) | Russian Federation | Research and development Company | 37.5 | 37.5 |
| 20. "Argos Therapeutics" Inc. (b) | The USA | Research and development Company | 30.40 | 35 |
| 21. "Biocad Holdings Limited" (c) | Cyprus | Research, development and manufacturing of pharmaceutical products | 20 | – |

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

(a) In August 2014 "PKB named after I.I. Mechnikov" merged with "Biomed named after I.I. Mechnikov" OJSC.
(b) The Group's share decreased due to dilution of interest (Note 9.1).
(c) On 27 July 2014 the Company acquired share in "Biocad Holdings Limited (Note 9.2).

These consolidated financial statements were authorised for issue by the Board of Directors of OJSC "Pharmstandard" on 27 April 2015.

## 2. Changes in classification of comparative information

In the process of preparation of the consolidated financial statements for the year ended 31 December 2014 the Company reconsidered its approach to presentation of the following items:

1. In the consolidated financial statements ended on 31 December 2013 agency fee in the amount of RR 1,037,886 and contract manufacturing fee in the amount of RR 110,698 net of the corresponding expenses in the amount of RR 74,790 were presented as other income. As a result of OTC Branded business spin-off, commencing from 1 January 2014 the Group is treating the above profit or loss items as integral elements of the primary operations of the Group and consequently presents them on a gross basis as revenue or cost of sales. The comparative information was adjusted accordingly and the effects of these adjustments on amounts presented in the consolidated statement of comprehensive income for the year ended 31 December 2013 were as follows:

| | As originally reported | Adjustments | As adjusted |
|---|---|---|---|
| Revenue | 55,907,597 | 1,148,584 | 57,056,181 |
| Cost of sales | (32,509,838) | (74,790) | (32,584,628) |
| Other income | 1,508,995 | (1,073,794) | 435,201 |

2. In the consolidated financial statements ended 31 December 2013 Deferred tax liability was presented on a net basis as the individual amounts were immaterial for the readers. Commencing from 1 January 2014 due to increased materiality of the amounts the Group presents Deferred tax liability and Deferred tax asset on a gross basis. The comparative information was adjusted accordingly and the effects of these adjustments on amounts presented in the consolidated statement of financial position as at 31 December 2013 were as follows:

| | As originally reported | Adjustments | As adjusted |
|---|---|---|---|
| Deferred tax asset | - | 258,050 | 258,050 |
| Deferred tax liability | (186,095) | (258,050) | (444,145) |

3. In the consolidated financial statements ended 31 December 2013 Foreign exchange gain was presented on a net basis as the individual amounts were immaterial for readers. Commencing from 1 January 2014 due to increased materiality of the amounts the Group presents Foreign exchange gain and loss on gross basis. The comparative information was adjusted accordingly and the effects of these adjustments on amounts presented in the consolidated statement of comprehensive income for the year ended 31 December 2013 were as follows:

| | As originally reported | Adjustments | As adjusted |
|---|---|---|---|
| Other income | 435,201 | 82,100 | 517,301 |
| Other expenses | (986,044) | (82,100) | (1,068,144) |

## 3. Basis of preparation of the financial statements

### Statement of compliance

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

### Basis of accounting

The Group's Russian entities maintain their accounting records in Russian Roubles ("RR") and prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation. The Group's Ukrainian subsidiary maintains its accounting records in Ukrainian Hryvnia ("UAH") and prepares its statutory financial statements in accordance with IFRS. The other Group's foreign entities located in the USA, Cyprus and Luxembourg primarily maintain their accounting records in US dollars and Euro and prepare their statutory accounting records in accordance with US GAAP, IFRS and the local regulation respectively. When necessary the local statutory financial statements have been adjusted to present these consolidated financial statements in accordance with IFRS. These adjustments principally relate to valuation and depreciation of property, plant and equipment, valuation and amortisation of intangible assets, certain valuation allowances, using fair values for certain assets, acquisition accounting for business combinations and the resulting income tax effects, and also to consolidation of subsidiaries and equity accounting of associates and joint ventures.

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

### Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial period except that the Group has adopted the following new and amended IFRS and IFRIC interpretations as at 1 January 2014.

The nature and the impact of each new standard and amendment is described below:

*Amendments to Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10 Consolidated Financial Statements and must be applied retrospectively, subject to certain transition relief. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. These amendments have no impact on the Group, since none of the entities in the Group qualifies to be an investment entity under IFRS 10.

*Amendments to IAS 32 Offsetting Financial Assets and Financial Liabilities* clarify the meaning of "currently has a legally enforceable right to set-off' and the criteria for non-simultaneous settlement mechanisms of clearing houses to qualify for offsetting and is applied retrospectively. These amendments have no impact on the Group, since none of the entities in the Group has any offsetting arrangements.

*Amendments to IAS 39 Novation of Derivatives and Continuation of Hedge Accounting* provide relief from discontinuing hedge accounting when novation of a derivative designated as a hedging instrument meets certain criteria and retrospective application is required. These amendments have no impact on the Group as the Group has no derivative financial instruments.

*IFRIC 21 Levies* clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached. Retrospective application is required for IFRIC 21. This interpretation has no impact on the Group as it has applied the recognition principles under IAS 37 Provisions, Contingent Liabilities and Contingent Assets consistent with the requirements of IFRIC 21 in prior years.

*In the 2010-2012 annual improvements cycle,* the IASB issued seven amendments to six standards, which included an amendment to IFRS 13 Fair Value Measurement. The amendment to IFRS 13 is effective immediately and, thus, for periods beginning at 1 January 2014, and it clarifies in the Basis for Conclusions that short-term

receivables and payables with no stated interest rates can be measured at invoice amounts when the effect of discounting is immaterial. This amendment to IFRS 13 has no impact on the Group.

### IFRSs and IFRIC interpretations not yet effective

- *IFRS 9 Financial Instruments:* in July 2014, the IASB issued the final version of IFRS 9 Financial Instruments which reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but no impact on the classification and measurement of the Group's financial liabilities.

- *Amendments to IAS 19 Defined Benefit Plans:* Employee Contributions: these amendments clarify that, if the amount of the contributions is independent of the number of years of service, an entity is permitted to recognise such contributions as a reduction in the service cost in the period in which the service is rendered, instead of allocating the contributions to the periods of service. It is not expected that this amendment would be relevant to the Group, since none of the entities within the Group has defined benefit plans with contributions from employees or third parties.

- *Annual improvements 2010-2012 Cycle:* these improvements are effective from 1 July 2014 and are not expected to have a material impact on the Group. They include:
  - *IFRS 3 Business Combinations:* the amendment is applied prospectively and clarifies that all contingent consideration arrangements classified as liabilities (or assets) arising from a business combination should be subsequently measured at fair value through profit or loss whether or not they fall within the scope of IFRS 9 (or IAS 39, as applicable).
  - *IFRS 8 Operating Segments:* the amendments are applied retrospectively and clarifies that an entity must disclose the judgements made by management in applying the aggregation criteria in paragraph 12 of IFRS 8, including a brief description of operating segments that have been aggregated and the economic characteristics (e.g., sales and gross margins) used to assess whether the segments are 'similar' and the reconciliation of segment assets to total assets is only required to be disclosed if the reconciliation is reported to the chief operating decision maker, similar to the required disclosure for segment liabilities.
  - *IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets:* the amendment is applied retrospectively and clarifies in IAS 16 and IAS 38 that the asset may be revalued by reference to observable data on either the gross or the net carrying amount. In addition, the accumulated depreciation or amortisation is the difference between the gross and carrying amounts of the asset.
  - *IAS 24 Related Party Disclosures:* the amendment is applied retrospectively and clarifies that a management entity (an entity that provides key management personnel services) is a related party subject to the related party disclosures. In addition, an entity that uses a management entity is required to disclose the expenses incurred for management services.

- *Annual improvements 2011-2013 Cycle:* these improvements are effective from 1 July 2014 and are not expected to have a material impact on the Group. They include:
  - *IFRS 3 Business Combinations:* the amendment is applied prospectively and clarifies for the scope exceptions within IFRS 3 that joint arrangements, not just joint ventures, are outside the scope of IFRS 3 and this scope exception applies only to the accounting in the financial statements of the joint arrangement itself.
  - *IFRS 13 Fair Value Measurement:* the amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable).
  - *IAS 40 Investment Property:* the description of ancillary services in IAS 40 differentiates between investment property and owner-occupied property (i.e., property, plant and equipment). The amendment is applied prospectively and clarifies that IFRS 3, and not the description of ancillary services in IAS 40, is used to determine if the transaction is the purchase of an asset or business combination.

- *IFRS 15 Revenue from Contracts with Customers:* IFRS 15 was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue. The new revenue standard is applicable to all

entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January 2017 with early adoption permitted. The Group is currently assessing the impact of IFRS 15 and plans to adopt the new standard on the required effective date.

- *Amendments to IFRS 11 Joint Arrangements:* Accounting for Acquisitions of Interests: the amendments to IFRS 11 require that a joint operator accounting for the acquisition of an interest in a joint operation, in which the activity of the joint operation constitutes a business must apply the relevant IFRS 3 principles for business combinations accounting. These amendments are not expected to have any impact to the Group.

- *Amendments to IAS 16 and IAS 38:* Clarification of Acceptable Methods of Depreciation and Amortisation: the amendments clarify the principle in IAS 16 and IAS 38 that revenue reflects a pattern of economic benefits that are generated from operating a business (of which the asset is part) rather than the economic benefits that are consumed through use of the asset. As a result, a revenue-based method cannot be used to depreciate property, plant and equipment and may only be used in very limited circumstances to amortise intangible assets. The amendments are effective prospectively for annual periods beginning on or after 1 January 2016, with early adoption permitted. These amendments are not expected to have any impact to the Group given that the Group has not used a revenue-based method to depreciate its non-current assets.

## 4.1 Basis of consolidation

### Subsidiaries

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

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

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

### Business combinations

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

The excess of purchase consideration over the Group's share of the fair value of identifiable net assets is recorded as goodwill (Note 4.6). If the cost of the acquisition is less than the Group's share of the fair value of identifiable net assets of the subsidiary acquired the difference is recognised directly in profit or loss.

### Investments in associates and joint ventures

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

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

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

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

## 4.2 Cash and short-term deposits

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

## 4.3 Value added tax

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

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

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

## 4.4 Inventories

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

## 4.5 Property, plant and equipment

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

| | Number of years |
|---|---|
| Buildings | 10 to 50 |
| Plant and machinery | 5 to 30 |
| Equipment, motor vehicles and other | 2 to 7 |

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

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

## 4.6 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.

## 4.7 Intangible assets other than goodwill

Intangible assets acquired separately from business combinations are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

Intangible assets with a finite life are amortised on a straight-line basis over the useful economic lives (for trademarks useful economic life is estimated between 15 and 20 years; for patents useful economic life is estimated accordingly to period which is reflected in patent, but not more than 20 years) and assessed for impairment whenever there is an indication that the intangible asset may be impaired. Amortisation periods and methods for intangible assets are reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in profit or loss in the expense category consistent with the function of the intangible asset.

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

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

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

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

## 4.8 Investments and other financial assets

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

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

### Loans and receivables

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

### Available-for-sale financial investments

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

### Fair value

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

### Amortised cost

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

### Impairment of financial assets

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

### Assets carried at amortised cost

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

### Available-for-sale financial investments

For AFS financial assets, the Group assesses at each reporting date whether there is objective evidence that an investment or a group of investments is impaired. In the case of equity investments classified as AFS, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost. 'Significant' is evaluated against the original cost of the investment and 'prolonged' against the period in which the fair value has been below its original cost. When there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognised in the statement of profit or loss – is removed from OCI and recognised in the statement of profit or loss. Impairment losses on equity investments are not reversed through profit or loss; increases in their fair value after impairment are recognised in OCI.

The determination of what is 'significant' or 'prolonged' requires judgement. In making this judgement, the Group evaluates, among other factors, the duration or extent to which the fair value of an investment is less than its cost.

## 4.9 Borrowings

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

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

## 4.10 Income taxes

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

Deferred income taxes are provided for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where the deferred income tax

arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

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

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

## 4.10 Income taxes

Deferred income tax liabilities are 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.

In respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognised only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

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

## 4.11 Leases

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

## 4.12 Derecognition of financial assets and liabilities

### Financial assets

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

### Financial liabilities

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

## 4.13 Provisions

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

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

## 4.14 Equity

### Share capital

Ordinary shares are classified as equity.

### Dividends

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

### Treasury shares

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

## 4.15 Revenue

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

## 4.16 Employee benefits

In 2014, under provision of the Russian legislation, social contributions are made through a social tax ("ST") allocated to state pension and social insurance funds calculated by the Group by the application of a ST regressive rate from 30% applicable only to the gross remuneration of individual employee not more than RR 624 p.a. to 10%. The Group's contributions relating to ST are expensed in the year to which they relate.

Total contributions for ST amounted to RR 869,928 during the year ended 31 December 2014 (2013: RR 887,978) and they were classified as labour costs in these consolidated financial statements.

In 2015, the threshold for application of 30% ST rate for individual employee was raised to RR 670 p.a. for social insurance fund and RR 711 p.a. for state pension fund.

## 4.17 Foreign currency transactions

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

At 31 December 2014, the exchange rates used for translation foreign currency balances were US$ 1 = 56.26 roubles; Euro 1 = 68.34 roubles; 1 Ukrainian Hryvnia = 3.56 roubles (2013: US$ 1 = 32.73 roubles; Euro 1 = 44.97 roubles; 1 Ukrainian Hryvnia = 3.97 roubles). The functional currency of the Ukrainian subsidiary is the Ukrainian Hryvnia. The functional currencies of the other foreign operations are the United States dollar (US$) and the Euro. As at the reporting date, the assets and liabilities of those subsidiaries having functional currency different from the Russian Rouble are translated into the presentation currency of the Group (the Russian Rouble) at the rate of exchange ruling at the reporting date and its statement of comprehensive income and cash flow statement are translated at the exchange rate prevailing at the date of transaction. The exchange differences arising on the translation are taken to a separate component of equity through other comprehensive income.

## 4.18 Impairment of non-financial assets

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

## 4.19 Government grants

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

## 4.20 Share-based payments

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

## 5. Significant accounting judgements and estimates

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

### Impairment of non-financial assets, except for goodwill

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

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

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

- *Trade marks, patents and licenses:* changes in current competitive conditions, changes in the regulations, expectations of growth in the industry, increased cost of capital, changes in the future availability of financing, introduction of alternative products on the market and other changes in circumstances that indicate impairment exists.

### Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which the goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. The carrying amount of goodwill at 31 December 2014 is RR 1,730,040 (2013: RR 1,769,556). More details are provided in Note 14.

### Allowance for doubtful accounts receivable

The Group maintains an allowance for doubtful accounts receivable to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts receivable, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial conditions of customers were to deteriorate, actual write-offs might be higher than expected. As at 31 December 2014, allowances for doubtful accounts receivable amounted to RR 225,186 (2013: RR 244,764). More details are provided in Note 16.

### Write-down of inventories to net realisable value

The Group determines the adjustment for write-down of inventories to net realisable value based on their expected future use and realisable value. The net realisable 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 and Ukrainian tax, currency and customs legislation is subject to varying interpretations and changes occur frequently. Further, the interpretation of tax legislation by tax authorities as applied to the transactions and activity of the Group's entities may not coincide with that of management. As a result, tax authorities may challenge transactions and the Group's entities may be assessed additional taxes, penalties and interest, which can be significant. In Russia and Ukraine the periods remain open to review by the tax and customs authorities with respect to tax liabilities for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods. As of 31 December 2014 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 31.

### 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.

## 6. Spin-off of Branded OTC business

In July-September 2013, the Board of Directors and the shareholders of the Company approved a plan of spin-off of the Group's Branded OTC business into a newly founded separate legal entity "OTCpharm" OJSC ("OTCpharm") with the purpose to increase the combined value of the Group and OTCpharm.

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

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

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

The purpose of the cash distribution was to provide OTCpharm with initial working capital to launch its independent operations. Further the cash distributed was ultimately used by OTCpharm to pay primarily for the Group supplies of the respective active pharmaceutical ingredients and finished goods (Note 12).

Although the trade marks were transferred out to OTCpharm the Group continued to use them until its re-registration to OTCpharm in accordance with the regulation. On 1 April 2014, the Group sold to OTCpharm all finished goods under OTCpharm trade marks and the respective active pharmaceutical ingredients ("APIs") balance (Note 12). Since 1 April 2014 OTCpharm started its operations independently from the Group and personnel of the Company involved in operation of branded OTC business was transferred to OTCpharm.

## 7. Acquisition of Bever

In August 2013, the Group acquired 100% of share capital of "Bever Pharmaceutical Pte Ltd" ("Bever") controlled by Alexander Shuster, one of the Company's Directors. Bever is a single asset entity that holds a 20 year-length contract that provides exclusive purchase rights for unique raw materials – APIs used for manufacturing of the Group's leading OTC products Arbidol and Afobazol and also sale of these APIs in Russia and CIS. This acquisition was related to the plan of spin-off of Branded OTC business.

The Group accounted for acquisition of Bever as acquisition of intangible asset (i.e. the exclusive favorable purchase contract). Considering that this acquisition was partly settled in the parent company's shares it was accounted for an equity-settled share-based payment transaction. Intangible asset was measured at recognition at its fair value of RR 13,936,025 with the corresponding increase in equity of RR 12,353,287 related to consideration paid in shares (the remaining amount of RR 1,582,738 was paid in cash).

On 23 December 2013, Bever was transferred to OTCpharm as a result of spin-off of the OTCbranded business (see Note 6).

## 8. Investments in joint ventures

### 8.1 Investments in joint venture Medtekhnika

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

### 8.2 Investments in joint venture NTS+

Main purpose of "NTS+" is to participate in building of a research and development center in the Vladimir region of the Russian Federation specialized in bioengineering medical products and universal diagnostic researches.

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

| | 2014 | 2013 |
|---|---|---|
| Current assets including cash and cash equivalents RR 39,205 (2013: RR 3,539) | 83,299 | 55,544 |
| Property, plant and equipment and other non-current assets | 1,371,112 | 1,224,080 |
| Current liabilities | (193,173) | (108,739) |
| Long-term loans and other non-current liabilities | (329,368) | (331,920) |
| **Equity** | **931,873** | **838,965** |
| Proportion of the Group's ownership | 37.5% | 37.5% |
| **Carrying amount of the investment** | **349,452** | **314,612** |

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

| | 2014 | 2013 |
|---|---|---|
| General and administrative expenses | (123,600) | (128,341) |
| Financial expenses, net | (30,064) | (31,651) |
| Other income, including income from non-core operations and rent RR 128,667 (2013: RR 92,875) | 262,512 | 102,995 |
| Other expenses | (70,648) | (45,771) |
| **Profit/(loss) before income tax** | **38,200** | **(102,768)** |
| Income tax benefit/(expense) | 54,707 | (49,877) |
| **Profit/(loss) and total comprehensive income for the year** | **92,907** | **(152,645)** |
| **Group's share of profit/(loss) and total comprehensive income for the year** | **34,840** | **(57,242)** |

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

## 9. Investments in associates

### 9.1. Investments in "Argos Therapeutics, Inc"

In 2013, Pharmstandard International S.A. invested US$ 36.8 million (RR 1,206,457) to purchase about 35% of voting preferred shares of Argos Therapeutics, Inc. ("Argos") incorporated in the USA, Delaware. Further in February 2014, Pharmstandard International S.A. additionally invested US$ 10.2 million (RR 354,233). In February 2014, Argos converted voting preferred shares to voting ordinary shares and issued certain additional number of voting ordinary shares. As a result of these transactions the Group's interest in Argos was diluted to 30.4%. Dilution was accounted for as deemed disposal which resulted in additional loss on deemed disposal in the amount of RR 1,669 including RR 9 382 accumulated foreign exchange gains reclassified to profit for the year. On 7 February 2014 Argos became listed on NASDAQ.

Argos is a biopharmaceutical company focused on the development and commercialisation of fully personalised immunotherapies for the treatment of cancer and infectious diseases based on its Arcelis™ technology platform. In accordance with the purchase agreement the Company received the right to appoint two members of the Board of Directors therefore the Company received a significant influence over Argos and recognised it as an associate applying the equity method for its accounting.

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

| | 2014 | 2013 |
|---|---|---|
| Cash and cash equivalents | 2,094,140 | 1,089,816 |
| Other current assets | 1,141,691 | 531,217 |
| Property, plant and equipment and other non-current assets | 385,346 | 52,454 |
| Current liabilities | (185,470) | (103,533) |
| Non-current liabilities | (1,671,905) | (329,914) |
| **Equity** | **1,763,802** | **1,240,040** |
| Proportion of the Group's ownership | 30.4% | 35% |
| **Carrying value of net assets** | **536,196** | **434,014** |
| Goodwill arising of acquisition of associate | 1,093,699 | 729,935 |
| **Carrying amount of investments** | **1,629,895** | **1,163,949** |

Summarised statement of comprehensive income of Argos is detailed below:

| | 2014 | 2013 |
|---|---|---|
| Revenue | 75,814 | 10,322 |
| Research and development expenses | (1,747,436) | (101,948) |
| General and administrative expenses | (330,268) | (23,364) |
| Other expenses | (84,301) | (684) |
| **Loss and total comprehensive income for the period** | **(2,086,191)** | **(115,674)** |
| **Group's share of loss for the year (35% before 7 February 2014 and 30.4% after 7 February 2014)** | **(634,202)** | **(40,486)** |

Foreign exchange differences related to the associate recognised in other comprehensive income amounted of RR 747,584 (2013: 0).

## 9.2. Investments in "Biocad Holding Limited"

On 30 April 2014, the Company signed contract with shareholders of "Biocad Holdings Limited" ("Biocad"), a company registered under the law of Cyprus with the purpose of acquiring 20% of the outstanding Biocad shares for the total cash consideration of US$ 100 million (RR 3,503,870).

Biocad is the controlling shareholder in several companies involved in the research and development, production and distributing of various pharmaceutical and biopharmaceutical products, primarily in Russian Federation. These major subsidiaries are Russian legal entities: "Biocad" CJSC, "Biocad Pharm" LLC, "I-Mab" LLC. Biocad has also several insignificant subsidiaries registered under the law of other countries.

On 27 July 2014, the Company finalised the acquisition. In accordance with the shareholder's agreement the Company obtained significant influence over strategic and operating policies of the Biocad and recognised it as associate applying the equity method of accounting.

Summarised financial information of Biocad, based on its consolidated financial statements is set out below:

| | 31 December 2014 | Fair value on the date of acquisition 27 July 2014 |
|---|---|---|
| Cash and cash equivalents | 6,806,030 | 52,243 |
| Other current assets | 2,199,192 | 2,113,041 |
| Property, plant and equipment | 1,041,489 | 1,024,130 |
| Intangible assets | 4,116,858 | 3,992,676 |
| Trade and other payables | (2,913,790) | (324,628) |
| Other current liabilities | (349,693) | (93,441) |
| Non-current liabilities | (722,149) | (766,553) |
| **Equity** | **10,177,937** | **5,997,468** |
| Proportion of the Group's ownership | 20% | 20% |
| **Carrying value of net assets** | **2,035,587** | **1,199,494** |
| Goodwill arising of acquisition of associate | 2,304,376 | 2,304,376 |
| **Carrying amount of investments** | **4,339,963** | **3,503,870** |

Summarised consolidated statement of profit or loss of Biocad since the date of recognition of associate 27 July to 31 December 2014 is detailed below:

| | |
|---|---|
| Revenue | 7,303,972 |
| Cost of sales | (1,074,982) |
| Research expenses | (149,446) |
| General and administrative expenses | (1,204,130) |
| Other income and expenses | 263,989 |
| Income tax expenses | (958,936) |
| **Profit for the period** | **4,180,467** |
| **Group's share of profit for the period** | **836,093** |

## 10. Acquisition of non-controlling interests

In August 2013, the Company acquired about 11% of non-controlling interests in Donelle Company Limited ("Donelle"). Total consideration paid in cash for the acquired non-controlling interests was RR 235,112. On December 2013, Donelle was transferred to OTCpharm as a result of spin-off of the OTC-branded business (see Note 6).

In May 2013, the Company acquired a 41.93% interest in "Pharmstandard-Biolik" PJSC resulting in an increase in the Company's interests to 96.93%. Total consideration paid in cash for the acquired non-controlling interests was RR 125,253.

## 11. Segment information

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

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

Management monitors the segments' assets, liabilities, sales, gross profit, segments' results and budgets of these business segments separately for the purpose of making decisions about resource allocation and performance assessment. For the management purposes, budgets of income and expense are planned and analysed for each of operating segments separately.

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

Segment assets consist primarily of property, plant and equipment, intangible assets including goodwill allocated to specified segment, inventories, financial assets, receivables and operating cash. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Capital expenditure comprises additions to property, plant and equipment.

There were no significant intercompany transactions between these operating segments.

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

| Year ended 31 December 2014 | Production and wholesale of pharmaceutical products ("Pharmaceutical products") | Production and wholesale of medical equipment | Group |
|---|---|---|---|
| Sales to external customers | 40,103,232 | 1,120,203 | 41,223,435 |
| **Total revenue** | **40,103,232** | **1,120,203** | **41,223,435** |
| Gross profit | 17,798,480 | 417,915 | 18,216,395 |
| **Segment result** | **13,699,491** | **(6,530)** | **13,692,961** |
| Financial income, net | | | (108,293) |
| Share in profit of joint venture and associates, net | | | 235,062 |
| **Profit before income tax** | | | **13,819,730** |
| Income tax expense | | | (2,724,267) |
| **Profit for the year** | | | **11,095,463** |
| Segment assets | 60,689,995 | 1,650,148 | 62,340,143 |
| Unallocated assets | | | 480,330 |
| **Total assets** | | | **62,820,473** |
| Segment liabilities | 16,293,365 | 289,082 | 16,582,447 |
| Unallocated liabilities | | | 5,417,686 |
| **Total liabilities** | | | **22,000,133** |
| Acquisition of property, plant and equipment (Note 13) | 2,382,508 | 8,880 | 2,391,388 |
| Depreciation and amortisation | 907,267 | 37,403 | 944,670 |
| Property, plant and equipment impairment (charge)/reversal (Note 13) | (63,841) | 10,591 | (53,250) |

As at 31 December 2014 the net unallocated liabilities of RR 4,937,356 consist of loans and borrowings of RR 4,002,941, income tax payable of RR 807,972 and net deferred tax liability of RR 126,443.

| Year ended 31 December 2013 | Production and wholesale of pharmaceutical products ("Pharmaceutical products") | Production and wholesale of medical equipment | Group |
|---|---|---|---|
| Sales to external customers | 56,007,903 | 1,048,278 | 57,056,181 |
| **Total revenue** | **56,007,903** | **1,048,278** | **57,056,181** |
| Gross profit | 24,129,245 | 342,308 | 24,471,553 |
| **Segment result** | **15,770,067** | **26,749** | **15,796,816** |
| Financial income, net | | | 163,442 |
| Share in loss of joint venture and associate, net | | | (97,728) |
| **Profit before income tax** | | | **15,862,530** |
| Income tax expense | | | (3,942,091) |
| **Profit for the year** | | | **11,920,439** |
| Segment assets | 61,141,673 | 1,465,632 | 62,607,305 |
| Unallocated assets | | | 258,050 |
| **Total assets** | | | **62,865,355** |
| Segment liabilities | 25,875,572 | 115,197 | 25,990,769 |
| Unallocated liabilities | | | 7,800,293 |
| **Total liabilities** | | | **33,791,062** |
| Acquisition of property, plant and equipment (Note 13) | 1,427,978 | 65,806 | 1,493,784 |
| Depreciation and amortisation | 915,000 | 38,083 | 953,083 |
| Property, plant and equipment impairment (charge)/reversal (Note 13) | (1,488) | 1,031 | (457) |
| Impairment of intangible assets (Note 14) | 100,000 | – | 100,000 |

As at 31 December 2013 the net unallocated liabilities of RR 7,542,243 consist of loans and borrowings of RR 7,024,080, income tax payable of RR 332,068 and net deferred tax liability of RR 186,195.

Major assets of the Group are placed in Russian Federation and major revenue is generated from the operation in Russian Federation. Revenues from certain customers in the Pharmaceutical products segment individually approximated or exceeded 10% of total Group's segment revenue.

The table below shows the revenue from these customers:

| Customer | 2014 | 2013 |
|---|---|---|
| The Ministry of Health of Russian Federation and its regional branches (federal state open auctions only) | 5,313,862 | 13,214,240 |
| Customer 1 | 3,661,399 | 5,862,567 |
| Customer 2* | 2,639,325 | 5,541,438 |
| Customer 3 | 2,320,332 | 5,121,244 |

* In 2014, more than 93% of total revenue from this customer was attributed to medicine Velcade®.

The Group's sales to the Ministry of Health of Russian Federation and its regional branches represent about 13% of the total Group's revenue in 2014 (2013: 23%).

## 12. Balances and transactions with related parties

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 in 2014 and 2013 or had balances outstanding at 31 December 2014 and 2013 are detailed below.

### Balances with related parties

| 2014 | Short-term financial assets – (a), Note 18 | Long-term financial assets – (b), Note 19 | Cash and shortterm deposits placed in related bank – Note 17 | Trade and other receivables and prepayments – (c) Note 16 | Trade and other payables – (d) Note 22 |
|---|---|---|---|---|---|
| Parent | 4,050,605 | – | – | 152,904 | – |
| Other related parties[1] | 172,000 | 42,900 | 6,455,195 | 5,939,141 | 2,509,714 |
| Joint venture | 37,000 | - | - | 79,540 | - |
| **Total** | **4,259,605** | **42,900** | **6,455,195** | **6,171,585** | **2,509,714** |

| 2013 | Short-term financial assets – (a), Note 18 | Long-term financial assets – (a), Note 19 | Cash and short term deposits placed in related bank – Note 17 | Trade and other receivables and prepayments – (c) Note 16 | Trade and other payables – (d) Note 22 |
|---|---|---|---|---|---|
| Parent | 752,772 | – | – | – | – |
| Other related parties | 227,530 | 72,000 | 10,050,603 | 100,082 | 6,948,528 |
| **Total** | **980,302** | **72,000** | **10,050,603** | **100,082** | **6,948,528** |

(a) This item is detailed in sub-sections "Loans provided to parent" and "Loans provided to other related parties" below.
(b) This item is primarily comprised of long-term deposits placed in related bank with maturity in 2016 and interest rate of 6.5%8% p.a.
(c) This item is primarily comprised of receivables from OTCpharm for sale of raw materials and finished goods as a part of spin off (Note 6), interest receivable from Augment, agency fee receivables from sale of certain related party products and prepayments for rent and other services.
(d) This item primarily comprised of (i) payables to OTCpharm for sales of OTC branded products under agency agreement in the amount of RR 646,502 and (ii) payables to Bever for purchase of API in the amount of RR 1,182,822 (Note 7); (iii) payables to other related party for purchase of Koagil VII in the amount of RR 453,640.

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

## Significant transactions with related parties

| Statement of comprehensive income caption | Relationship | 2014 | 2013 |
|---|---|---|---|
| Agency fee income (included in revenue) (A) | Other related parties | 888,638 | 27,122 |
| Contractual manufacturing income from OTCpharm (included in revenue) (B) | Other related parties | 1,373,268 | – |
| Revenue from sale of active pharmaceutical ingredients to OTCpahrm (included in revenue) (C) | Other related parties | 1,586,941 | – |
| Revenue from sale of finished goods to OTCpharm (included in revenue) (C) | Other related parties | 2,355,984 | – |
| Revenue from sale of third-parties products (included in revenue) | Associate | 620,020 | – |
| Revenue from sale of third-parties products to OTCpharm (included in revenue) (C) | Other related parties | 55,076 | – |
| Interest income from deposits placed in a related bank | Other related parties | 19,225 | 18,335 |
| Interest income from loans provided to parent and other related parties | Parent and other related parties | 110,766 | 38,511 |
| License fee (included in distribution costs) (D) | Other related parties | (123,783) | (3,515) |
| Warehouse rental expenses (included in distribution costs) | Other related parties | (127,670) | (113,171) |
| Office rental expenses (included in general and administrative expenses) | Other related parties | (69,419) | (64,606) |
| Cost of sales (E) | Other related parties | (2,608,314) | (3,083,333) |
| Consulting on venture investments (included in general and administrative expenses) (F) | Other related parties | (106,099) | – |
| Other income (G) | Other related parties | 274,859 | 12,301 |
| Other income | Joint venture | 70,159 | - |
| Research and development expenditure | Other related parties | (31,454) | – |
| Cession of rights for loan issued by third party (H) | Other related parties | 727,882 | – |
| Purchase of promissory notes from related bank (I) | Other related parties | 3,420,978 | – |

*(A) Agency fee income*
The Company holds agency contracts with related parties for distribution and sales of certain products owned by those related parties (see Note 25).

*(B) Contractual manufacturing income*
The Group holds contractual manufacturing contracts for production of OTC branded medicines with OTCpharm (Note 25).

*(C) Revenue from sales to OTCpharm*
The Group sold to OTCpharm inventory related to OTC business to enable to launch independent operations of OTCpharm since 1 April 2014 (Notes 6 and 25).
Also since 1 April 2014, the Group is supplying certain API to OTCpharm under regular sales contracts (Note 25).

*(D) License fee*
The Group paid license fee to OTCpharm for usage of trade marks before 1 April 2014 (Note 6).

*(E) Cost of sales*
The Group holds a purchase contracts for supply of third-party products, primarily Koagil VII, manufactured by a related party. The total cost of RR 2,608,314 (2013: RR 3,083,333) includes the cost of this product in the amount of RR 1,776,376 (2013: RR 2,814,606) sold by the Group primarily through open state auctions. The remaining amount included in cost of sales primarily represents cost of raw materials and third-parties products purchased from other related parties.

(F) Consulting on venture investments
This item primarily represents consulting expenses incurred to related party in connection with identification, analysis and monitoring of R&D start up companies – potential targets of investment by Pharmstandard International S.A.

*(G) Other income*
Other income primarily includes income from operating lease of cars and warehouses to OTCpharm, income from royalty, utilities, sale of materials and other income from transactions with associate (Note 29).

*(H) Cession of rights for loan issued by third party*

On 24 December 2014, the Company signed with a related party cession agreement. Based on this agreement the Company paid to the related party RR 727,882 and received legal right of claim from a third party of short-term loan of US$ 12,500 thousand (RR 689,165) bearing interest rate of 6.5% p.a. (Note 18) and interest receivable of RR 61,255.

*(I) Purchase of promissory notes*

In 2014, the Company purchased from the related bank promissory notes of RR 3,420,978 at their pair value. Further the Company sold those promissory notes to a third party for cash consideration of RR 3,501,090 and recognised income from this transaction in the amount of RR 80,112 (Note 29).

### Loans provided to parent

In 2013 and 2014, the Company's parent "Augment Investments Limited" ("Augment"), a company registered under the laws of Cyprus (see Note 24), applied to the Company with request to provide short-term interest loans for the purpose of financing the current business activity of Augment not related to the Group.

In October 2013, the Group provided unsecured US$ denominated short-term loan to Augment of US$ 60,000 thousand (RR 1,935,978 at the exchange rate as of date of issue of loan) with maturity date of 14 October 2014 and fixed interest rate of 5.25%. In November and December 2013, Augment partly repaid this loan in the amount of US$ 37,000 thousand (RR 1,209,971). Outstanding of principal amount of loan payable as at 31 December 2014 is US$ 23,000 thousand (RR 1,293,943). In October 2014, the Company signed an additional agreement to extend the maturity date to 12 October 2015.

During 2014, the Group provided additional unsecured US$ denominated short-term loans to Augment with maturity in 2015 in the total amount of US$ 64,000 thousand (RR 2,560,159) with fixed interest rate from 2.75% to 5.25% p.a. During 2014, Augment partly repaid those loans in the amount of US$ 15,000 thousand (RR 784,305). Outstanding of principal amount of loans payables as at 31 December 2014 is US$ 49,000 thousand (RR 2,756,662).

### Loans provided to other related parties

In December 2012, the Company provided an unsecured short-term loan to other related party of RR 72,000 with maturity date of 27 December 2013 and fixed interest rate of 12% p.a. This loan provided for the purpose of financing the current business activity of that related party. In December 2013, the Company signed an additional agreement to extend the maturity date to 19 October 2015 (Note 18).

In August 2014, the Company provided an unsecured short-term loan to other related party of RR 75,000 with maturity date of 31 December 2015 and fixed interest rate of 12% p.a. (Note 18). The amount of RR 38,000 of this loan was repaid in 2014. In October 2014, the Company provided an unsecured short-term loan to other related party of RR 700,000 with maturity date of 31 December 2015 and fixed interest rate of 10% p.a. (Note 18). Of this loan the amount of RR 600,000 was repaid in 2014.

### Compensation to key management personnel

Total compensation to key management personnel, amounted to RR 55,599 for the year ended 31 December 2014 (2013: RR 54,753). Such compensation represents the payroll and bonuses included in general and administrative expenses.

### Transactions with key management

In August 2013, the Group acquired 100% share capital of Bever controlled by Alexander Shuster, one of the Company's Directors (Note 7). In August 2013, the Group also acquired from Alexander Shuster 5.465% of non-controlling interest in Donelle for the total agreed consideration of RR 117,556 settled in cash.

## 13. Property, plant and equipment

Property, plant and equipment consist of the following:

| 31 December 2014 | Land | Buildings | Plant and machinery | Equipment, motor vehicles and other | Assets under construction | Total |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| **Balance at 1January 2014** | **442,564** | **4,804,039** | **4,562,537** | **811,079** | **1,553,569** | **12,173,788** |
| Additions | – | 3,508 | 43,964 | 187,619 | 2,156,297 | 2,391,388 |
| Transfers | – | 234,246 | 1,389,863 | 13,267 | (1,637,376) | – |
| Disposals | – | (1,322) | (38,204) | (89,658) | (47,279) | (176,463) |
| Foreign exchange differences | – | (15,391) | (19,033) | (1,473) | (12,238) | (48,135) |
| **Balance at 31 December 2014** | **442,564** | **5,025,080** | **5,939,127** | **920,834** | **2,012,973** | **14,340,578** |
| **Accumulated depreciation and impairment** | | | | | | |
| **Balance at 1 January 2014** | **–** | **664,019** | **2,707,851** | **359,364** | **39,316** | **3,770,550** |
| Depreciation charge | – | 152,441 | 521,803 | 136,330 | – | 810,574 |
| Disposals | – | (763) | (21,565) | (78,069) | (1,720) | (102,117) |
| Impairment charge/(reversal) | – | (6,724) | (3,945) | – | 63,919 | 53,250 |
| Foreign exchange differences | – | (1,837) | (4,594) | (574) | (2,005) | (9,010) |
| **Balance at 31 December 2014** | **–** | **807,136** | **3,199,550** | **417,051** | **99,510** | **4,523,247** |
| **Net book value** | | | | | | |
| **Balance at 1 January 2014** | **442,564** | **4,140,020** | **1,854,686** | **451,715** | **1,514,253** | **8,403,238** |
| **Balance at 31 December 2014** | **442,564** | **4,217,944** | **2,739,577** | **503,783** | **1,913,463** | **9,817,331** |

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

In 2014 and 2013, the Group did not borrow money for capital construction and there were no new qualifying assets, therefore no borrowing costs were capitalised.

The Group assets include only an insignificant portion of land on which the Group's factories and buildings, comprising the Group's principal manufacturing facilities, are located, whilst the major portion of the land

is held under operating lease agreements with the state municipal bodies. The lease agreements specify lease terms between 1 and 20 years. Long-term agreements have an option to prolong the lease term for another 10 years and include a purchase option after termination of the lease. Purchase price will be determined based on fair value of the land as determined by the municipal authorities. The total amount of rental payments for the use of the land during 2014 was RR 32,105 (2013: RR 25,090). Such payments are reassessed by the state authorities on an annual basis. No such reassessment has been completed for 2015 and beyond as of the date of approval of these consolidated financial statements for issue.

In 2014, the Group signed with OTCpharm operating lease agreements. In accordance with agreements the Group leased out to OTCpharm cars and warehouses with net book value at 31 December 2014 RR 144,669. Income from operating lease in the amount of RR 77,161 is recognised as other income (Note 12 and Note 29).

## 14. Intangible assets

| 31 December 2014 | Goodwill | Trademarks, patents and licenses | Development costs | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| **Balance at 1 January 2014** | **1,769,556** | **1,286,573** | **279,100** | **3,335,229** |
| Additions | – | 48,065 | 45,627 | 93,692 |
| Transfers | – | 143,845 | (143,845) | – |
| Foreign exchange differences | (39,516) | – | – | (39,516) |
| **Balance at 31 December 2014** | **1,730,040** | **1,478,483** | **180,882** | **3,389,405** |
| **Accumulated amortisation and impairment** | | | | |
| Balance at 1 January 2014 | – | 132,712 | – | 132,712 |
| Amortisation expense | – | 134,096 | – | 134,096 |
| **Balance at 31 December 2014** | **–** | **266,808** | **–** | **266,808** |
| **Net book value** | | | | |
| **Balance at 1 January 2014** | **1,769,556** | **1,153,861** | **279,100** | **3,202,517** |
| **Balance at 31 December 2014** | **1,730,040** | **1,211,675** | **180,882** | **3,122,597** |

| 31 December 2013 | Goodwill | Trademarks, patents and licenses | Development costs | Total |
|---|---|---|---|---|
| **Cost** | | | | |
| **Balance at 1 January 2013** | **2,584,302** | **7,186,198** | **180,360** | **9,950,860** |
| Additions (a) | – | 14,786,962 | 98,740 | 14,885,702 |
| Reclassification to assets held for distribution (Note 6) | (835,000) | (20,686,587) | – | (21,521,587) |
| Foreign exchange differences | 20,254 | – | – | 20,254 |
| **Balance at 31 December 2013** | **1,769,556** | **1,286,573** | **279,100** | **3,335,229** |
| **Accumulated amortisation and impairment** | | | | |
| **Balance at 1 January 2013** | **–** | **1,907,922** | **–** | **1,907,922** |
| Amortisation expense | – | 248,345 | – | 248,345 |
| Reclassification to assets held for distribution (Note 6) | – | (2,023,555) | – | (2,023,555) |
| **Balance at 31 December 2013** | **–** | **132,712** | **–** | **132,717** |
| **Net book value** | | | | |
| **Balance at 1 January 2013** | **2,584,302** | **5,278,276** | **180,360** | **8,042,938** |
| **Balance at 31 December 2013** | **1,769,556** | **1,153,861** | **279,100** | **3,202,517** |

(a) In 2013 the Group acquired (i) Bever which is a holder of exclusive contracts of RR 13,936,025 (Note 7) and (ii) exclusive license on manufacturing patent and distribution of product named of Sirturo® of RR 850,937.

Carrying amount and remaining amortisation period of major trademarks and patents as of 31 December are as follows:

| | Carrying amount | | Remaining amortisation period (years) | |
|---|---|---|---|---|
| Name | 2014 | 2013 | 2014 | 2013 |
| Sirturo® | 767,763 | 844,539 | 9 | 10 |
| Epostim® | 143,519 | 162,655 | 8 | 9 |
| Pegaltevir ® | 134,256 | – | 5 | – |

## Impairment testing of goodwill

Goodwill acquired through business combinations has been allocated for impairment testing purposes to the following groups of cash-generating units, which are also reportable segments of the Group:
- production and wholesale of pharmaceutical products group of units ("Pharmaceuticals"); and
- production and wholesale of medical equipment group of units ("Equipment").

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

| | Pharmaceuticals | | Equipment | | Total | |
|---|---|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| Carrying amount of goodwill | 1,511,186 | 1,550,702 | 218,854 | 218,854 | 1,730,040 | 1,769,556 |

The recoverable amount of the cash-generating units has been determined based on a value in use calculation using cash flow projections developed on the basis of financial budgets approved by management covering a five-year period and cash flows beyond the five-year period are extrapolated using a 5% growth rate that is the same as the mid-term average growth rate for pharmaceuticals and medical equipment market (2013: 5%). The discount rate applied to cash flow projections is 18% (2013: 14.8%).

Key assumption used in value in use calculations

The calculation of value in use for both Pharmaceuticals and Equipment groups of cash-generating units are most sensitive to the following assumptions:
- Discount rates;
- Raw material price inflation;
- Currency rates changes;
- Growth rate used to extrapolate cash flows beyond the budget period.

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

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

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

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

## Sensitivity to changes in assumptions

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

## 15. Inventories

Inventories consist of the following:

| | 2014 | 2013 |
|---|---|---|
| Raw materials – at cost | 2,124,480 | 2,294,666 |
| Work in progress – at cost | 474,208 | 451,305 |
| Finished goods – at net realisable value | 4,451,087 | 4,740,783 |
| | **7,049,775** | **7,486,754** |

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

| | 2014 | 2013 |
|---|---|---|
| **Balance at 1 January** | **216,842** | **234,389** |
| Additional write-downs | 99,257 | 206,520 |
| Unused amounts reversed | (21,858) | (18,819) |
| Utilised during the year | (152,755) | (206,664) |
| Foreign exchange differences | (5,277) | 1,416 |
| **Balance at 31 December** | **136,209** | **216,842** |

## 16. Trade and other receivables

| | 2014 | 2013 |
|---|---|---|
| Trade receivables (net of allowance for impairment of receivables of RR 225,186 (2013: RR 244,764)) | 13,236,008 | 23,201,077 |
| Interest receivable – third parties | 33,519 | 23,900 |
| Interest receivable – related parties (Note 12) | 181,221 | 21,278 |
| Trade receivables – related parties (Note 12) | 5,863,421 | 60,449 |
| Other receivables – related parties (Note 12) (a) | 117,897 | - |
| Other receivables (a) | – | 662,359 |
| | **19,432,066** | **23,969,063** |

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

At 31 December 2014 RR 3,108,066 of trade and other receivables were denominated in currencies other than Russian Roubles, primarily in US$.

At 31 December 2013 RR 792,800 of trade and other receivables were denominated in currencies other than Russian Roubles, primarily in Euro.

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

| | 2014 | 2013 |
|---|---|---|
| Balance at 1 January | 244,764 | 107,118 |
| Additional allowance | 160,158 | 175,725 |
| Unused amounts reversed | (177,806) | (38,797) |
| Utilised during the year | (1,642) | (133) |
| Translation differences | (288) | 851 |
| Balance at 31 December | 225,186 | 244,764 |

## 17. Cash and short-term deposits

Cash and short-term deposits consist of the following:

| | 2014 | 2013 |
|---|---|---|
| Cash in bank – Russian Roubles | 499,072 | 9,966,621 |
| Cash in bank – US$ and Euro | 4,537,243 | 28,101 |
| Cash in bank – Ukrainian Hryvnia | 33,147 | 1,444 |
| Short-term bank deposits – Russian Roubles (a) | 500,000 | 5,130,500 |
| Short-term bank deposits – US$ and Euro (a) | 1,128,389 | – |
| Short-term bank deposits – Ukrainian Hryvnia | 10,670 | – |
| Short-term bank deposits placed in related bank – Russian Roubles (a) | 1,635,300 | 80,000 |
| Short-term bank deposits placed in related bank – US$ (b) | 71,364 | – |
| Short-term deposits on state open auctions – Russian Roubles (c) | 126,363 | 158,209 |
| | **8,541,548** | **15,364,875** |

Substantially all cash and short-term deposits of the Group are placed in the related bank (Note 12). Cash balances with the related bank carry no interest.

(a) Deposits denominated in RR bear an interest rate of 1.5%-20% p.a. (2013: 5%-9.5% p.a.). Deposits denominated in US$ and Euro bear an interest rate of 3.6% p.a.
(b) These cash deposits are restricted for use as placed to secure participation in state open auctions.

## 18. Short-term financial assets

| | 2014 | 2013 |
|---|---|---|
| **Accounted for as loans and receivables** | | |
| Short-term loans provided to the parent – US$ – (Note 12) | 4,050,605 | 752,772 |
| Short-term loan provided to third parties – Russian Roubles (a) | 887,669 | – |
| Short-term loans provided – US$ – (Note 12) (a) | 689,165 | – |
| Promissory notes – Russian Roubles | 427,580 | 433,325 |
| Short-term loan provided to related parties – Russian Roubles – (Note 12) | 209,000 | 10,430 |
| Short-term bank deposits – US$ | 66,166 | – |
| Short-term bank deposits placed in related bank – Russian Roubles – (Note 12) | – | 217,100 |
| Short-term bank deposits – Ukrainian Hryvnia | – | 25,262 |
| **Accounted for as financial assets available for sale** | | |
| Securities and other | 8,661 | 14,443 |
| | **6,338,846** | **1,453,322** |

(a) In 2014 the Company provided unsecured short-term loans to third parties with maturity in 2015 and fixed interest rates of 10%-18% p.a.

Short-term loans to third parties in the amount of RR 1,189,165 were provided for financing of certain investment projects of potential future interest for the Group. Recoverability of short-term loans is guaranteed by future economic benefits from these projects assessed by Group management based on long-term business plans.

## 19. Long-term financial assets

| | 2014 | 2013 |
|---|---|---|
| **Long-term loans and deposits** | | |
| Long-term loan provided to third party – Russian Roubles (a) | 40,000 | – |
| Long-term loan provided to related parties – Russian Roubles – (Note 12) | – | 72,000 |
| Long-term bank deposits placed in related bank – Russian Roubles – (Note 12) | 42,900 | – |
| Long-term loan provided to third party – US$ (b) | 253,163 | – |
| Long-term bank deposit – Russian Roubles | – | 400,000 |
| **AFS financial assets at fair value through OCI** | | |
| Unquoted equity shares (c) | 328,174 | 65,458 |
| Quoted equity shares (c) | 618,842 | - |
| | **1,283,079** | **537,458** |

(a) On 9 June 2014 the Company provided unsecured long-term loan to third party with maturity on 27 December 2017 and fixed interest rate of 15% p.a.

(b) On 19 December 2014 the Company provided unsecured long-term loan to third party with maturity on 31 December 2017 and fixed interest rate of 9% p.a. Long-term loan was provided for financing of certain investment project of potential future interest for the Group, recoverability of this loan is guaranteed by future economic benefits from this project assessed by Group management based on long-term business plan.

(c) As at 31 December 2014 other financial investments include: (i) RR 225,034 (31 December 2013: RR 65,458) investments in preferred shares of Protagonist Therapeutics, Inc. ("Protagonist") located in the USA, Delaware; Protagonist is a peptide and peptidomimetic therapeutics company pursuing technology platform driven discovery and development of disulfade rich peptides (DRPs); (ii) RR 618,842 investments in preferred shares of Proteon Therapeutics, Inc. located in the USA, Delaware; Proteon is a biopharmaceutical company developing novel, first-in-class pharmaceuticals for patients with renal and vascular diseases; Proteon is listed on NASDAQ, fair value of investment in Proteon is determined by reference to published price quotations on active market and (iii) RR 103,140 investments in preferred shares of Allena Pharmaceuticals located in the USA, Commonwealth of Massachusetts; Allena is a company developing and commercialising non-systemic protein therapeutics to treat metabolic and orphan diseases. The Group has no control or significant influence over these entities.

## 20. Short-term borrowings and loans

| | 2014 | 2013 |
|---|---|---|
| Short-term loan – Russian Roubles (a) | 4,000,000 | 7,021,700 |
| Other loans | 2,941 | 2,380 |
| | **4,002,941** | **7,024,080** |

(a) As at 31 December 2014 this balance included RR 4,000,000 (2013: RR 4,021,700) unsecured loan provided by Citibank under interest rate of 11.39% p.a. (2013: 8.65% p.a.). As at 31 December 2013 this balance also included RR 3,000,000 unsecured loan provided by Nordea bank under interest rate of 8.79% p.a.; in February 2014, this loan was fully repaid by the Company.

## 21. Taxes payable other than income tax

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

| | 2014 | 2013 |
|---|---|---|
| Value-added tax | 533,505 | 777,722 |
| Social taxes | 72,205 | 70,849 |
| Property tax | 24,648 | 16,765 |
| Other taxes | 25,266 | 42,947 |
| | **655,624** | **908,283** |

## 22. Trade and other payables

| | 2014 | 2013 |
|---|---|---|
| Trade payables | 4,658,904 | 3,981,641 |
| Payable to OTCPharm (Notes 6 and 12) | – | 3,500,650 |
| Payables for products procurement – third parties (a) | 7,032,004 | 12,562,998 |
| Payables for products procurement, raw materials and other payables – related parties (Note 12) | 1,863,212 | 3,447,878 |
| Issued promissory notes – US$ and Euro (b) | 431,401 | 255,260 |
| Payables to employees | 517,065 | 426,493 |
| Payable to OTCPharm (agency contract) – related party (Note 12) | 646,502 | – |
| Other payables (c) | 685,263 | 756,804 |
| | **15,834,351** | **24,931,724** |

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

At 31 December 2014 RR 3,760,587 (2013: RR 3,281,531) of total payables were denominated in currencies other than Russian Rouble, primarily in US$ and Euro.

## 23. Other non-current liabilities

| | 2014 | 2013 |
|---|---|---|
| Deferred income | 69,000 | 139,100 |
| Other | 23,472 | 11,662 |
| | **92,472** | **150,762** |

The subsidiary of the Group "Pharmapark" LLC received government grants to finance certain development costs. This amount represents cash proceeds from government grants and it will be credited to profit or loss over useful life of the intangible asset recognised upon completion of the development stage.

## 24. Share capital

In accordance with its charter documents the share capital of the Company is RR 37,793. The authorised number of ordinary shares is 37,792,603 with par value of 1 (one) Russian Rouble. All authorised shares are issued and fully paid. The Company holds 3.8% of issued shares as treasury shares.

As of 31 December 2014 and 2013 54.32% of voting shares of OJSC "Pharmstandard" were held by Augment controlled by Victor Kharitonin, a Russian citizen.

23.58% of ordinary shares are traded on the London Stock Exchange (LSE) and 18.3% on the Moscow Stock Exchange.

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

### Earnings per share

Earnings per share are as follows:

| | 2014 | 2013 |
|---|---|---|
| Weighted average number of ordinary shares outstanding | 36,355,683 | 34,629,722 |
| Profit for the year attributable to the ordinary shareholders | 10,841,234 | 11,805,787 |
| Basic and diluted earnings per share, Russian Roubles | 298.2 | 340.92 |

## 25. Revenue

Revenue breakdown by product groups comprised the following:

| | 2014 | 2013 |
|---|---|---|
| **Pharmaceutical products** | | |
| Over the Counter ("OTC") – (a) | 5,547,561 | 16,457,827 |
| **Prescription** | | |
| Branded | 5,924,459 | 5,974,312 |
| Non-branded | 1,006,400 | 801,474 |
| | **6,930,859** | **6,775,786** |
| Third parties products (b) | 19,024,923 | 30,451,243 |
| Other – substances and APIs (a) | 2,856,044 | 1,174,463 |
| Clearance sale of OTC branded inventory to OTCpharm due to spinoff (e) | 2,411,060 | – |
| **Total pharmaceutical products** | **36,770,447** | **54,859,319** |
| Contractual manufacturing (Note 12) – (c) | 1,503,922 | 110,698 |
| Agency fee income (Note 12) – (d) | 1,828,863 | 1,037,886 |
| Medical equipment | 1,120,203 | 1,048,278 |
| | **41,223,435** | **57,056,181** |

(a) On 1 April 2014 OTCpharm started its operation independently of the Group and since this date revenue from sale of the most of OTC branded products is being recognised by OTCpharm.
(b) Third parties products sales include sales of branded pharmaceutical products such as Velcade, Mabtera, Koagil VII, Mildronate, IRS®-19, Imudon®, Prezista, Revlimid, Cerezim, Pulmozim and other manufactured by other pharmaceutical companies.
(c) Since 2014, the Group provides contract manufacturing services primarily to OTCpharm (Note 12).
(d) The Company holds agency contracts for distribution and sale of certain products owned by related and third parties.
(e) In April and May 2014, the Group sold outstanding inventory balance related to OTC business to OTCpharm to enable it to launch independent operations (Notes 6 and 12).

## 26. Cost of sales

The components of cost of sales were as follows:

| | 2014 | 2013 |
|---|---|---|
| Materials and components | 6,149,948 | 6,515,683 |
| Third parties products | 13,570,790 | 23,162,756 |
| Production overheads | 2,039,923 | 1,574,557 |
| Depreciation and amortisation | 746,956 | 795,617 |
| Direct labour costs | 499,423 | 536,016 |
| | **23,007,040** | **32,584,628** |

The total amount of cost of sales includes (i) RR 1,063,576 of cost of the clearance sales of OTCbranded products to OTCpharm and (ii) RR 1,462,459 of cost of active pharmaceutical ingredients sold by the Group to OTCpharm.

## 27. Selling and distribution costs

Selling and distribution costs were as follows:

| | 2014 | 2013 |
|---|---|---|
| Advertising | 1,573,496 | 3,537,001 |
| Labour costs | 1,503,273 | 1,570,834 |
| Freight, communication and insurance of goods in transit | 221,799 | 260,670 |
| Trainings and other services | 68,792 | 54,255 |
| Certification expenses | 113,209 | 115,868 |
| Rent | 140,196 | 125,001 |
| Commission and license fee | 144,573 | 78,079 |
| Materials, maintenance and utilities | 122,376 | 139,738 |
| Travel and representative expenses | 129,799 | 191,001 |
| Depreciation | 71,849 | 80,659 |
| Other expenses | 44,155 | 40,475 |
| | **4,133,517** | **6,193,581** |

## 28. General and administrative expenses

General and administrative expenses were as follows:

| | 2014 | 2013 |
|---|---|---|
| Labour costs | 1,404,360 | 1,278,439 |
| Services, legal, audit and consulting expense | 305,449 | 115,651 |
| Travel and representative expenses | 33,571 | 41,484 |
| Taxes other than income tax | 23,781 | 21,373 |
| Property and other insurance | 21,303 | 21,272 |
| Communication expenses | 29,695 | 29,787 |
| Depreciation | 125,865 | 83,876 |
| Rent | 132,115 | 118,681 |
| Materials, maintenance and utilities | 167,866 | 164,448 |
| Other | 56,421 | 55,302 |
| | **2,300,426** | **1,930,313** |

## 29. Other income

Other income comprised the following:

| | 2014 | 2013 |
|---|---|---|
| Foreign exchange gain | 2,166,253 | 238,668 |
| Income from non-core operations – related party (Note 12) | 259,539 | - |
| Gain from disposal of property, plant and equipment | 39,418 | 47,912 |
| Income received as penalties | 96,018 | 127,977 |
| Reversal of impairment – property, plant and equipment (Note 13) | 14,943 | 2,091 |
| Reversal of impairment – financial assets | 61,213 | – |
| Gain from transactions with promissory notes (Note 12) | 80,112 | – |
| Other income | 225,949 | 100,653 |
| | **2,943,445** | **517,301** |

## 30. Other expenses

Other expenses comprised the following:

| | 2014 | 2013 |
|---|---|---|
| Foreign exchange loss | 525,425 | 82,100 |
| Charity | 31,116 | 10,527 |
| Bank charges | 28,210 | 30,958 |
| Other taxes and penalties (a) | 129,603 | 410,681 |
| Biolik expenses resulting from suspension of production (Note 32) | 95,973 | 124,811 |
| Research expenses (b) | 36,881 | 168,675 |
| Impairment of property, plant and equipment (Note 14) | 68,193 | 2,548 |
| Impairment of intangible assets (Note 6 and 14) | – | 100,000 |
| Other | 117,535 | 137,844 |
| | **1,032,936** | **1,068,144** |

(a) Other taxes and penalties primarily include property tax expenses and penalties accrual as a result of tax audit.
(b) These expenses represent certain non-recurring research projects.

## 31. Income tax

| | 2014 | 2013 |
|---|---|---|
| Income tax expense – current | 2,783,919 | 4,044,679 |
| Deferred tax benefit – origination and reversal of temporary differences | (59,652) | (102,588) |
| **Income tax expense** | **2,724,267** | **3,942,091** |

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

| | 2014 | 2013 |
|---|---|---|
| **Profit before income tax** | **13,819,730** | **15,862,530** |
| Theoretical tax charge at Russian statutory rate of 20% | 2,763,946 | 3,172,506 |
| Effect of the difference in tax rates in countries other than Russia | (1,067) | (23,149) |
| Tax effect from treasury shares settlement (Note 7) | – | 556,767 |
| Effect from intra-group dividends eliminated in consolidation (taxed at rate of 5-10%) | 7,261 | 19,457 |
| Share of results of associates and joint ventures | (47,012) | 19,546 |
| Tax effect of items which are not deductible or assessable for taxation purposes: | | |
| Non-deductible expenses | 1,139 | 196,964 |
| **Income tax expense** | **2,724,267** | **3,942,091** |

Movements in deferred tax balances were as follows:

| | 1 January 2013 | Temporary differences recognition and reversal in profit and loss | Effect of spinoff (Note 6) | Effect from obtaining control over joint venture (Note 8.1) | 31 December 2013 | Temporary differences recognition and reversal in profit and loss | 31 December 2014 |
|---|---|---|---|---|---|---|---|
| **Tax effects of taxable and deductible temporary differences – asset (liability)** | | | | | | | |
| Property, plant and equipment | (571,480) | 33,726 | – | (244) | (537,998) | (23,865) | (561,863) |
| Intangible assets | (515,890) | (10,922) | 492,449 | 61 | (34,302) | 60,955 | 26,653 |
| Trade and other receivables | 32,231 | (93,589) | – | – | (61,358) | (23,602) | (84,960) |
| Inventories | 205,057 | 147,715 | – | 109 | 352,881 | 84,122 | 437,003 |
| Trade and other payables | 36,163 | 2,610 | – | 1,611 | 40,384 | (24,294) | 16,090 |
| Financial instruments | 2,442 | 4,980 | – | – | 7,422 | (7,422) | – |
| Other | 28,809 | 18,068 | – | (1) | 46,876 | (6,242) | 40,634 |
| **Total net deferred tax liability** | **(782,668)** | **102,588** | **492,449** | **1,536** | **(186,095)** | **59,652** | **(126,443)** |

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;
- write down of inventory to net realisable value, unrealised profit due to intragroup purchases of materials, discounts recognised in taxation as other income;
- fair value adjustments on acquisition;
- fair value of financial instruments in excess of the cost of these instruments for tax purpose;
- impairment of trade receivables;
- 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 24,431,808 as at 31 December 2014 (2013: RR 19,084,856).

## 32. Contingencies, commitments and operating risks

### Operating environment of the Group

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

In 2014, the Russian economy was negatively impacted by a significant drop in crude oil prices and a significant devaluation of the Russian Rouble, as well as sanctions imposed on Russia by several countries. In December 2014, the Rouble interest rates have increased significantly after the Central Bank of Russia raised its key rate to 17%.The combination of the above resulted in reduced access to capital, a higher cost of capital, increased inflation and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects.

The Group also operates in Ukraine. In 2014, the economic and political situation in Ukraine deteriorated significantly. As a result, Ukraine has experienced a fall in gross domestic product, a significant negative balance of payments and a sharp reduction in foreign currency reserves. Furthermore in 2014 the Ukrainian Hryvnia significantly devalued to major foreign currencies and the National Bank of Ukraine imposed certain restrictions on foreign currency operations. Restrictions have also been introduced for certain cross-border settlements, including payments of dividends. International rating agencies have downgraded sovereign debt ratings for Ukraine. Currently, a loan programme extension, which may necessitate certain austerity measures, is being negotiated by Ukraine with the International Monetary Fund. The combination of the above events has resulted in a deterioration of liquidity and much tighter credit conditions where credit is available.

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

### Taxation

Russian tax, currency and customs legislation can be interpreted in different ways and is susceptible to frequent changes. The interpretation made by the Company's management of the legislation in question as applied to the operations and activities of the Company's enterprises may be challenged by the relevant regional or federal authorities.

In addition, certain amendments to tax legislation were passed in 2014 and enter into force from 2015 which are aimed at combating tax evasion through the use of low-tax jurisdictions and aggressive tax planning structures. In particular, those amendments include definitions of the concepts of beneficial ownership and tax residence of legal entities at their actual place of business, and an approach to the taxation of controlled foreign companies.

These changes, as well as recent trends in the application and interpretation of certain provisions of Russian tax legislation, indicate that the tax authorities may take a tougher line in interpreting the law and checking tax returns. As a result, tax authorities may raise questions about transactions and accounting methods which they did not question before. This may result in significant amounts of additional tax charges, penalties and

fines being imposed. It is not possible to determine claim amounts for suits which may be, but have not actually been, filed, or to assess the likelihood of an adverse outcome. Tax audits may cover the three calendar years immediately preceding the year in which the audit occurs. In certain circumstances an audit can also cover earlier periods.

The management is of the opinion that, as at 31 December 2014, it has correctly interpreted the relevant provisions of law, and it is highly likely that the Company's position in regard to tax, currency and customs legislation will remain unchanged.

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 at 31 December 2014. Should the tax authorities decide to issue a claim and prove successful in the court, they would be entitled to recover the amount claimed, together with fines (in Russia amounting to 20% of such amount and interest at the rate of 1/300 of the Central Bank of the Russian Federation rate for each day of delay for late payment of such amount). Management believes that it is not probable that the ultimate outcome of such matters would result in a liability. Therefore, no provision for these contingencies was recorded in these consolidated financial statements.

### Russian transfer pricing legislation

The new Russian transfer pricing legislation, which came into force on 1 January 2012, allows the tax Russian tax authority to apply transfer pricing adjustments and impose additional profits tax liabilities in respect of all "controlled" transactions if the transaction price differs from the market level of prices. A list of "controlled" transactions includes transactions performed with related parties based on domestic and cross-border agreements and certain types of cross-border transactions with independent parties. For domestic transactions the transfer pricing rules apply only if the amount of all transactions with related party exceeds 1 billion roubles in 2014 (apart from some exceptions provided by the Tax Code); all cross-border transactions with related parties are controlled without application of any financial thresholds. In cases where the domestic transaction resulted in an accrual of additional tax liabilities for one party, another party could apply the symmetrical adjustment to its profit tax liabilities according a special notification issued by the authorised body in due course.

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

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

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

### Insurance policies

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

### Operating lease agreements

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

### Commitment liabilities and guarantees

In 2012, the Group provided certain unsecured guaranties with maturity period from two years to three years for related parties to provide some state contracts signed by these related parties. Outstanding amount of

guaranties at 31 December 2014 is RR 88,740 with maturity period February 2016. The management believes that provided guaranties have remote financial risk for the Group.

In July 2014, the Company provided unsecured financial guaranties in the total amount of RR 500,000 with maturity period not later than March-April 2015 to certain pharmacy chains to facilitate increase of direct sales of Group's products to these pharmacy chains. The management believes that provided guarantees would result in remote financial risks for the Group.

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

In December 2012, the Ukrainian authorities performed an extraordinary inspection of "Biolik" compliance with the applicable production quality standards. The inspection revealed certain formal deficiencies in the controls over production quality resulting in suspension in "Biolik" production process until resolution of those deficiencies. Those deficiencies were primarily due to the reconstruction of production and maintenance work to improve the quality of "Biolik's" products. In December 2013, "Biolik" production process was restarted for certain products. In 2014, the issues revealed by the inspection were completely resolved and "Biolik" restarted its normal operations.

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

### Fair values

Management believes that fair value of cash and cash equivalents, short-term financial assets, trade and other receivables and payables and short-term borrowings and loans approximate their carrying amounts due to their short maturity. The Group has no long-term borrowings and loans and derivative financial instruments as of 31 December 2014 and 31 December 2013.

### Fair value hierarchy

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

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

31 December 2014:

| | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **Assets measured at fair value** | | | | |
| Unquoted equity shares (Note 19) | 328,174 | - | - | 328,174 |
| Quoted equity shares (Note 19) | 618,842 | 618,842 | - | - |
| **Assets for which fair values are disclosed** | | | | |
| Short-term loans provided (Note 18) | 5,836,439 | - | - | 5,836,439 |
| Long-term loans provided (Note 19) | 293,163 | - | - | 293,163 |
| Securities (Notes 18) | 8,253 | 5,830 | – | 2,423 |

31 December 2013:

| | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| **Assets measured at fair value** | | | | |
| Unquoted equity shares (Note 19) | 65,458 | - | - | 65,458 |
| **Assets for which fair values are disclosed** | | | | |
| Short-term loans provided (Note 18) | 763,202 | - | - | 763,202 |
| Long-term loans provided (Note 19) | 72,000 | - | - | 72,000 |
| Securities (Note 18) | 13,574 | 10,826 | – | 2,748 |

## Financial risk management objectives and policies

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

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

### *Interest rate risk*

Management believes that the Group does not have significant interest rate risk as at 31 December 2014 and 31 December 2013. The Group has certain short-term financial investments (loans and bank deposits, see Notes 17, 18 and 19), at fixed interest rates based on current market rates at the date of initial recognition and has short-term borrowings and loans (Note 20) at fixed interest rates based on current market rates at the date of initial recognition. Therefore, the Group has no risk to interest rates changes due to possible changes in market interest rates.

### *Foreign exchange risk*

The Group has certain US dollar and Euro denominated cash and short-term deposits (Note 17), short-term financial assets (Note 18), trade and other payables (Note 22) and trade and other receivables (Note 16). Therefore, the Group is exposed to foreign exchange risk.

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

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

| | Increase/decrease in US$ rate | Effect on profit before tax |
|---|---|---|
| **As at 31 December 2014** | | |
| US$/Roubles exchange rate | +28.54% | 2,657,819 |
| US$/Roubles exchange rate | -28.54% | (2,657,819) |

| | Increase/decrease in US$ rate | Effect on profit before tax |
|---|---|---|
| **As at 31 December 2013** | | |
| US$/Roubles exchange rate | +20% | (157,781) |
| US$/Roubles exchange rate | -10% | 78,891 |

| | Increase/decrease in Euro rate | Effect on profit before tax |
|---|---|---|
| **As at 31 December 2014** | | |
| Euro/Roubles exchange rate | +29.58% | 383,984 |
| Euro/Roubles exchange rate | -29.58% | (383,984) |

| | Increase/ decrease in Euro rate | Effect on profit before tax |
|---|---|---|
| **As at 31 December 2013** | | |
| Euro/Roubles exchange rate | +20% | (101,901) |
| Euro/Roubles exchange rate | -9% | 43,976 |

| | Increase/decrease in US$ rate | Effect on profit before tax |
|---|---|---|
| **As at 31 December 2014** | | |
| US$/Ukrainian Hryvnia exchange rate | +28.93% | (152,991) |
| US$/Ukrainian Hryvnia exchange rate | -28.93% | 152,991 |

| | Increase/decrease in US$ rate | Effect on profit before tax |
|---|---|---|
| **As at 31 December 2013** | | |
| US$/Ukrainian Hryvnia exchange rate | +30% | (91,233) |
| US$/Ukrainian Hryvnia exchange rate | -5% | 15,206 |

*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.

| As at 31 December 2014 | Total | Less than 4 months | 4 to 6 months | 6 to 12 months | More than 12 months |
|---|---|---|---|---|---|
| Borrowings and loans (Note 20) | **4,342,739** | 151,451 | 75,725 | 4,115,563 | – |
| Trade and other payables | **15,402,950** | 15,402,950 | - | - | - |
| Other non-current liabilities | **23,472** | – | – | – | 23,472 |
| **Total** | **19,769,161** | **15,554,401** | **75,725** | **4,115,563** | **23,472** |

| As at 31 December 2013 | Total | Less than 4 months | 4 to 6 months | 6 to 12 months | More than 12 months |
|---|---|---|---|---|---|
| Borrowings and loans (Note 20) | **7,347,389** | 3,180,184 | 57,821 | 4,109,384 | – |
| Other current liabilities (a) | **3,500,650** | 3,500,650 | – | – | – |
| Trade and other payables | **21,175,814** | 21,175,814 | - | - | - |
| Other non-current liabilities | **1,879** | – | – | – | 1,879 |
| **Total** | **32,025,732** | **27,856,648** | **57,821** | **4,109,384** | **1,879** |

*Credit risk*

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

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

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

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

| | | | Not impaired but past due | | | | |
|---|---|---|---|---|---|---|---|
| | Total | Neither impaired nor past due | Less 1 month | 1-2 months | 2-3 months | 3 to 6 months | >6 months |
| 31 December 2014 | 19,432,066 | 14,242,641 | 814,441 | 733,756 | 480,738 | 2,728,979 | 431,511 |
| 31 December 2013 | 23,969,063 | 21,930,722 | 1,185,580 | 255,609 | 268,224 | 209,417 | 119,511 |

## Sales concentration to a small group of customers

The Group works with five distributors that together represent about 37% of the Group's revenue for 2014 excluding sales to the Ministry of health of the Russian Federation under state open auctions and the clearance sales to OTCpharm in April-May 2014. It is common practice of the Russian pharmaceutical market to work with the limited number of large distributors.

## Capital management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital. The Group manages its capital structure and makes adjustments to it, in light of changes

in economic conditions. To maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

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.

| | 2014 | 2013 |
|---|---|---|
| Borrowings and loans | 4,002,941 | 7,024,080 |
| Trade and other payables | 15,834,351 | 24,931,724 |
| Less: cash and short-term deposits | (8,541,548) | (15,364,875) |
| **Net debt** | **11,295,744** | **16,590,929** |
| Capital | 39,174,393 | 27,628,445 |
| **Capital and net debt** | **50,470,137** | **44,219,374** |
| Gearing ratio | 22% | 38% |

## 34. Material partly-owned subsidiaries

Proportion of equity interest held by non-controlling interests is summarized below:

| Name | Country of incorporation and operation | 2014 % share | 2013 % share |
|---|---|---|---|
| "Pharmstandard-Tomskhimpharm" OJSC | Russian Federation | 9 | 9 |
| **Other** | | | |
| "Pharmstandard-Biolik" PJSC (Note 10) | Ukraine | 3.07 | 3.07 |
| MDR Pharmaceuticals | Cyprus | 49.95 | 49.95 |
| Bigpearl Trading Limited | Cyprus | 49.995 | 49.995 |
| "Pharmapark" LLC | Russian Federation | 49.995 | 49.995 |
| "Biomed named after I.I.Mechnikov" CJSC | Russian Federation | 50.155 | 50.155 |
| "PKB named after I.I.Mechnikov" CJSC (Note 1) | Russian Federation | – | 50.155 |
| "Pharmatsevticheskiye innovatsii" LLC | Russian Federation | 49.995 | 49.995 |
| "EKK" OJSC | Russian Federation | 64.71 | 64.71 |
| Moldildo trading Limited | Cyprus | 25 | 25 |
| "Pharmstandard-Medtechnika" LLC | Russian Federation | 25 | 25 |
| "Sellthera Pharm" LLC | Russian Federation | 25 | 25 |

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

| Summarised statement of profit or loss for 2014 | Pharmstandard-Tomskkhimpharm | Other |
|---|---|---|
| Revenue | 3,129,735 | 2,607,780 |
| Cost of sales | (1,949,704) | (1,180,736) |
| Selling and distribution costs | (693,541) | (379,799) |
| Administrative expenses | (121,758) | (378,162) |
| Other income (expense), net | 85,289 | (312,407) |
| Financial income (expense), net | – | (3,777) |
| **Profit before income tax** | **450,021** | **352,899** |
| Income tax | (93,163) | (123,622) |
| Profit for the year | 356,858 | 229,277 |
| **Attributable to non-controlling interests** | **32,117** | **222,112** |

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

| Summarised statement of financial position as at 31 December 2014 | Pharmstandard-Tomskkhimpharm | Other |
|---|---|---|
| Inventories, receivables, cash and short-term deposits and other current assets | 3,326,916 | 2,693,010 |
| Property, plant and equipment, intangible assets and other non-current financial assets | 465,401 | 2,379,916 |
| Trade, other payables and other current liabilities | (263,959) | (2,169,288) |
| Deferred tax liabilities and other non-current liabilities | (23,710) | (419,456) |
| **Total equity** | **3,504,648** | **2,484,182** |
| **Attributable to:** | | |
| Non-controlling interests | 315,418 | 1,330,529 |

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

### Dividends paid by a subsidiary

In 2014, an amount of RR 32,269 was paid by the Company's subsidiary "Bigpearl Trading Limited" (Cyprus) to non-controlling shareholders (2013: RR 23,498).

## 35. Events after the reporting period

On 6 January 2015 Pharmstandard International S.A. acquired preferred shares of enGene Inc. for cash consideration of 770 thousand US$ (RR 43,644) which represent 4.18% of company's share. Engene Inc. is a company incorporated in Monreal, Canada and focused on a highly flexible nucleotide delivery technology targeting mucosal tissues to treat numerous prevalent, chronic diseases via the induction or suppression of protein expression levels.

On 17 April 2015 Pharmstandard International S.A. acquired preferred shares of Jounce Therapeutics for cash consideration of 5 million US$ (RR: 252,647) which represent 2.4% of company's share. Jounce Therapeutics is a company incorporated in the USA and focused on a creation of highly durable treatment for cancer by optimal use of the immune system.