“Biovit” LLC

(Since 5 May 2006 OJSC “Pharmstandard”)

Consolidated Financial Statements

For the year ended 31 December 2005

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(Since 5 May 2006 OJSC “Pharmstandard”

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For the Year Ended 31 December 2005

Contents

Report of Independent Auditors

To the Shareholder and Management of OJSC "Pharmstandard"*:*

We have audited the accompanying consolidated balance sheet of "Biovit" LLC, a Russian limited liability company reorganized into Open Joint Stock Company "Pharmstandard" on 5 May 2006, (hereinafter referred to as "the Company"), as of 31 December 2005 and the related consolidated statements of operations, cash flows and changes in equity and net assets attributable to the Participant of the Company for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Because we were appointed auditors of the Company during 2005, we were not able to observe the counting of the physical inventories as at 1 January 2004 or satisfy ourselves concerning those inventory quantities by alternative means. Since opening inventories enter into the determination of the results of operations, we were unable to determine whether adjustments to opening equity and net assets attributable to the Participant of the Company and the results of operations might be necessary for 2004.

In our opinion, except for the effect on the corresponding figures for 2004 of the adjustments, if any, to the results of operations for the year ended 31 December 2004, which we might have determined to be necessary had we been able to observe beginning inventory quantities as at 1 January 2004, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of 31 December 2005, and the results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards.

30 June 2006

“Biovit ” LLC

(Since 5 May 2006 OJSC “Pharmstandard”)

Consolidated Balance Sheet at 31 December 2005

(in thousands of Russian Roubles)

	Notes	2005	2004
ASSETS			
Non-current assets			
Property, plant and equipment	**8**	**3,348,928**	1,716,459
Investment property		**18,787**	37,926
Intangible assets	**9**	**221,499**	-
Investments in associates	**10**	**-**	370,466
Other non-current assets	**7**	**216,857**	166,857
		3,806,071	2,291,708
Current assets			
Inventories	**11**	**1,043,141**	661,447
Trade and other receivables	**12**	**1,830,858**	1,269,179
VAT recoverable		**370,176**	199,479
Prepayments		**279,169**	322,764
Short term investments		**94,019**	248,149
Other current assets	**14**	**252,574**	279,159
Cash and cash equivalents	**13**	**243,983**	65,599
		4,113,920	3,045,776
Assets classified as held for sale	**10**	**393,121**	-
		4,507,041	3,045,776
Total assets		**8,313,112**	5,337,484
EQUITY AND LIABILITIES			
Equity			
Minority interest		**1,134,474**	349,050
Non-current liabilities			
Finance lease payable	**18**	**-**	81,955
Deferred tax liability	**25**	**441,463**	231,672
Other non-current liabilities		**60,292**	64,526
Net assets attributable to Participant of the Company	**19**	**2,790,388**	2,183,895
		3,292,143	2,562,048
Current liabilities			
Trade payables, other payables and advances received	**17**	**2,794,789**	546,539
Short-term borrowings	**15**	**583,530**	1,495,604
Finance lease payable	**18**	**81,955**	109,048
Income tax payable		**74,257**	24,529
Other taxes payable	**16**	**351,964**	250,666
		3,886,495	2,426,386
Total equity and liabilities		**8,313,112**	5,337,484

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

General Director I.K. Krylov

Finance Director E.V. Arkhangelskaya

30 June, 2006

The accompanying notes on pages 8-33 are an integral part of these consolidated financial statements.

“Biovit” LLC
(Since 5 May 2006 OJSC “Pharmstandard”)

Consolidated Statement of Operations

For the Year Ended 31 December 2005

(in thousands of Russian Roubles)

	Notes	2005	2004
Sale of goods	**20**	**5,684,824**	3,945,684
Cost of sales	**21**	**(2,507,102)**	(2,219,981)
Gross profit		**3,177,722**	1,725,703
Selling and distribution costs	**22**	**(1,069,452)**	(531,611)
General and administrative expenses	**23**	**(443,326)**	(521,985)
Other expenses	**24**	**(126,608)**	(160,694)
Interest income		**11,774**	3,659
Interest expense		**(106,413)**	(77,756)
Profit before income tax		**1,443,697**	437,315
Income tax expense	**25**	**(424,374)**	(117,719)
Profit for the year		**1,019,323**	319,596
Attributable to:			
Participant of the Company		**906,221**	305,110
Minority interests		**113,102**	14,486
Basic and diluted earnings per share, Russian Roubles	**19**	**23.98**	8.08

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

General Director I.K. Krylov

Finance Director E.V. Arkhangelskaya

30 June, 2006

The accompanying notes on pages 8-33 are an integral part of these consolidated financial statements.

"Biovit" LLC
(Since 5 May 2006 OJSC "Pharmstandard")

Consolidated Statement of Cash Flows

For the Year Ended 31 December 2005

(in thousands of Russian Roubles)

	Notes	2005	2004
Cash flows from operating activities:			
Profit before income tax		**1,443,697**	437,315
Adjustments for:			
Depreciation of property, plant and equipment	**8**	**181,373**	71,704
Allowances for impairment of receivables and inventories	**11,12**	**3,981**	57,123
Loss on disposal of property, plant and equipment	**8**	**49,785**	13,921
Interest expense, net		**94,639**	74,097
Operating cash flows before working capital changes		**1,773,475**	654,160
Increase in trade receivables	**12**	**(242,908)**	(269,787)
Increase in inventories	**11**	**(76,853)**	(136,157)
Increase in VAT recoverable		**(170,697)**	(123,265)
Decrease in prepayments		**43,595**	212,145
Decrease in other current assets	**14**	**101,843**	230,681
Increase (decrease) in trade payables, other payables and advances received	**17**	**250,826**	(127,847)
Increase in taxes payable other than income tax		**101,298**	107,921
Cash generated from operations		**1,780,579**	547,851
Income tax paid	**24**	**(320,047)**	(75,897)
Interest paid, net		**(93,152)**	(54,637)
Net cash from operating activities		**1,367,380**	417,317
Cash flows from investing activities:			
Purchase of property, plant and equipment and intangible assets	**8,9**	**(889,098)**	(188,894)
Cash in acquired subsidiary		**57,105**	-
Cash received from sale of investment property		**19,138**	-
Cash received from sale of short-term investments, net		**154,131**	-
Cash paid for short-term investments, net		**-**	(200,987)
Cash paid for investments in associates	**10**	**-**	(120,000)
Deposits placed in related bank	**7**	**(71,649)**	-
Loans provided to related parties	**7**	**(154,007)**	(447,194)
Loans repaid by related parties	**7**	**151,194**	136,000
Net cash used in investing activities		**(733,186)**	(821,075)
Cash flows from financing activities:			
Proceeds from increase of charter capital		**-**	37,383
Proceeds from loans and borrowings	**15**	**286,193**	1,535,634
Repayment of loans and borrowings	**15**	**(699,025)**	(933,664)
Repayment of loans from related parties	**7,15**	**(499,242)**	-
Proceeds from loans from related parties	**7,15**	**-**	371,876
Repayment of finance lease liabilities	**18**	**(109,048)**	-
Cash advance received for future share issue	**7, 17**	**814,386**	-
Dividends paid	**19**	**(249,074)**	(576,395)
Net cash (used in)/from financing activities		**(455,810)**	434,834
Net increase in cash and cash equivalents		**178,384**	31,076
Cash and cash equivalents at the beginning of the year	**13**	**65,599**	34,523
Cash and cash equivalents at the end of the year	**13**	**243,983**	65,599

The accompanying notes on pages 8-33 are an integral part of these consolidated financial statements.

“Biovit” LLC
(Since 5 May 2006 OJSC “Pharmstandard”)

Consolidated Statement of Changes in Equity and Net Assets Attributable to the Participant of the Company

For the Year Ended 31 December 2005

(in thousands of Russian Roubles)

		Net assets attributable to the Participant of the Company			Equity
	Notes	**Charter capital**	**Cumulative surplus of net assets**	**Total net assets attributable to the Participant of the Company**	**Minority interest**
Balance at 31 December 2003		10	2,411,623	2,411,633	340,328
Increase in charter capital	**19**	37,783	-	37,783	-
Profit for the year		-	305,110	305,110	14,486
Dividends	**19**	-	(570,631)	(570,631)	(5,764)
Balance at 31 December 2004		**37,793**	**2,146,102**	**2,183,895**	**349,050**

		Net assets attributable to the Participant of the Company			Equity
	Notes	**Charter capital**	**Cumulative surplus of net assets**	**Total net assets attributable to the Participant of the Company**	**Minority interest**
Balance at 31 December 2004		37,793	2,146,102	2,183,895	349,050
Profit for the year		-	906,221	906,221	113,102
Distribution to Participant of the Company	**5**	-	(53,145)	(53,145)	-
Minority interests arising on acquisition of subsidiary	**5**	-	-	-	674,813
Dividends	**19**	-	(246,583)	(246,583)	(2,491)
Balance at 31 December 2005		**37,793**	**2,752,595**	**2,790,388**	**1,134,474**

The accompanying notes on pages 8-33 are an integral part of these consolidated financial statements.

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

1. Corporate Information

“Biovit” LLC and its subsidiaries (“the Group”) principal activities include production and wholesale distribution of pharmaceutical and medical products. The Group’s corporate office is in Dolgoprudny, Likhachevsky proezd, 5B, Moscow region, Russia and its manufacturing facilities are based in Kursk, Tomsk, Ufa, St. Petersburg, Nizhny Novgorod and Tyumen. The parent company, “Biovit” LLC (the “Company”) was incorporated as a Russian limited liability company in 2003. The Company held shares of voting interests in the following major subsidiaries consolidated within the Group as of 31 December 2005 and 2004:

Entity	Country of incorporation	Activity	2005 % share	2004 % share
“Pharmstandard” LLC	Russia	Management company and trading house	**99**	99
“Pharmstandard-Leksredstva” OJSC	Russia	Manufacturing of pharmaceutical products	**99**	99
“Pharmstandard-Tomskhimpharm” OJSC	Russia	Manufacturing of pharmaceutical products	**91**	91
“Pharmstandard-Ufavita” OJSC	Russia	Manufacturing of pharmaceutical products	**56***	56*
“Pharmstandard-Octyabr” OJSC	Russia	Manufacturing of pharmaceutical products	**93**	93
“Pharmstandard-Phitofarm-NN” LLC	Russia	Manufacturing of pharmaceutical products	**99**	99
“TZMOI” OJSC	Russia	Manufacturing of medical equipment	**55**	-
“Urlan Invest” LLC (since 2006 “TMK” LLC)	Russia	Manufacturing of medical equipment	**100**	-

* Additional 22% of voting shares were owned by companies controlled by the Group’s ultimate controlling party (Note 19)

The Group was formed through a reorganization in which the ownership interests in the companies listed above have been acquired by the Company from parties under common control.

As the Group has been formed through a reorganisation of entities under common control, these consolidated financial statements have been prepared using the uniting of interests method, and, as such, the financial statements, including corresponding figures, have been presented as if transfers of ownership interests in subsidiaries to the Company had occurred on the date they were originally established or acquired by the transferring party (the “Predecessor”).

These consolidated financial statements were authorized for issue by the Board of Directors of the OJSC "Pharmstandard", the legal successor of Biovit LLC (Note 28), on 30 June 2006.

2. Basis of Preparation of the Financial Statements

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

Group companies maintain their accounting records in Russian Roubles ("RR") and prepare their statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation. The statutory financial statements have been adjusted to present these financial statements in accordance with IFRS. These adjustments principally related to valuation and depreciation of tangible fixed assets, certain valuation reserves, purchase accounting for business combinations and the resulting income tax effects.

The consolidated financial statements have been prepared under the historical cost convention except as disclosed in the accounting policies below.

As discussed above, the Group was formed through the reorganization of entities under common control using the uniting of interest method. Assets and liabilities were recognized using the carrying value of the predecessor Companies.

The Company has also applied an exemption permitted by IFRS 1 which allows an entity to measure property, plant and equipment at the date of transition to IFRS at fair value and use that fair value as deemed cost. As a result, the fair values of the property, plant and equipment as at the date of transition were used to arrive at deemed cost.

Also, in accordance with IFRS 1, the Company has applied the exemption, permitted for first time adopter, from purchase accounting to business combinations which occurred prior to the date of transition to IFRS. Accordingly, the Company determined the deemed cost of goodwill arising on acquisition of the subsidiaries at the date of transition to IFRS as the difference between the predecessor's interest in the net assets of the subsidiaries and the predecessor's cost of investments in these subsidiaries. Because the predecessor's interest in the net assets exceeded the cost of the subsidiaries, the difference was recorded as part of the net assets attributable to the participant as of 1 January 2004.

The Group has adopted IFRS effective at 31 December 2005 from 1 January 2004, the date of transition to IFRS.

IFRSs and IFRIC Interpretations not yet effective

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

- IAS 19 (amended 2004) "Employee Benefits";
- IAS 39 (amended 2005) "Financial Instruments: Recognition and Measurement";
- IFRS 7 "Financial Instruments: Disclosures";
- IFRIC 4 "Determining whether an Arrangement contains a Lease"

IFRS 7 "Financial Instruments: Disclosures" replaces the disclosure regulations of IAS 32 and must be applied to reporting periods that commence on or after 1 January 2007. The adoption of IFRS 7 may significantly affect the presentation of disclosures of financial instruments. The Group expects that the adoption of the pronouncements listed above will have no significant impact on the Group's financial statements in the period of initial application.

3. Summary of Significant Accounting Policies

3.1 Principles of Consolidation

Subsidiaries

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

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

Acquisition of Subsidiaries

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

The excess of purchase consideration over the fair value of the Group’s share of identifiable net assets is recorded as goodwill. If the cost of the acquisition is less than the fair value of the Group’s share of identifiable net assets of the subsidiary acquired the difference is recognized directly in the statement of operations for business combinations subsequent to 1 January 2004, the date of the Group’s transition to IFRS.

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

Acquisition of Subsidiaries from Parties under Common Control

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

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

3. Summary of Significant Accounting Policies (continued)

3.3 Cash and Cash Equivalents

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

3.4 Trade and Other Receivables

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

3.5 Value Added Tax

The tax authorities permit the settlement of sales and purchases value added tax (VAT) on a net basis.

Value Added Tax Payable

VAT is payable to tax authorities upon collection of receivables from customers. VAT on purchases, which have been settled at the balance sheet date, is deducted from the amount payable.
In addition, VAT related to sales which have not been collected at the balance sheet date (VAT deferred) is also included in the balance of VAT payable. Where provision has been made for impairment of receivables, impairment loss is recorded for the gross amount of the debtor, including VAT. The related VAT deferred liability is maintained until the debtor is written off for tax purposes.

Value Added Tax Recoverable

VAT recoverable relates to purchases, which have not been settled at the balance sheet date. VAT recoverable is reclaimable against VAT related to sales upon payment for the purchases.

3.6 Inventories

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

3.7 Assets held for sale

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

3. Summary of Significant Accounting Policies (continued)

3.8 Property, plant and equipment

Property, plant and equipment are stated at cost or deemed cost at the date of transition to IFRS (herein referred to as cost) less accumulated depreciation and impairment losses. Deemed cost was determined for property, plant and equipment at 1 January 2004 by reference to their fair value through valuation by an independent appraisal company.

Depreciation is calculated on a straight-line basis. The depreciation periods, which represent the estimated useful economic lives of the respective assets, are as follows:

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

The asset’s residual values, useful lives and methods are reviewed, and adjusted as appropriate, at each financial year-end.

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

When each major inspection is performed, its cost is recognised in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied.

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

3.9 Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group’s share of the identifiable assets, liabilities and contingent liabilities of the acquired subsidiary or associate at the date of acquisition. 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.

3. Summary of Significant Accounting Policies (continued)

3.9 Goodwill (continued)

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

3.10 Other Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is 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 are amortised over the useful economic lives of 10 to 20 years. Research costs are recognised as an expense as incurred.

3.11 Borrowings

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

3.12 Deferred Income Taxes

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

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

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

3. Summary of Significant Accounting Policies (continued)

3.13 Foreign Currency Transactions

The consolidated financial statements are presented in the national currency of the Russian Federation, Russian Rouble (RR), which is the functional currency of the Group. Transactions in foreign currencies are initially recorded in the functional currency at the exchange rate ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All resulting differences are taken to the consolidated statement of operations. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

3.14 Provisions

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

3.15 Charter capital

Charter Capital

Contributions of participants in accordance with the Company's charter documents are classified as charter capital. Charter capital and cumulative surplus of net assets (earnings accumulated over the entire period of the Group's existence) are jointly presented as a non-current liability - net assets attributable to Participant of the Company.

Dividends

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

3.16 Revenue Recognition

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

3. Summary of Significant Accounting Policies (continued)

3.17 Employee Benefits

Pension Costs

In the normal course, of business the Group contributes to the Russian Federation state pension scheme on behalf of its employees. Mandatory contributions to the governmental pension scheme are expensed when incurred.

4. Significant Accounting Estimates

4.1 Judgements

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

Lease agreements

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

4.2 Estimation Uncertainty

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

Useful life of property, plant and equipment

The Group assesses the remaining useful lives of items of property, plant and equipment at least at each financial year-end and, if expectations differ from previous estimates, the changes are accounted for as a change in an accounting estimate in accordance with IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”.

4.2 Estimation Uncertainty (continued)

Fair Values of Assets and Liabilities Acquired in Business Combinations

The Group is required to recognize separately, at the acquisition date, the identifiable assets, liabilities and contingent liabilities acquired or assumed in the business combination at their fair values, which involves estimates. Such estimates are based on valuation techniques, which require considerable judgment in forecasting future cash flows and developing other assumptions. More details are provided in Note 5.

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 2005 was RR 218,854 (2004: nil). More details are provided in Note 9.

Allowance for doubtful accounts

The Group maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of an allowance for doubtful accounts, management bases its estimates on the aging of accounts receivable balances and historical write-off experience, customer credit worthiness and changes in customer payment terms. If the financial condition of customers were to deteriorate, actual write-offs might be higher than expected. As of 31 December 2005, allowances for doubtful accounts have been created in the amount of RR 83,049 (2004: 98,090).

Inventory Provision

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

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

5. Business Combination

On 1 January 2005, an entity under common control, the Predecessor as defined in Note 3.1 acquired 55% of the voting shares of OJSC “TZMOI”, a company involved in the production of the medical equipment and located in Tyumen, Russia for cash consideration of RR 1,043,625. Shortly after acquisition the Predecessor transferred the stake in OJSC “TZMOI” to the Group for RR 1,096,770. The respective payable was recorded by the Group as of 31 December 2005 (Notes 6 and 17).

The Predecessor’s carrying amounts of identifiable assets, liabilities and contingent liabilities of “TZMOI” as at the date of acquisition were as follows:

	Recognised on acquisition
Property, plant and equipment	977,174
Other non-current assets	14,927
Cash and cash equivalents	57,105
Trade, prepayments and other receivables	303,730
Inventories	267,382
Available-for-sale investments	70,027
Other current assets	50,796
	1,741,141
Trade, advances received and other payables	86,268
Income tax payable	5,877
Deferred tax liability (Note 25)	149,412
	241,557
Fair value of net assets	**1,499,584**
Less: minority interests	**(674,813)**
Group’s share of the fair value of net assets	**824,771**
Goodwill arising on acquisition (Note 9)	**218,854**
Consideration paid by the Predecessor	**1,043,625**

These consolidated financial statements are presented as if OJSC “TZMOI” had been acquired by the Group on the date it was originally acquired by the Predecessor. The assets and liabilities of OJSC “TZMOI” transferred under common control are recorded in the financial statements at the carrying amounts of the Predecessor at the date of the transfer. Related goodwill inherent in the Predecessor's original acquisition is also recorded in the consolidated financial statements. The difference of RR 53,145 between the consideration paid by the Predecessor and the cost of the OJSC “TZMOI” stake for the Group was accounted for in these consolidated financial statements as a distribution to the Participant of the Company.

As OJSC TZMOI has never prepared financial statements in accordance with IFRS, it is impracticable to present the carrying amounts of its assets and liabilities, determined in accordance with IFRSs, immediately before the combination.

From the date of the combination, OJSC TZMOI contributed RR 74,856 to the net profit of the Group (excluding minority interests).

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

6. Segment Information

The Group is organised into two main business segments: (1) production and wholesale of pharmaceutical products and (2) production and wholesale of medical equipment. The second segment arose as a result of TZMOI acquisition in 2005 as described in Note 5 and is entirely represented by TZMOI.

There are no material transactions between the segments.

Segment assets consist primarily of property, plant and equipment, intangible assets, inventories, receivables and operating cash, and mainly exclude investments. Segment liabilities comprise operating liabilities and exclude items such as taxation and certain corporate liabilities. Capital expenditure comprises additions to property, plant and equipment. Impairment loss and provisions relate only to those charges made against allocated assets.

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

Year ended 31 December 2005	**Production and wholesale of pharmaceutical products**	**Production and wholesale of medical equipment**	**Eliminations**	**Group**
Sales to external customers	4,673,704	1,011,120	-	5,684,824
Inter-segment sales	-	10,861	(10,861)	-
Total revenue	**4,673,704**	**1,021,981**	**(10,861)**	**5,684,824**
Segment result	**1,349,585**	**192,111**	**(3,360)**	**1,538,336**
Interest expense, net	(94,639)	-	-	(94,639)
Profit before income tax	1,254,946	192,111	(3,360)	1,443,697
Income tax expense	(368,364)	(56,010)	-	(424,374)
Net profit	**886,582**	**136,101**	**(3,360)**	**1,019,323**
Segment assets	6,236,063	2,077,049	-	8,313,112
Total assets	**6,236,063**	**2,077,049**	**-**	**8,313,112**
Segment liabilities	1,971,396	115,681	-	2,087,077
Unallocated liabilities	-	-	5,091,561	5,091,561
Total liabilities	**1,971,396**	**115,681**	**5,091,561**	**7,178,638**
Capital expenditure	780,741	108,357	-	889,098
Depreciation and amortisation	123,681	57,692	-	181,373

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

7. Balances and Transactions with Related Parties

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

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

The nature of the related party relationships for those related parties with whom the Group entered into significant transactions or had significant balances outstanding at 31 December 2005 and 2004 are detailed below.

Balances with Related Parties:

Balance sheet caption	Relationship	2005	2004
Trade and other receivables (Note 12)			
Trade receivables	Associate	**12,925**	-
Other current assets (Note 14)			
Current loans to related parties	Entity under common control	**104,007**	151,194
Deposits in related bank	Associate	**71,649**	-
Cash and cash equivalents (Note13)			
Cash in related bank	Associate	**33,622**	51,169
Deposits in related bank	Associate	**147,697**	-
Prepayments			
Advance paid to related party (a)	Entity under common control	**-**	212,209
Other non-current assets			
Non-current loans to related bank	Associate	**210,000**	160,000
Short-term borrowings (Note 15)			
Current loans from related parties	Entity under common control	**-**	565,734
Current loans from related bank	Associate	**70,000**	-
Trade payables, other payables and advances received (Note 17)			
Advances received – related parties(b)	Entities under common control and minority shareholders	**814,386**	-
Other payables (c)	Entity under common control	**1,132,440**	-

(a) In December 2004, the Company provided and advance to related party which was repaid in February 2005.

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

7. Balances and Transactions with Related Parties (continued)

(b) Included in this amount are cash advances of RR802,400 received by the Company’s subsidiary OJSC Pharmstandard – Ufavita from the entities controlled by the Group’s ultimate controlling party (Note 19) in accordance with share subscription agreements between those entities and OJSC Pharmstandard – Ufavita in connection with the additional OJSC Pharmstandard – Ufavita share issuance which was registered subsequent to year end (Note 28).

(c) Other payables included the obligation for 55% of the voting shares of OJSC “TZMOI” in the amount of 1,096,770 to a related party under common control which re-sold those shares to the Group after their initial acquisition from an unrelated party in 2005 (Note 5).

Major conditions of the loans and deposits listed above are as follows:

Caption	Interest rate, %		Maturity period	
	2005	2004	2005	2004
Current loans to related parties	12%	4%	6-12 months	6-12 months
Deposits	8-9%	-	2-6 months	-
Non-current loans	11%	2%	6 years	7 years
Current loans from related parties	-	1-2%	-	4-8 months
Current loans from related bank	14%	-	4 months	-

Outstanding balances at year end are unsecured and settlement occurs in cash. There have been no guarantees provided or received for any related party receivables.

Transactions with Related Parties:

Statement of operations caption	Relationship	2005	2004
Sales of medical equipment	Associate	**17,593**	-
Property insurance (a)	Entity under common control	**21,200**	144,711
Warehouse rental expenses (included in distribution costs)	Entity under common control	**7,365**	4,187
Office rental expenses (included in general and administrative expenses)	Entity under common control	**3,422**	3,587

(a) In 2005 and 2004 the Group paid property insurance premium classified as general and administrative expense to an entity acting on behalf of the Group’s ultimate controlling party (Note 19). These transactions were terminated in April 2005.

Compensation to Key Management Personnel:

Key management personnel comprise 3 persons as of 31 December 2005 and 2004. Total compensation to key management personnel included in general and administrative expenses in the statement of operations amounted to RR 2,559 for the year ended 31 December 2005 (2004: RR 1,611).

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

8. Property, Plant and Equipment

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

31 December 2005	Land	Buildings	Plant and machinery	Equipment and motor vehicles	Assets under construction	Total
Cost						
Balance at 31 December 2004	**6,192**	**1,047,969**	**463,437**	**14,360**	**256,205**	**1,788,163**
Additions	13,857	20,338	358,835	7,348	486,075	886,453
Acquisition through business combination (Note 5)	29,052	532,562	305,271	26,328	83,961	977,174
Transfers	-	41,280	74,331	20,070	(135,681)	-
Disposals		(50,807)	(39,169)	(12,585)	(1,469)	(104,030)
Balance at 31 December 2005	**49,101**	**1,591,342**	**1,162,705**	**55,521**	**689,091**	**3,547,760**
Accumulated Depreciation						
Balance at 31 December 2004	-	33,722	36,452	1,530	-	71,704
Depreciation charge	-	51,880	110,237	19,256	-	181,373
Disposals	-	(13,673)	(36,930)	(3,642)	-	(54,245)
Balance at 31 December 2005	**-**	**71,929**	**109,759**	**17,144**	**-**	**198,832**
Net Book Value						
Balance at 31 December 2004	6,192	1,014,247	426,985	12,830	256,205	1,716,459
Balance at 31 December 2005	**49,101**	**1,519,413**	**1,052,946**	**38,377**	**689,091**	**3,348,928**

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

8. Property, Plant and Equipment (continued)

31 December 2004	**Land**	**Buildings**	**Plant and machinery**	**Equipment and motor vehicles**	**Assets under construction**	**Total**
Cost						
Balance at 1 January 2004	6,192	1,086,694	264,424	15,155	130,511	1,502,976
Additions	-	-	148,140	-	188,894	337,034
Transfer to investment property	-	(37,926)	-	-	-	(37,926)
Transfers	-	3,789	50,873	8,507	(63,169)	-
Disposals	-	(4,588)	-	(9,302)	(31)	(13,921)
Balance at 31 December 2004	**6,192**	**1,047,969**	**463,437**	**14,360**	**256,205**	**1,788,163**
Accumulated Depreciation						
Balance at 1 January 2004	-	-	-	-	-	-
Depreciation charge	-	33,722	36,452	1,530	-	71,704
Balance at 31 December 2004	**-**	33,722	36,452	1,530	-	71,704
Net Book Value						
Balance at 1 January 2004	6,192	1,086,694	264,424	15,155	130,511	1,502,976
Balance at 31 December 2004	**6,192**	**1,014,247**	**426,985**	**12,830**	**256,205**	**1,716,459**

Bank borrowings are secured on plant and machinery to the value of RR 286,193 as of 31 December 2005 (2004: RR 279,000) - see Note 15.

The above tables include plant and machinery leased under finance lease agreements as of 31 December 2005 and 2004 as follows:

	2005	**2004**
Cost	**148,140**	148,140
Accumulated depreciation	**(22,207)**	(7,407)
	125,933	140,733

The Group assets include only a minor portion of the land on which the Group's factories and buildings, comprising the Group's principal manufacturing facilities, are located, whilst the major portion of the land is used under operating lease agreements with the state municipal bodies.

Total amount of rental payments for the use of the land was RR 10,474 in 2005 (2004: RR 8,424). Such payments are assessed by the state authorities on an annual basis.

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

9. Intangible Assets

	Goodwill	Other	Total
Cost			
Balance at 31 December 2004	-	-	-
Additions	-	2,645	2,645
Acquisition through business combination (Note 5)	218,854	-	218,854
Balance at 31 December 2005	**218,854**	**2,645**	**221,499**
Accumulated Amortisation			
Balance at 31 December 2004	-	-	-
Amortisation expense	-	-	-
Balance at 31 December 2005	**-**	**-**	**-**
Net Book Value			
Balance at 31 December 2004	-	-	-
Balance at 31 December 2005	**218,854**	**2,645**	**221,499**

Impairment testing of goodwill

Goodwill acquired through business combinations has been allocated to OJSC TZMOI, which is the cash-generating unit for impairment testing.

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

10. Assets Classified as Held for Sale

The Group had investments in several associates, which represented non-core businesses, with a total carrying amount of RR 393,121 and RR 370,466 as of 31 December 2005 and 2004, respectively, which were classified as assets held for sale due to approval of the Group's plan on their disposal in 2006.

In 2005, the Group entered into negotiations with related parties regarding sale of the investments in the associates and on the basis of those negotiations management was confident that the carrying value of the respective investments was fully realizable. This was confirmed subsequent to the year end when the significant amount of investments in the associates of RR 370,466 was realized from a sale to a related party (Note 28).

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

11. Inventories

Inventories consist of the following:

	2005	2004
Raw materials (at cost)	**496,434**	281,415
Work in progress (at cost)	**94,665**	17,552
Finished goods:		
- at cost	**469,645**	417,542
- at net realisable value	**452,042**	362,480
	1,043,141	661,447

The amount of write-down of inventories recognised as an expense is RR 1,654 (2004: RR 15,499). This expense is included in the cost of sales line item as a cost of materials and components recognised as an expense, which is disclosed in Note 21.

No inventories have been pledged or restricted in use at 31 December 2005 (2004: RR 153,245 was pledged - see Note 15).

12. Trade and Other Receivables

	2005	2004
Trade receivables (net of provision for impairment of receivables of RR 78,915 and RR 98,090 as at 31 December 2005 and 2004, respectively)	**1,738,103**	1,237,126
Other receivables (net of provision for impairment of receivables of RR 4,134 and RR nil as at 31 December 2005 and 2004, respectively)	**92,755**	32,053
	1,830,858	1,269,179

RR 27,691 of trade receivables were denominated in currencies other than Russian Roubles (primarily in US$) at 31 December 2005 (2004: RR 104,947).

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

13. Cash and Cash Equivalents

Cash and cash equivalents comprise the following:

	2005	2004
Cash in bank – Roubles (Note 7)	**94,058**	59,539
Cash in bank – US$ and Euro	**2,228**	6,060
Short-term bank deposits with less than 90 days maturity - Roubles (Note 7)	**147,697**	-
	243,983	65,599

Balances with banks generally carry no interest. Short-term bank deposits earn interest at 8% to 9% per annum.

14. Other Current Assets

	2005	2004
Loans to related parties (Note 7)	**104,007**	151,194
Bank deposits with maturity over 90 days (Note 7)	**71,649**	-
Other	**76,918**	127,965
	252,574	279,159

15. Short-term Borrowings

	2005	2004
International Moscow Bank	**425,604**	424,251
Related bank (Note 7)	**70,000**	-
Related parties (Note 7)	**-**	565,734
Expobank	**-**	75,000
Sberbank	**-**	279,000
Other	**87,926**	151,619
	583,530	1,495,604

As at 31 December 2005, loans are guaranteed by collateral of property, plant and equipment. See Notes 8 and 11.

All the borrowings bear a fixed interest rate and are rouble denominated. Their maturity period varied from 4 to 8 months in 2005 and 2004. The interest rate for bank borrowings ranged from 10 to 14% per annum. (2004: 9-14% per annum). Loans from related parties attracted interest at rates disclosed in Note 7.

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

16. Other Taxes Payable

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

	2005	2004
Value-added tax	**338,879**	232,737
Property and other taxes	**12,036**	13,554
Tax penalties and interest	**1,049**	4,375
	351,964	250,666

17. Trade and Other Payables and Advances Received

	2005	2004
Trade payables	**789,532**	522,044
Other payables – related party (Note 7)	**1,132,440**	-
Advances received – related party (Note 7)	**814,386**	-
Other payables	**58,431**	24,495
	2,794,789	546,539

RR 34,883 of trade payables were denominated in currencies other than Russian Rouble (primarily US$) at 31 December 2005 (2004: RR 55,445).

18. Obligations under Finance Leases

Obligations under finance leases comprised the following:

	2005	2004
Finance lease liabilities – minimum lease payments:		
Not later than 1 year	**94,953**	119,078
Later than 1 year and not later than 5 years	**-**	115,179
	94,953	234,257
Less: interest	**(12,998)**	(43,254)
Present value of finance lease liabilities	**81,955**	191,003
Representing lease liabilities		
- current	**81,955**	109,048
- non-current	**-**	81,955

Obligations under finance leases relate to a lease with an effective interest of 11% per annum.

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

19. Charter Capital

The sole participant of “Biovit” LLC is “AUGMENT INVESTMENTS LIMITED”, a company registered under the laws of Cyprus. The Group’s ultimate controlling party is a Russian citizen Victor Kharitonin.

In accordance with Russian legislation, participants of a limited liability company have a right to exit the company and receive the actual value of the participant’s interest which is determined as their proportionate share of net assets reported in the statutory accounts. Based on the provisions of the law determining the exit period, the net assets attributable to the Participant have been presented within non-current liabilities.

Charter capital of the Company in accordance with its charter documents is RR 37,793 as of 31 December 2005 and 2004. The increase in charter capital by RR 37,783 was registered in 2004 and fully paid in cash.

In May 2006, the Company was re-registered as Pharmstandard, an open joint stock company, as described in Note 28. The authorised number of ordinary shares upon reorganization equated to 37,792,603 with a par value per share of one Russian Rouble. All the issued shares were exchanged for ownership interest previously held by the Participant.

Upon reorganisation of the Company into an open joint stock company, it is subject to Russian legislation on joint stock companies. In accordance with such legislation, dividends may only be declared from accumulated undistributed and unreserved earnings as shown in Russian statutory financial statements. The Company had approximately RR 28,893 of undistributed and unreserved earnings as at 31 December 2005 (2004: RR 37,132). In addition, the Company’s share in the undistributed and unreserved earnings of the subsidiaries was approximately RR 2,954,265 as at 31 December 2005 (2004: RR 2,033,887).

In the 4th quarter 2005 and 2004, Group company OJSC “Pharmstandard-Leksredstva” declared and paid total dividends of RR 249,073 and RR 576,395 in respect of 2005 and 2004, respectively.

Upon reorganisation of the Company into an open joint stock company, earnings per share is calculated by dividing the net income attributable to ordinary shareholders by the weighted average number of ordinary shares in issue during the period. The Group has no dilutive potential ordinary shares; therefore, the diluted earnings per share equal basic earnings per share. Earnings per share calculated retrospectively are as follows:

	2005	**2004**
Weighted average number of ordinary shares outstanding (thousands)	**37,793**	37,793
Profit for the year attributable to Participant of the Company (sole shareholder since 5 May 2006)	**906,221**	305,110
Basic and diluted earnings per share, Russian Roubles	**23.98**	8.08

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

20. Sales of goods

The Groups’ products may be divided into pharmaceuticals, which comprise generic products sold either in the OTC (“Over-the-counter”) market or with a prescription, and medical equipment and disposables.

Sales breakdown by product groups comprised the following:

Product group	2005	2004
Pharmaceutical products		
OTC		
Branded generics	3,274,968	2,766,200
Non-branded generics	626,948	580,500
	3,901,916	**3,346,700**
Prescription		
Branded generics	440,127	294,400
Non-branded generics	292,990	260,800
	733,117	**555,200**
Medical equipment and disposables	**1,011,120**	**-**
Other	**38,671**	**43,784**
	5,684,824	**3,945,684**

21. Cost of Sales

The components of cost of sales were as follows:

	2005	2004
Materials and components	**1,574,150**	1,388,257
Production overheads	**617,990**	725,824
Depreciation	**158,662**	50,470
Direct labour costs	**156,300**	55,430
	2,507,102	2,219,981

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

22. Selling and Distribution Costs

Selling and distribution costs comprised the following:

	2005	2004
Marketing and advertising	**592,136**	157,581
Insurance of goods in transit	**116,256**	69,754
Labour costs	**105,475**	89,654
Freight and communication	**67,043**	53,634
Utilities and services	**63,566**	53,751
Certification expenses	**27,744**	19,421
Rent	**25,361**	24,092
Commission	**21,584**	17,267
Materials and maintenance	**12,899**	10,319
Travel and entertainment	**12,200**	9,760
Depreciation	**9,436**	8,900
Other expenses	**15,752**	17,478
	1,069,452	531,611

23. General and Administrative Expenses

General and administrative expenses comprised the following:

	2005	2004
Labour costs	**161,697**	138,052
Utilities and services	**116,199**	109,749
Taxes other than income tax	**34,058**	29,078
Property insurance (Note 7)	**21,200**	144,711
Freight and communication	**15,247**	13,017
Depreciation	**13,275**	12,334
Rent	**12,306**	10,506
Materials and maintenance	**7,575**	6,467
Other	**61,769**	58,071
	443,326	521,985

24. Other Expenses

Other expenses comprised the following:

	2005	2004
Loss from disposal of plant and equipment	**49,785**	13,922
Charity	**15,533**	15,565
Other	**61,290**	131,207
	126,608	160,694

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

25. Income Tax

	2005	**2004**
Income tax expense – current	**363,995**	84,152
Deferred tax expense – origination and reversal of temporary differences	**60,379**	33,567
Income tax expense	**424,374**	117,719

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

	2005	**2004**
Income before taxation	**1,443,697**	437,315
Theoretical tax charge at statutory rate of 24%	**346,487**	104,956
Tax effect of items which are not deductible or assessable for taxation purposes:		
Non-deductible expenses	**77,887**	12,763
Income tax expense	**424,374**	117,719

Movements in deferred tax balances were as follows:

	31 December 2003	**Differences recognition and reversal**	**31 December 2004**	**Differences recognition and reversal**	**Effect of business combination (Note 5)**	**31 December 2005**
Tax effects of deductible temporary differences – asset (liability):						
Property, plant and equipment	(204,214)	(11,906)	(216,120)	(16,200)	(143,662)	(375,982)
Trade and other receivables	8,431	(27,071)	(18,640)	(35,175)	2,169	(51,646)
Inventories	(3,019)	6,107	3,088	(9,004)	(7,919)	(13,835)
Other	697	(697)	-	-	-	-
Total net deferred tax liability	**(198,105)**	**(33,567)**	**(231,672)**	**(60,379)**	**(149,412)**	**(441,463)**

26. Contingencies, Commitments and Operating Risks

Operating Environment of the Group

Whilst there have been improvements in the Russian economic situation, such as an increase in gross domestic product and a reduced rate of inflation, Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

Taxation

Russian tax legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in its interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. It is not practical to determine the amount of unasserted claims that may manifest, if any, or the likelihood of any unfavourable outcome. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years proceeding the year of review. Under certain circumstances reviews may cover longer periods. Management believes that its interpretation of the relevant legislation is appropriate and that it is probable that the Group's tax position will be sustained. Because of the uncertainties associated with the Russian tax and legal systems, the ultimate amount of taxes, penalties and interest assessed, if any, may be in excess of the amount expensed to date and accrued as of 31 December 2005.

Management's estimate of the amount of possible liabilities, including fines, that could be incurred in the event that the tax authorities disagree with the Group's position on certain tax matters and certain tax practices used by the Group is approximately RR 55,222 at 31 December 2005. Should the Russian tax authorities decide to issue a claim and prove successful in the court, they would be entitled to recover the amount claimed, together with fines amounting to 20% of such amount and interest at the rate of 1/300 of the Central Bank of Russia rate for each day of delay for late payment of such amount. Management believes that it is not probable that the ultimate outcome of such matters would result in a liability. Therefore, no provision for these contingencies was recorded in the accompanying financial statements.

27. Financial Risk Management

The Group’s principal financial instruments comprise bank loans and cash and cash equivalents. The main purpose of these financial instruments is to raise finance for the Group’s operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations. During the year the Group did not undertake trading in financial instruments.

Credit Risk

Financial assets, which potentially subject Group entities 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. The carrying amount of accounts receivable, net of allowance for impairment of receivables, represents the maximum amount exposed to credit risk. The Group has no significant concentrations of credit risk. Although collection of receivables could be influenced by economic factors, management believes that there is no significant risk of loss to the Group beyond the allowance already recorded.

Except for cash deposited with related parties (Note 7), cash is placed in financial institutions, which are considered at time of deposit to have minimal risk of default.

Interest Rate Risk

The Group’s income and operating cash flows are substantially independent of changes in market interest rates.

Fair values of financial instruments

Fair values of cash and cash equivalents, borrowings, trade and other receivables and trade and other payables approximate their carrying amounts due to their short maturity.

28. Post Balance Sheet Events

Reorganization into joint stock company

In May 2006 Biovit LLC was renamed as Pharmstandard and reorganized into an open joint stock company. The authorised number of ordinary shares upon reorganization equated to 37,792,603 with a par value per share of one Russian Rouble.

28. Post Balance Sheet Events (continued)

Other post balance sheet events

Included in the balance sheet as of 31 December 2005 are assets held for sale in the amount of RR 370,466 which were sold to a related party in the period from January 2006 to May 2006 at their carrying value.

Additional share issue was registered by OJSC Pharmstandard–Ufavita on 18 January 2006 and the respective advances from the entities controlled by the Group's ultimate controlling party (Notes 7 and 19) of RR 802,400 (Note 7) were converted into OJSC Pharmstandard–Ufavita capital. Further, prior to the reorganization of Biovit LLC described above, those entities sold all the additional shares in OJSC Pharmstandard–Ufavita to the Company for RR 802,400. As a result of these transactions, the Company's interest in OJSC Pharmstandard–Ufavita increased from 56% at 31 December 2005 to 97% at 30 June 2006. The Participant provided to the Company a cash contribution in the amount of RR 802,400 to finance the acquisition of these additional shares in OJSC Pharmstandard–Ufavita.

Acquisition of minority interest in OJSC "TZMOI"

In June 2006, the entities controlled by the Group's ultimate controlling party acquired a 34% minority interest in the Company's subsidiary, OJSC "TZMOI", for RR 434,953 and subsequently sold this interest to the Company for the same amount resulting in an increase of the Company's interest in OJSC "TZMOI" from 55% to 89%.