Management's Discussion and Analysis

The following discussion should be read in conjunction with the audited consolidated financial statements prepared in accordance with US GAAP and the related notes, published simultaneously with this MD&A. This discussion includes forward-looking statements that involve risks and uncertainties. Actual results could differ materially from those anticipated in the forward–looking statements as a result of numerous factors, including certain factors discussed later in this MD&A.

For financial reporting purposes, Tatneft converts metric tons of crude oil to barrels using a conversion factor of 7.123. This factor represents a blend of varying conversion factors specific to each of Tatneft's fields. Because the proportion of actual production by field varies from period to period, total reserves and production volumes for the Group in barrels converted from tons using the blended rate may differ from total reserves and production calculated on a field by field basis.

Background

OAO Tatneft (the "Company") and its subsidiaries (jointly referred to as the "Group" or "Tatneft") is one of the largest vertically integrated oil companies in Russia in terms of crude oil production and proved oil reserves. The Company is an open joint-stock company organized under the laws of the Russian Federation with the headquarters located in City of Almetyevsk, Tatarstan. The principal business of the Group is to explore for, develop, produce and market crude oil and refined products. The Group is also expanding its activities to further develop its refining and petrochemicals segments.

As of December 31, 2008 OAO Svyazinvestneftekhim, a company wholly owned by the government of Tatarstan, together with its subsidiary, hold approximately 36% of the Company's voting stock. These shares were contributed to Svyazinvestneftekhim by the Ministry of Land and Property Relations of Tatarstan in 2003. Tatarstan also holds a "Golden Share", a special governmental right, in the Company. The exercise of its powers under the Golden Share enables the Tatarstan government to appoint one representative to the Board of Directors and one representative to the Revision Committee of the Company as well as to veto certain major decisions, including those relating to changes in the share capital, amendments to the Charter, liquidation or reorganization of the Company and "major" and "interested party" transactions as defined under Russian law. The Golden Share currently has an indefinite term. The Tatarstan government, including through OAO Svyazinvestneftekhim, also controls or exercises significant influence over a number of the Company's suppliers and contractors, such as the electricity producer OAO Tatenergo and the petrochemicals company OAO Nizhnekamskneftekhim.

The majority of the Group's crude oil and gas production and other operations are located in Tatarstan, a republic of the Russian Federation situated between the Volga River and the Ural Mountains and located approximately 750 kilometers southeast of Moscow.

The Group currently holds most of the exploration and production licenses and produces substantially all its crude oil in Tatarstan.

As of December 31, 2008, the Group's total proved reserves (SPE/WPC) of crude oil and condensate were 790 million tons (5,625 million barrels) using the year end constant oil price, and 878 million tons (6,255 million barrels) using 12-month average oil price for the year 2008.

Key financial and operational results

	Year ended December 31, 2008	Change	Year ended December 31, 2007
Sales (millions of RR)	444,332	24.72%	356,276
Net income (millions of RR)	8,413	(80.56)%	43,279
EBITDA (*) (millions of RR)	25,120	(64.25)%	70,269
Basic and Diluted net income per share of common stock (RR)			
Common…………….	3.79	(80.56)%	19.50
Preferred……………...	3.53	(81.68)%	19.27
Crude oil production by the Group (thousand of tons)	26,060	0.5%	25,933
Crude oil production by the Group (thousand of barrels)	185,628	0.5%	184,719
Gas production by the Group (millions of cubic meters)	762.1	3.2%	738.5
Refined gas products produced (thousand of tons)	1,078.7	(6.5)%	1,154
Crude and condensate proved reserves (millions of bbl) (**)	5,625	(8.4)%	6,140

(*) *As defined on page 17*
(**) *Using the year end constant price case. The Group's crude and condensate reserves as of December 31, 2008 using 12-month average crude oil price case were 6,255 million barrels.*

During 2008 our net income was RR 8,413 million, which is RR 34,866 million, or 80.56%, less than in 2007. Our net income was significantly impacted by the nonrecurring and exceptional items discussed below.

During the first seven months of 2008 our performance was supported by an increase in average crude oil market prices compared to the same period of 2007 despite effect of increasing cost of purchased crude oil, taxes other than income taxes and transportation tariffs. Expansion of the world's financial and economic crisis resulting in, *inter alia*, a slump in crude oil market prices, which started in the third quarter and was most dramatic in the fourth quarter of 2008, a loss from the ruble devaluation, high level of export duties rates (calculated based on a much higher oil price than the market price realized at the time of sales) and a substantial drop in value of the Group's financial investments in the fourth quarter led to a decrease in our net income in 2008 compared to 2007. In 2008 there were a number of significant nonrecurring and exceptional items many of which are related to the world's financial and economic crisis. These factors, as well as other drivers impacting the results of our operations are considered in detail below.

Nonrecurring and exceptional items

The following significant nonrecurring and exceptional charges impacted the Group's results of operations for the year ended December 31, 2008:

- Bad debt provision on accounts receivable related to sales of crude oil to Ukraine prior to October 2007 (see Selling, general and administrative expenses section, p. 16).
- Loss from equity investment in IPCG Fund (included in the Other income and loss section , p. 17).
- Foreign exchange loss in a subsidiary (TANECO) having substantial bank debt denominated in US dollars (included in the Other income and loss section , p. 17).

- Impairment of a subsidiary involved in a noncore activity under SFAS 144 provisions of US GAAP (included in the Loss on disposals of property, plant and equipment and impairment of investments section, p. 16)
- Accumulated prior years' losses of two companies carrying out exploratory activities which were fully consolidated for the first time in our consolidated financial statements under the provision of FIN 46R. Investments in these companies were previously accounted for under the equity method (see Exploration expenses section, p 15).
- Provision related to indirect shareholding interests in Ukrtatnafta (see section Loss on disposals of property, plant and equipment and impairment of investments section, p. 16)
- Revaluation of pension obligation of the Group (see section Selling, general and administrative expenses section, p. 16 and Other operating expenses, p 15)
- Disposal of a medical facility, a social asset of the Group (see Maintenance of social infrastructure and transfer of social assets section, p. 17).
- Write-off of certain debt considered by the Group as unrecoverable (included in the Loss on disposals of property, plant and equipment and impairment of investments section, p. 16).
- Accumulated prior years' losses of a company in petrochemical segment first time consolidated in the Group's financial statements (included in the Loss on disposals of property, plant and equipment and impairment of investments section, p. 16).

Reconciliation of Net income to Net income before nonrecurring and exceptional items

RR millions	Year ended December 31, 2008
Net income	8,413
Nonrecurring and exceptional items:	
Bad debt provision related to Ukrainian sales[(1)]	10,786
Loss from equity investment in IPCG Fund	9,470
Foreign exchange loss on US dollar denominated debt of TANECO	6,582
Impairment of a non-core subsidiary	2,587
Provision related to indirect shareholding interests in Ukrtatnafta	2,004
Revaluation of pension obligation of the Group	1,658
Exploration expenses of newly consolidated companies (prior year losses)	1,455
Disposal of a medical facility	1,379
Write-off of unrecoverable debt	960
Prior year losses of first time consolidated company	689
Net income before nonrecurring and exceptional items	**45,983**

[(1)] In the nine months 2008 US GAAP financial statements and the related MD&A the amount was shown taking into account the fluctuation of the foreign exchange rate, where in the financial statements and the related MD&A for the 2008 year we are presenting the net amount.

The nonrecurring and exceptional items contributed to the Group's deferred tax benefit as of December 31, 2008.

Net income before nonrecurring and exceptional items is a non-US GAAP financial measure. The Company believes that net income before nonrecurring and exceptional items provides useful information to investors. Net income before nonrecurring and exceptional items should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under US GAAP.

Segment information

Our operations are currently divided into the following main segments:

• **Exploration and production** –consists of the Company's oil and gas extraction and production divisions, well repair and reservoir oil yield improvement subdivisions, pumping equipment repair centers, security and logistics. Most oil and gas exploration and production activities are concentrated within OAO Tatneft.

- **Refining and marketing –**consists of our participation in OAO TANECO, a company established to build and operate a refining and petrochemical complex with a throughput capacity of up to fourteen million tones of crude oil per year in Nizhnekamsk, Tatarstan; our gas production, transportation and refining division Tatneftegaspererabotka, OOO Tatneft-AZS-Center and OOO Tatneft-AZS-Zapad, management companies for the Tatneft branded gas stations network; and certain other oil trading and ancillary companies.

- **Petrochemicals -** our petrochemicals segment has been consolidated under a management company, Tatneft-Neftekhim, which manages OAO Nizhnekamskshina, one of the largest tire manufacturers in Russia, and the companies technologically integrated with it, including OAO Nizhnekamsk Industrial Carbon Plant, ZAO Yarpolymermash-Tatneft, OAO Nizhnekamskiy Mekhanicheskiy Zavod and OOO Nizhnekamskiy Shinny Zavod CMK. OOO Tatneft-Neftekhimsnab and OOO Trading House Kama are responsible for procuring supplies and marketing products produced by the companies within this segment, respectively.

These segments are determined by the way management recognizes the segments within the Group for making operating decisions and how they are evident from the Group structure.

Executive overview

Recent developments and outlook

E&P activities in Tatarstan

One of the Company's primary strategic goals is to maintain current levels of crude oil production from its licensed fields in Tatarstan. In 2008 the Company increased production by 0.1% from its fields in Tatarstan compared to 2007. Due to the relative maturity of the Company's main producing fields significant portion of all crude oil produced by the Company in Tatarstan was extracted using various enhanced recovery techniques. In 2008 the Company put 334 new production wells into operation in Tatarstan.

Effective from January 1, 2007 the Company benefits from the differentiated taxation of crude oil production from certain of its fields in Tatarstan, including the Company's largest field - Romashkinskoye (more fully discussed in the Taxation subsection of Certain Macroeconomic Factors Affecting the Group's Results of Operations below).

E&P activities outside of Tatarstan

The Group continues to expand its operations outside of Tatarstan. In 2008 the Group obtained one new exploration and production license in the Orenburg region and two new exploration licenses in the Samara region.

Tatneft is planning to continue expansion and diversification of its reserve base by gaining access, including through establishing strategic alliances, to reserves outside of Tatarstan, particularly in the Kalmykia Republic, the Ulyanovsk, Samara, Orenburg and Krasnoyarsk regions, Nenets Autonomous Region and the Chuvash Republic. Outside of the Russian Federation, Tatneft is engaged in projects in Libya, Syria and other countries.

Highly viscous oil (natural bitumen) production

During 2008 the Company continued a pilot project to produce highly viscous oil (natural bitumen) from the Ashalchinskoye field in Tatarstan using parallel steam injection and producing wells. Highly viscous oil production from the pilot project wells currently yields up to 25 tons per day. The Company continues to assess the economic parameters and development of the related activities relating to highly viscous oil production in Tatarstan.

The Group benefits from a zero unified production tax rate related to the production of highly viscous oil in Tatarstan.

Crude oil refining and marketing

During 2008 the Group continued the development and construction by OAO TANECO ("TANECO"), formerly known as ZAO Nizhnekamsk Refinery, of a new refining and petrochemicals complex in Nizhnekamsk, Tatarstan. Expenditures related to the construction in 2008 were primarily financed from a US$ 2 billion senior secured credit facility arranged by ABN AMRO (now RBS), BNP Paribas (Suisse) SA, Citibank International PLC, Bayerische Hypo-und Vereinsbank AG, Sumitomo Mitsui Finance Dublin and WestLB AG earlier in the year.

Petrochemicals

In 2008 the core entity of the Group's petrochemicals segment – OAO Nizhnekamskshina produced 11.9 million tires. A new advanced rubber mix production line was launched in 2007 with monthly capacity of 1,200 tons, which allows Nizhnekamskshina to produce modern high performance tires. The Group continued to invest in the modernization and upgrading of Nizhnekamskshina's production facilities to strengthen its market competitiveness.

Resource base

As determined by the Group's independent petroleum engineering consultants, Miller and Lents, Ltd., the following information presents the balances of our crude oil and condensate reserves as of December 31, 2008 and 2007 under the Society of Petroleum Engineers and the World Petroleum Congress definitions.

(A) Year End Constant Price Case

Net crude and condensate reserves (in mmbbl)	**At December 31, 2008**	**Changes in 2008**		**At December 31, 2007**
		Production	**Revision**	
Proved reserves	5,625	(186)	(329)	6,140
Probable reserves	642			2,141
Possible reserves	248			610

(B) 12-Month Average Oil Price Case

Net crude and condensate reserves (in mmbbl)	**At December 31, 2008**
Proved reserves	6,255
Probable reserves	701
Possible reserves	604

Evaluation of the Group's oil and gas reserves using the year end constant price case is required for the purposes of preparing the Group's financial statements under US GAAP for the year ending December 31, 2008. This requirement is related to oil and gas reserves definitions established by the U.S. Securities and Exchange Commission (SEC). Due to recent changes in the regulations, the SEC definitions now permit the use of 12-month average oil price case for the purposes of reporting the Group's oil and gas reserves starting with the year of 2009. The Group believes that the 12-month average oil price case gives a fair presentation of the Group's reserves in current economic conditions, especially in a highly volatile oil price environment such as observed during the year of 2008.

Most evaluated properties are located in the Volga-Ural Oil Basin and include more than 100 developed and producing oil fields, containing approximately 29,200 active completions. In addition, in 2008, estimated reserves for 21 bitumen oil fields were recorded.

Operational highlights

	Year ended December 31, 2008	Year ended December 31, 2007
Crude oil production (millions of metric tons)…………	26.1	25.9
Crude oil production (millions of barrels)……………..	185.6	184.7
Refining and tolling of crude oil throughput (millions of metric tons)………………………………………….	0.5	0.5
Refining and tolling of crude oil throughput (millions of barrels)……………………………………………….	3.8	3.9
Gas production by the Group (million of cubic meters)..	762.1	738.5
Refining of gas products throughput (million of cubic meters)……………………………………………….	683.8	658.8

Crude oil and gas production

Crude oil production of the Group (including production of consolidated subsidiaries OAO Ilekneft, ZAO Tatneft-Samara, ZAO Tatneft-Severny and ZAO Kalmtatneft) increased by 0.5% to 26.1 million metric tons in 2008. Increase of crude oil production is mainly the result of implementing modern secondary and tertiary methods and new technologies on the Company's fields in Tatarstan as well as increase of production from fields outside of Tatarstan. Our gas production increased by 3.2% to 762.1 million cubic meters in 2008 from 738.5 million cubic meters in 2007.

Export of crude oil from Russia

The Group continues to utilize Transneft, the state-owned monopoly owner and operator of Russia's trunk crude oil and export pipelines, upon export of its crude oil. During 2008, the Group exported from Russia approximately 66% of its crude oil production compared with approximately 69% in 2007.

Certain Macroeconomic Factors Affecting the Group's Results of Operations

The Group's results of operations and the period to period changes therein have been and will continue to be affected by various factors outlined below.

Crude oil and refined product prices

The price at which we sell crude oil and refined products is the primary driver of our revenues.

In the first half of 2008, the price growth was driven by an escalation in geopolitical tensions which was strengthened by financial market speculation. The continued US dollar fluctuations and supply concerns also boosted prices. In the second half of 2008, the volatility of crude oil prices was significant: the price reached both its peak ($144.2 at the beginning of July) and bottom values since the beginning of the year. At the end of December 2008, the crude oil market suffered the most significant price fluctuations ever. The world financial crisis sent the crude oil price to a twelve month minimum ($33.6 at the end of December).

There is no independent or uniform market price for crude oil in Russia primarily because a significant portion of crude oil destined for sale in Russia is produced by vertically integrated Russian oil companies and is refined by the same vertically integrated companies. Crude oil that is not exported from Russia, refined by the producer or otherwise sold is offered for sale in the domestic market at prices determined on a transaction-by-transaction basis.

Substantially all the crude oil we sell in export and domestic markets is Urals blend. The table below represents average and year end crude oil prices worldwide and in Russia for 2008 and 2007.

Oil prices

World market	Average for year ended December 31		Change	Year ended December 31		Change
	2008	2007		2008	2007	
	(in US dollars per barrel, except for figures in percent)					
Brent crude	97.0	72.5	*33.7%*	36.5	96.0	*(61.9)%*
Urals crude (*CIF Mediterranean*)*	94.5	69.5	*35.9%*	36.1	93.6	*(61.4)%*
Urals crude (*CIF Rotterdam*)*	94.6	69.3	*36.5%*	35.7	92.6	*(61.5)%*

Source: Platts

* The company sells crude oil on foreign markets on various delivery terms. Therefore, our average realized sales prices differ from average reported market prices.

Russian market	Average for year ended December 31		Change	Year ended December 31		Change
	2008	2007		2008	2007	
	(in RR per ton, except for figures in percent)					
Crude oil*	6,786	6,288	*7.9%*	2,627	8,062	*(67.4)%*

Source: Kortes

* Excluding VAT

Transportation of crude oil and refined products

Due to the fact that main Russian crude oil production regions are remote from the main crude oil and refined products markets crude oil production companies are dependent on the extent of diversification of transport infrastructure and access to it. Thus, transportation cost is an important macroeconomic factor affecting our operations and financial results.

The Group transports substantially all of the crude oil that it sells in export and local markets through trunk pipelines in Russia that are controlled by Transneft.

Transportation of crude oil is based on contracts with Transneft and its subsidiaries, which set forth the basic obligations of the contracting parties, including the right of Transneft to blend or substitute a company's oil with oil of other producers. The Group's crude oil is blended in the Transneft pipeline system with other crude oil of varying qualities to produce an export blend commonly referred to as Urals. The Group benefits from this blending since the quality of its crude oil is generally lower than that produced by many other oil companies due to the relatively high sulfur content.

A significant portion of crude oil and refined products transported by pipeline is delivered to marine terminals for onward transportation. There are significant constraints present in Russia's oil shipment terminals due to geographic location, weather conditions, and port capacity limitations. However, government sponsored and private programs are seeking to improve port facilities.

In 2008 the Company shipped 47% (54% in 2007) of crude oil for export through Transneft's Druzhba pipeline (mainly to Poland, Czech Republic and Hungary); 46% (30% in 2007) of crude oil was shipped through Black Sea ports (mainly Novorossiysk); 6% (11% in 2007) of crude oil exported through Baltic Sea port Primorsk and 1% (5% in 2007) of crude oil was shipped through Ukrainian ports (mainly Yuzhnyi).

Transneft establishes and collects on prepayment terms a ruble tariff on domestic shipments and an additional US dollar tariff on exports. The Federal Tariff Service ("FST") is authorized to periodically review and set the tariff rates applicable for each segment of the pipeline. The tariffs are dependent on transport destination, delivery volume, distance of transportation, and several other factors. Tariffs are to be revised by FST at least annually.

Inflation and foreign currency exchange rate fluctuations

A significant part of the Group's revenues are derived from export sales of crude oil and refined products which are denominated in US dollars. The Group's operating costs are primarily denominated in Rubles.

Accordingly, the relative movements of Ruble inflation and Ruble/US dollar exchange rates can significantly affect the results of operations of the Group. For instance, operating margins are generally adversely affected by an appreciation of the Ruble against the US dollar, because this will generally cause costs to increase relative to revenues. The Group has not historically used financial instruments to hedge against foreign currency exchange rate fluctuations.

The following table shows the rates of inflation in Russia, the period-end and average Ruble/US dollar exchange rates, the rates of nominal appreciation of the Ruble against the US dollar, and the rates of real change in the value of the Ruble against the US dollar for the periods indicated.

	Year ended December 31, 2008	**Year ended December 31, 2007**
Ruble inflation	13.3%	11.9%
US $ period-end exchange rate	29.38	24.55
Average US $ exchange rate	24.85	25.57
Nominal appreciation (devaluation) of the Ruble	(19.7)%	6.8%
Real Ruble appreciation (devaluation)	(5.3)%	20.0%

Sources: Federal Service of State Statistics and the Central Bank of Russia

At present, the Ruble is not a convertible currency outside the Commonwealth of Independent States. Exchange restrictions and controls still exist related to converting Rubles into other currencies.

Taxation

The Group is subject to numerous taxes that have a significant effect on its results of operations. Russian tax legislation is and has been subject to varying interpretations and frequent changes.

In addition to income taxes, the Group is also subject to:

- unified natural resources production tax (or unified production tax);
- export duties;
- excise taxes on refined products;
- value added taxes;
- property taxes;
- land tax;
- vehicle tax;
- other local taxes and levies; and
- tax penalties and interest.

These taxes, except for value added taxes, are reflected in Taxes other than income taxes in the Group's consolidated statements of operations and comprehensive income. In addition, the Group is subject to payroll-based taxes, which are included as salary costs within Selling, general and administrative expenses or Operating expenses, as appropriate.

The table below presents a summary of statutory tax rates that the Company and the majority of its subsidiaries were subject to for the respective periods:

	Year ended December 31, 2008	Year ended December 31, 2007	Change	Taxable base
Income tax – maximum rate	24%	24%	-	Taxable income
VAT	18%	18%	-	Added value
Property tax – maximum rate	2.2%	2.2%	-	Taxable property
	(in RR per metric ton, except for figures in percent)			
Unified production tax, average rates(1)	3,329	2,470	*34.8%*	Metric ton produced (crude oil)
Refined products excise tax:				
High octane gasoline	3,629	3,629	-	Metric ton produced and sold domestically (2)
Low octane gasoline	2,657	2,657	-	
Diesel fuel	1,080	1,080	-	
Motor oils	2,951	2,951	-	
Straight run gasoline	2,657	2,657	-	
	(in US $ per metric ton, except for figures in percent)			
Crude oil export duty, average rates	355.2	206.5	*72.0%*	Metric ton exported
Refined products export duty average rates:				
Light refined products (gasoline products) and mid refined products (diesel fuel)	251.6	151.5	*66.1%*	Metric ton exported
Fuel oil (mazut)	135.6	81.6	*66.2%*	

(1) *Without taking into account differentiated taxation*

(2) *Excise taxes are paid on refined products produced and sold domestically. Excise taxes are paid by the companies that sell refined products to the end customers, while producers and intermediary re-sellers accrue excise tax and subsequently recover it subject to certain conditions set by the legislation.*

During 2008, the tax rates specific to the oil industry rose substantially compared to the previous year. Unified production tax increased by 35%, average crude oil export duties by 72%, and average refined products export duties by 66%.

The increase in unified production tax rates in 2008 is a result of increase in the average Urals blend price by 35% partly offset by a decrease in the average exchange rate of US dollar against Ruble by 3% for the year ended December 31, 2008 as compared to the year ended December 31, 2007. Excise taxes on refined products remained at the same level as in the respective period of 2007.

Unified production tax rate. Pursuant to the Federal Law No.151-FZ ‘‘On Amendments in Chapter 26 of Part II of the Tax Code of the Russian Federation and Considering Certain Expired Legislative Acts of the Russian Federation’’ dated July 27, 2006 (the ‘‘New Natural Resources Production Tax Law’’) effective from January 1, 2007, the rate for the unified production tax is differentiated. Under the New Natural Resources Production Tax Law, the tax rate for the production of oil is set at RR 419 per ton (unchanged from 2005). This tax rate is applied with a discount based on the levels of the international oil prices and the levels of depletion of the related oil fields as determined under Russian resource classification guidelines. Such formula benefits producers with oil fields having a depletion level 80% and above as determined by the Russian resourse reserve classifications.

Under the New Natural Resources Production Tax Law, the Company receives a benefit of 3.5% per field for each percent of depletion in excess of the 80% threshold. As Romashkinskoye field, the Company's largest, along with certain other fields, is more than 80% depleted, the Company received a benefit from these fields in 2008 of RR 8.3 billion.

Also one of the key provisions of the New Natural Resources Production Tax Law is zero unified production tax rate for high viscous crude oil (defined as crude oil of more than 200 Megapascal second under reservoir conditions) where the direct (segregated) method of accounting for produced oil is used. Since April 2007, the Company's production of highly viscous crude oil from the Ashalchinskoye and Mordovo-Karmalskoye fields was subject to a zero unified production tax rate, resulting in tax benefit in twelve-month period of 2008 attributed to that production of RR 57 million.

Effective from January 1, 2009, the unified production tax rate calculation was changed. The threshold crude oil price up to which the tax rate is zero was raised from $9.00 to $15.00 per barrel. This leads to a $1.3 per barrel decrease in crude oil extraction tax expenses in Russia. Also, the list of regions where, depending on the period and volume of production, zero crude oil extraction tax rate applies (established by the New Natural Resources Production Tax Law) is extended. In particular, it now includes Caspian offshore and the Nenetsky Autonomous District (the Company has operations in the latter).

Crude oil export duties. Prior to October 1, 2008, the Russian government set export tariff rates for two-month periods. The rates in a specific two-month period were based on Urals blend international market prices in the preceding two months. Thus, the calculation method that the Russian government employed to determine export tariff rates resulted in a two-month gap between movements in crude oil prices and the revision of the export duty rate based on those crude oil prices.

This method of calculation changed in September 2008. The Russian government set the specific crude oil export duty rate for October and November 2008 at $372.20 and $287.30 per tonne respectively, in order to compensate oil companies for the negative effect of decline in crude oil prices. Beginning from December 2008, the crude oil export duty rate will be revised monthly on the basis of the immediately preceding one-month period of crude oil price monitoring.

The Government determines the export duty rate, which is dependent on the average Urals price for the monitoring period according to the following table:

Quoted Urals price (P), USD per tonne	Maximum Export Duty Rate
0 – 109.50	0%
109.50 – 146.00	35.0% * (P - 109.50)
146.00 – 182.50	USD 12.78 + 45.0% * (P - 146.00)
>182.50	USD 29.20 + 65.0% * (P - 182.50)

The export duty on crude oil increased by 72% in 2008 to US$ 355.2 per tonne (US$ 48.5 per barrel) from US$ 206.5 per tonne (US$ 28,2 per barrel) in 2007. The increase in these comparative periods was associated with the growth of Urals prices, which increased during the whole year by 36% to US$ 94.5 per barrel in 2008 compared to US$ 69.5 per barrel in 2007.

Starting from 2007, crude oil exported from Russia to Belorussia became subject to export duties. The latest amendments made by customs authorities set a multiplier of 0.335 for 2008 (0.293 for 2007) to be applied to the regular export duty rate set by the Russian Government for calculation of export duty on crude oil exports from Russia to Belorussia. Starting from January 1, 2009 this multiplier was increased to 0.356.

Property tax. In accordance with the amendments to Russian legislation effective from January 1, 2004 the maximum property tax rate was set to 2.2%. Exact tax rates are set by the local authorities.

Value added tax (VAT). The Group is subject to value added tax (or VAT) of 18% on most purchases. VAT payments are recoverable against VAT received on domestic sales. Export sales are not subject to VAT. Input VAT related to export sales is recoverable from the Russian government. The Group's results of operations exclude the impact of VAT.

Income tax. Before 2009, operations in the Russian Federation were subject to an income tax rate of 24%. The Federal income tax rate was 6.5% and a regional income tax rate varied from 13.5% to 17.5% at the discretion of the individual regional administrations. Starting on January 1, 2009, the total income tax rate is decreased to 20%, including federal part which decreased to 2.0% and the regional part which varies between 13.5% and 18.0%.

Year ended December 31, 2008 compared to Year ended December 31, 2007

The table below details certain income and expense items from our consolidated statements of operations and comprehensive income for the period indicated.

RR millions	Year ended December 31, 2008	Year ended December 31, 2007	Change
Sales and other operating revenues	**444,332**	**356,276**	**24.7%**
Costs and other deductions			
Operating	65,961	59,623	10.6%
Purchased oil and refined products	58,919	43,297	36.1%
Exploration	3,770	1,577	139.1%
Transportation	11,556	8,431	37.1%
Selling, general and administrative	36,571	22,349	63.6%
Depreciation, depletion and amortization	10,139	10,379	(2.3)%
Loss on disposals of property, plant and equipment and investments and impairments	1,684	5,253	(67.9)%
Taxes other than income taxes	217,271	146,299	48.5%
Maintenance of social infrastructure and transfer of social assets	4,258	2,340	82%
Total costs and other deductions	**410,129**	**299,548**	**36.9%**
(Losses)/earnings from equity investments	(9,556)	5,789	(265.1)%
Foreign exchange loss	(6,135)	(2,623)	133.9%
Interest income	3,753	2,779	35%
Interest expense, net of amounts capitalized	(580)	(60)	866.7%
Other loss, net	(3,531)	(4)	88,175%
Total other (loss) / income	**(16,049)**	**5,881**	**(372.9)%**
Income before income taxes and minority interest	**18,154**	**62,609**	**(71)%**
Current income tax expense	(16,043)	(18,895)	(15.1)%
Deferred income tax benefit	6,701	641	945.4%
Total income tax expense	**(9,342)**	**(18,254)**	**(48.8)%**
Minority interest	(399)	(1,076)	(62.9)%
Net income	**8,413**	**43,279**	**(80.6)%**

The analysis of the main financial indicators of the above financial information is provided below.

Sales and other operating revenues

A breakdown of sales and other operating revenues (by product) is provided in the following table:

RR millions	Year ended December 31, 2008	Year ended December 31, 2007
Crude oil	346,261	270,960
Refined products	55,544	43,226
Petrochemicals	21,993	23,180
Corporate and other sales	20,534	18,910
Total sales and other operating revenues	**444,332**	**356,276**

Sales and other operating revenues increased in 2008 by 24.7% to RR 444,332 million from RR 356,276 million in 2007. The increase is mainly attributable to an overall increase in crude oil and refined product prices as well as increased volumes of crude oil sold to non-CIS destinations.

Sales of crude oil

Sales of crude oil increased by 27.8% to RR 346,261 in 2008 from RR 270,960 million in 2007. The table below provides an analysis of the changes in sales of crude oil:

	Year ended December 31, 2008	Change	Year ended December 31, 2007
Domestic sales of crude oil			
Revenues (RR millions)	65,806	*19.7%*	54,954
Volume (thousand tons)	*9,162*	*2.3%*	*8,957*
Realized price (RR per ton)	*7,183*	*17.1%*	*6,135*
CIS export sales of crude oil [1]			
Revenues (RR millions)	15,800	*(72.7)%*	57,893
Volume (thousand tons)	*1,587*	*(70.6)%*	*5,401*
Realized price (RR per ton)	*9,956*	*(7.1)%*	*10,719*
Non-CIS export sales of crude oil			
Revenues (RR millions)	264,655	*67.4%*	158,113
Volume (thousand tons)	*15,637*	*26.2%*	*12,394*
Realized price (RR per ton)	*16,925*	*32.7%*	*12,757*

[1] CIS is an abbreviation for Commonwealth of Independent States

Sales of refined products

Sales of refined products increased by 28.5% to RR 55,544 million in 2008 from RR 43,226 million in 2007. The table below provides an analysis of the changes in sales of refined products:

	Year ended December 31, 2008	Change	Year ended December 31, 2007
Domestic sales of refined products			
Revenues (RR millions)	48,707	*31.6%*	37,013
Volume (thousand tons)	*2,892*	*(1.6)%*	*2,939*
Realized price (RR per ton)	*16,842*	*33.7%*	*12,594*
CIS export sales of refined products			
Revenues (RR millions)	673	*(74.8)%*	2,669
Volume (thousand tons)	*53*	*(64.7)%*	*150*
Realized price (RR per ton)	*12,698*	*(28.6)%*	*17,793*
Non-CIS export sales of refined products			
Revenues (RR millions)	6,164	*73.9%*	3,544
Volume (thousand tons)	*408*	*24%*	*329*
Realized price (RR per ton)	*15,108*	*40.3%*	*10,772*

Sales of petrochemical products

The table below provides an analysis of petrochemical products sales.

RR millions	Year ended December 31, 2008	Change	Year ended December 31, 2007
Tiers sales	21,209	*(5.8)%*	22,516
Other petrochemicals sales	784	*18.1%*	664
Total sales of petrochemical products	**21,993**	***(5.1)%***	**23,180**

The decrease in sales of petrochemical products was primarily attributable to the lower volume sold. The Group's production of tires in 2008 decreased by 4% compared to 2007 and amounted to 11.9 million tires.

Other sales

Other sales increased by 8.6% to RR 20,534 million in 2008 from RR 18,910 million in 2007. Other sales primarily represent sales of materials and equipment and various oilfield services provided by the Company's production subsidiaries to third parties (such as drilling, lifting, construction, repairs, and geophysical works). The increase in 2008 of other sales was mainly attributable to the increased sales of goods, as well as transportation services and other services sales.

Costs and other deductions

Operating expenses. Operating expenses include the following type of costs:

RR millions	Year ended December 31, 2008	Year ended December 31, 2007
Crude oil extraction expenses	28,783	22,168
Petrochemical production expenses	18,415	18,287
Other operating expenses	18,763	19,168
Total operating expenses	**65,961**	**59,623**

Operating expenses include the following main categories: lifting expenses connected with extraction of crude oil, refining and processing expenses, cost of petrochemicals production, cost of materials other than oil and gas, and other direct costs.

Crude oil extraction expenses. The Group's extraction ("lifting") expenses relate to oil and gas production and are incurred by the Company's oil and gas producing divisions and subsidiaries. They include expenditures related to repairs of extraction equipment, labor costs, expenses on artificial stimulation of reservoirs, fuel and electricity costs, materials and goods consumed in oil and gas production, and other similar costs.

Expenses of the Company's oil and gas production units and subsidiaries consisting of the sale of services and goods (such as electricity, heat, etc.) that are unrelated to core activities, accretion of the Company's asset retirement obligations, and the change in crude oil and refined products inventory, have been excluded from extraction expenses and are included in other operating costs.

Lifting expenses averaged to RR 155 per barrel in 2008 compared to RR 120 per barrel in 2007. The increase of 29.1% is primarily a result of increases in equipment service costs, repair expenses and electricity tariffs.

Petrochemical production expenses. Petrochemical production expenses primarily include the costs of raw materials, labour, maintenance and electricity consumed in the production of petrochemical products. Cost of petrochemical products increased by 0.7% to RR 18,415 million in 2008 primarily due to increases in the electricity tariffs, salary and repair expenses. This growth was relatively insignificant due to the lower volume of tires and other petrochemicals produced in 2008 compared to the prior year.

Other operating expenses include accretion of the asset retirement obligation, change in crude oil and refined products inventory, and the costs of other services, goods and materials not related to the core oil and gas production activities of the Group. Other operating expenses decreased to RR 18,763 million, or by 2.1%, compared to 2007 due to decrease of costs of other services Also, other operating expenses in 2008 included part of revaluation of pension obligations of the Group to its employees in the amount of RR 855 mln.

Cost of purchased crude oil and refined products. A summary of purchased oil and refined products for 2008 and 2007, respectively, is as follows:

RR millions	**Year ended December 31, 2008**	**Year ended December 31, 2007**
Purchased refined products (RR millions)	38,046	29,938
Volume (thousand tons)	*2,331*	*2,403*
Average price per ton (RR)	*16,319*	*12,460*
Purchased crude oil (RR millions)	20,873	13,359
Volume (thousand tons)	*1,656*	*1,334*
Average price per ton (RR)	*12,603*	*10,014*
Total purchased oil and refined products	**58,919**	**43,297**

Purchases of refined products increased by 27% to RR 38,046 million in 2008 from RR 29,938 million in 2007 due to increase in average purchase price per ton by 31%.

Purchases of crude oil in 2008 increased by 56% to RR 20,873 million from RR 13,359 million in 2007 due to increase in volumes of purchased crude oil for trading by 24% as well as increase in average purchase price per ton by 26%.

Exploration expenses. Exploration expenses consist primarily of exploratory drilling, geological and geophysical costs, and the costs of carrying and retaining undeveloped properties. Exploration expenses increased to RR 3,770 million in 2008 from RR 1,577 million in 2007 mainly due to first-time consolidation of exploratory companies under provision of FIN 46R. Such activities have not yet resulted in the discovery of proved crude oil or gas reserves. Investments in these companies were previously accounted for under the equity method. Accumulated losses of these companies amounted to RR 1,455 million were recorded in our 2008 financial statements.

Transportation expenses. Transportation expenses relate to the delivery of our own crude oil production as well as purchased crude and refined products, which are primarily carried out using Transneft pipeline for deliveries of crude oil to our customers. Transportation costs increased by 37.1% to RR 11,556 million in 2008 from RR 8,431 million in 2007 due to an increase in transportation tariffs.

Selling, general and administrative expenses. Certain selling, general and administrative expenses are by nature fixed costs, which are not directly attributable to production, such as payroll, general business costs, insurance, advertising, share based compensation, legal fees, consulting and audit services, charity and other expenses, including bad debt provisions. Selling, general and administrative expenses increased by RR 14,222 million to RR 36,571 million in 2008 compared to 2007, primarily as a result of an increase in our bad debt provision on accounts receivables related to sales of crude oil to Ukraine prior to October 2007 in the amount of RR 10,786 million (see Commitments and Contingent Liabilities section on page 21). Also, Selling, general and administrative expenses in 2008 included part of revaluation of pension obligations of the Group to its top management in the amount of RR 803 mln.

Loss on disposals of property, plant and equipment and impairment of investments. Loss on disposals of property, plant and equipment and impairment of investments in 2008 amounted to RR 1,684 million compared to RR 5,253 million in 2007.

During 2008 the losses included the following charges:

- impairment under SFAS 144 provisions of US GAAP of long-lived assets of OAO LDS-1000, the owner and operator of an ice hockey arena in the city of Kazan, acquired in April 2006, in the amount of RR 2,587 million;
- provision related to indirect shareholding interests in Ukrtatnafta in the amount of RR 2,004 mln (see Commitments and Contingent Liabilities section on page 21);
- a write-off of an unrecoverable debt of a third-party company under liquidation in the amount of RR 960 million;
- accumulated prior years' losses of a company in petrochemical segment first time consolidated in the Group's financial statements in the amount of RR 689 million.

Taxes other than income taxes. Taxes other than income taxes include the following:

	Year ended December 31, 2008	Year ended December 31, 2007
Export duties	136,541	85,327
Unified production tax	77,235	58,049
Property tax	1,493	1,398
Excise taxes	328	300
Penalties and interest	121	205
Other	1,553	1,020
Total taxes other than income taxes	**217,271**	**146,299**

Taxes other than income taxes increased by 48.5% to RR 217,271 million in 2008 from RR 146,299 million in 2007. The increase was primarily a result of an increase in export duty and unified production tax rates, which are linked to crude oil market prices partly offset by introduction of differentiated rates of unified production taxes. In 2008 compared to 2007, our export duties increased by 60% compared to an increase in export duty rate by 72%. The Group's unified production tax increased by 33.1% compared to an increase in unified production tax rate by 35%. Our expenses on excise tax increased to RR 328 million from RR 300 million in the corresponding period of 2007, due to the increase in production and selling domestically of taxable refined products (mainly diesel fuel and gasoline). Other taxes include land tax and non-recoverable VAT.

Effective January 1, 2007, the base tax rate formula for unified production tax was modified to provide a benefit for fields whose depletion rate is 80% or above as determined under Russian resource classification. Under these new rules, the Company receives a benefit of 3.5% per field for each percent of depletion in excess of the 80% threshold. As Romashkinskoye field, the Company's largest, along with certain other fields are more than 80% depleted, the Company received a benefit in 2008 of RR 8.3 billion.

Since April 2008, the Company applied a zero unified production tax rate to production of highly viscous crude oil from Ashalchinskoye and Mordovo-Karmalskoye fields, resulting in the twelve months of 2008 tax benefit of RR 57 million.

Maintenance of social infrastructure and transfer of social assets. Social infrastructure expenses relate primarily to housing, schools and cultural buildings in Tatarstan. Maintenance of social infrastructure expenses and transfer of social assets increased to RR 4,258 million in 2008 from RR 2,340 million in 2007, which was mainly due to the disposal of a medical facility, a social asset of the Group, at the amount of RR 1,379 million.

Other income and loss

The Group recorded losses from equity investments amounted to RR 9,556 million in 2008 compared to a RR 5,789 million profit in 2007. This loss was mainly due to an increase of the IPCG Fund losses amounted to RR 9,470 million attributed to the Group compared to RR 4,545 million gain in 2007.

Our foreign exchange loss increased from RR 2,623 million in 2007 to RR 6,135 million in 2008 due to decrease of the average exchange rate of the Russian Ruble against the US dollar in 2008 compared to 2007. This loss was mainly due to foreign exchange loss in the amount of RR 6,582 million on US dollars denominated debt under secured credit facility for the construction of TANECO's refinery and petrochemical complex.

Interest income increased by 35% to RR 3,753 million in 2008 compared to 2007 due to more interest received on our short-term and long-term certificates of deposit. Interest expense increased from RR 60 million to RR 580 million in 2008 in comparison to 2007, which is a result of debt issuance (average debt increased in 2008 compared with 2007).

Other loss, net in 2008 amounted to RR 3,531 million compared with RR 4 million of other loss, net in 2007. The change is primarily due to realized losses recorded on our trading investments.

Reconciliation of net income to EBITDA (earnings before interest, income taxes, depreciation and amortization)

RR millions	**Year ended December 31, 2008**	**Year ended December 31, 2007**
Net income	8,413	43,279
Add back:		
Minority interest	399	1,076
Income tax expense	9,342	18,254
Depreciation, depletion and amortization	10,139	10,379
Interest expense	580	60
Interest and dividend income	(3,753)	(2,779)
EBITDA	**25,120**	**70,269**

EBITDA is a non-US GAAP financial measure, defined as net income before interest, taxes and depreciation and amortization. The Company believes that EBITDA provides useful information to investors because it is an indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions and other investments and our ability to incur and service debt. While depreciation and amortization are considered operating costs under US GAAP, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. Our EBITDA calculation is commonly used as a basis for some investors, analysts and credit rating agencies to evaluate and compare the periodic and future operating performance and value of companies within the oil and gas industry. EBITDA should not be considered in isolation as an alternative to net income, operating income or any other measure of performance under US GAAP. EBITDA does not consider our need to replace our capital equipment over time.

Credit ratings

In 2008, Fitch Ratings affirmed the Group's long –term foreign currency issuer default rating at BB with a stable outlook.

In 2008, Moody's assigned to the Group a corporate family rating at Ba2 with a stable outlook.

A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organization. Similar ratings on Tatneft and/or on different types of securities do not necessarily mean the same thing. The ratings do not address the marketability of any of our securities or their market price. Any change in the credit ratings of Tatneft or our securities could adversely affect the price that a subsequent purchaser will be willing to pay for our securities. We recommend that you analyze the significance of each rating independently from any other rating.

Financial Condition Summary Information

The following table shows certain key financial indicators:

RR millions	At December 31, 2008	At December 31, 2007
Current assets	116,620	126,595
Long-term assets	276,360	243,624
Total assets	**392,980**	**370,219**
Current liabilities	32,043	38,428
Long-term liabilities	96,078	63,233
Total liabilities	**128,121**	**101,661**
Shareholders' equity	**260,276**	**264,059**
Working capital	84,577	88,167
Current ratio	3.64	3.29

Working capital position

As of December 31, 2008 working capital of the Group amounted to RR 84,577 million compared to RR 88,167 million as of December 31, 2007. The decrease in the working capital is primarily attributable to a decrease in accounts receivable.

Liquidity and Capital Resources

The following table shows a summary from the Consolidated Statements of Cash Flows:

RR millions	Year ended December 31, 2008	Year ended December 31, 2007
Net cash provided by operating activities	47,852	48,033
Net cash used for investment activities	(61,735)	(39,624)
Net cash provided by/(used for) financing activities	14,291	(2,268)
Increase in cash and cash equivalents	408	6,141

Net cash provided by operating activities

Our primary source of cash flow is funds generated from our operations. Net cash provided by operating activities decreased by 0.4% to RR 47,852 million in 2008 from RR 48,033 million in 2007 primarily due to lower cash generation capacity of the Group in the fourth quarter.

Net cash used for investing activities

Net cash used for investing activities increased by 55.8% to RR 61,735 million in 2008 from RR 39,624 million in 2007, which is primarily due to an increase in spending for purchases of property, plant and equipment, mostly by TANECO.

Net cash provided by/ (used for) financing activities

Cash flow provided by financing activities amounted to RR 14,291 million in 2008 compared to RR 2,268 million used for financing activities in 2007. This is primarily due to net debt proceeds of RR 29,749 million in 2008 compared with net debt proceeds of RR 9,283 million in 2007.

Additions to property, plant and equipment

The following additions to property, plant and equipment (by segment) were made in 2008, compared to 2007:

RR millions	Year ended December 31, 2008	Year ended December 31, 2007
Exploration and production	23,391	19,445
Refining and marketing	26,613 [1]	10,754
Petrochemicals	6,263[2]	2,061
Corporate and other	4,207	2,175
Total additions to property, plant and equipment	**60,474**	**34,435**

[1] Includes RR 25,876 million expenditure related to the refinery construction by TANECO
[2] Includes RR 5,266 million expenditure related to the new metal cord tires production line

Analysis of Debt

At December 31, 2008, long-term debt, including the current portion of long-term debt, amounted to RR 44,889 million as compared to RR 9,326 million at December 31, 2007. The related increase is due to an increase in the long-term foreign currency denominated debt through disbursements under the US$ 2 bln secured credit facility for the construction of TANECO's refinery and petrochemical complex.

The aggregate maturities of total long-term debt, including current portion as of December 31, 2008 are as follows:

RR millions	At December 31, 2008
2009	76
2010	43,736
2011	1,046
2012	-
2013 and thereafter	31
Total long-term debt	**44,889**

Contractual obligations, other contingencies and off balance sheet arrangements

Social commitments

The Group contributes significantly to the maintenance of local infrastructure and the welfare of its employees within Tatarstan, which includes contributions towards the construction, development and maintenance of housing, hospitals and transport services, recreation and other social needs. Such funding is periodically determined by the Board of Directors after consultation with governmental authorities and recorded as expenditures when incurred.

Guarantees

The Group has no outstanding guarantees at December 31, 2008 and 2007.

Commitments and Contingent Liabilities

The Group is subject to various lawsuits and claims arising in the ordinary course of business. The outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present. In the case of all known contingencies the Group accrues a liability when the loss is probable and the amount is reasonably estimable. Based on currently available information, management believes that it is remote that future costs related to known contingent liability exposures would have a material adverse impact on the Group's consolidated financial statements.

Ukrtatnafta

Historically, and in particular during 2007, there have been a number of attempts by Ukraine to challenge AmRUZ and Seagroup's acquisition of shares in Ukrtatnafta, and in particular, by the State Property Fund and NJSC Naftogaz of Ukraine ("Naftogaz"). Naftogaz is 100% owned by the Ukrainian Government and also owner of record of 43% Ukrtatnafta's common shares.

The challenges were suspended in April 2006 when the Supreme Court of Ukraine ruled the payment for Ukrtatnafta shares made with promissory notes issued by AmRUZ and Seagroup was lawful. However, in May 2007 the Ministry of Fuel and Energy of Ukraine ("MFEU") resumed its attempts and, as a result, succeeded in obtaining alleged and doubtful court decisions, after which it announced the transfer into Naftogaz's custody the 18.3% of Ukrtatnafta's shares, representing the entire holdings of AmRUZ and Seagroup in Ukrtatnafta. Subsequent to these actions, MFEU effectively began to exclude the Group from exercising their shareholder rights related to Ukrtatnafta.

In October 2007 the existing management of Ukrtatnafta, as appointed by its shareholders, was forcibly removed based on an alleged court order. Subsequently, individuals who obtained the ability to manage Ukrtatnafta took certain actions effectively assisting MFEU in taking control over the shares in Ukrtatnafta owned by SeaGroup and AmRUZ. In addition, Ukrtatnafta subsequently refused to settle its payables to ChMPKP Avto, a Ukrainian intermediary that previously purchased crude from the Group for deliveries to Ukrtatnafta. Following this forced change of control of Ukrtatnafta, the Company (originally the key crude supplier to the Kremenchug refinery) suspended its crude oil deliveries to Ukrtatnafta and initiated legal proceedings against the Ukrainian owners in international arbitration.

In May 2008, Tatneft commenced international arbitration against Ukraine on the basis of the agreement between the government of the Russian Federation and the Cabinet of Ministries of Ukraine on the Encouragement and Mutual Protection of Investments of November 27, 1998 ("Russia-Ukraine BIT"). The arbitration concerns losses suffered by Tatneft as a consequence of the forcible takeover of Ukrtatnafta. Tatneft requested the arbitral tribunal declare Ukraine has breached the Russian-Ukraine BIT and to order MFEU to restore Ukrtatnafta's lawful management and pay compensation in excess of US$1.1 billion. The Group is in the process of preparing similar requests for arbitration on behalf of Seagroup and AmRUZ.

On September 4, 2008, the Business Court of the City of Kiev, at the request of the General Prosecutor's Office, ruled to liquidate Ukrtatnafta, effectively requiring a return on initial shareholder contributions, including any cash contributions and reversion of the Kremenchug refinery assets to the Ukraine shareholders. This decision has not become effective and is currently under appeal.

There are a number of legal proceedings currently in process in the Ukraine, Russian Federation and International courts to recover the Group's assets. As of December 31, 2008 there have been no additional material developments with any of the legal proceedings described above. As a result of the ongoing legal dispute over shareholding interests, in 2008 the Company fully provided for its indirect investments in Ukrtatnafta.

Quantitative and qualitative disclosures about market risks

We are exposed to market risk from changes in both foreign currency exchange rates and interest rates. We are exposed to foreign exchange risk to the extent that our costs are denominated in currencies other than rubles. We are subject to market risk from changes in interest rates that may affect the cost of our financing. We do not use financial instruments, such as foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage these market risks. We also do not hold or issue derivative or other financial instruments for trading purposes.

Interest rate risk

We are exposed to interest rate risk on our indebtedness that bears interest at floating rates and to a lesser extent, on our indebtedness that bears interest at fixed rates. At December 31, 2008 we had approximately RR 50,679 million in loans outstanding, of which approximately RR 3,819 million bore interest at fixed rates and approximately RR 46,860 million bore interest at floating rates determined by reference to the LIBOR for US dollar deposits (for details please refer to Note 13 "Debt" of the audited consolidated financial statements).

We undertake debt obligations to support general corporate purposes including capital expenditures and working capital needs. Upward fluctuations in interest rates increase the cost of new debt and the interest cost of outstanding variable rate borrowings. Fluctuations in interest rates can also lead to significant fluctuations in the fair value of our debt obligations. However, our sensitivity to decreases in interest rates and corresponding increases in the fair value of our debt portfolio would unfavorably affect our results and cash flows only to the extent that we elected to repurchase or otherwise retire all or a portion of our fixed-rate debt portfolio at prices above carrying value.

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the ruble relative to the US dollar. At December 31, 2008, approximately RR 49,825 million of our indebtedness was denominated in US dollars (out of approximately RR 50,624 million of our total indebtedness at that date). Depreciation in the value of the ruble relative to the US dollar will increase the cost in rubles of our foreign currency denominated costs and expenses and of our debt service obligations for foreign currency denominated indebtedness. A depreciation of the ruble relative to the US dollar will also result in foreign exchange losses as the ruble value of our foreign currency denominated indebtedness is increased. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a significant portion of our revenues are US dollar denominated and thus more closely match our foreign currency costs and debt service obligations. Furthermore, accounts receivable of RR 10,913 million at December 31, 2008 were also US dollar based and serve to mitigate our exposure to foreign currency fluctuations. As of December 31, 2008, the ruble had depreciated against the US dollar by approximately 19.7% since December 31, 2007. We recognized a net foreign currency translation loss of RR 6,135 million in 2008.

Commodity instruments

Substantially all of our crude oil and refined products are sold on the spot market or under short-term contracts at market sensitive prices. Market prices for export sales of crude oil and refined products are subject to volatile trading patterns in the commodity futures market. Average selling prices can differ from quoted market prices due to the effects of uneven volume distributions during the period, quality differentials, different delivery terms compared to quoted benchmarks, different conditions in local markets and other factors. Domestic prices generally follow the trend of world market prices but are volatile due to the nature of the Russian market. We do not use any derivative instruments to hedge our production in order to decrease our price risk exposure.

Critical accounting policies

The preparation of consolidated financial statements in conformity with US GAAP requires management to select appropriate accounting policies and to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities. For a full description of our significant accounting policies, please refer to Note 3 of our audited consolidated financial statements.

Forward-looking statements

Certain statements in this report are not historical facts and are ‘‘forward-looking’’ (as such term is defined in the US Private Securities Litigation Reform Act of 1995). We may from time to time make written or oral forward-looking statements in reports to shareholders and in other communications. Examples of such forward-looking statements include, but are not limited to:

- projections of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios;
- statements of our plans, objectives or goals, including those related to products or services;
- statements of future economic performance; and
- statements of assumptions underlying such statements.

Words such as ‘‘believes,’’ ‘‘anticipates,’’ ‘‘expects,’’ ‘‘intends’’ and ‘‘plans’’ and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution readers that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements.

These factors include:

- inflation, interest rate, and exchange rate fluctuations;
- the price of oil;
- the effect of, and changes in, Russian or Tatarstan government policy;
- the effect of terrorist attack or other geopolitical instability, either within Russia or elsewhere;
- the effects of competition in the geographic and business areas in which we conduct operations;
- the effects of changes in laws, regulations, taxation or accounting standards or practices;
- our ability to increase market share and control expenses;
- acquisitions or divestitures;
- technological changes; and
- our success at managing the risks of the aforementioned factors.

This list of important factors is not exhaustive; when relying on forward-looking statements to make decisions with respect to our shares or Global Depositary Shares (GDSs), investors and others should carefully consider the foregoing factors and other uncertainties and events, especially in light of the difficult political, economic, social and legal environment in which we operate. Such forward-looking statements speak only at the date on which they are made, and we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.