Management's Discussion and Analysis

The following discussion should be read in conjunction with the unaudited interim condensed 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 tonnes 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 tonnes using the blended rate may differ from total reserves and production calculated on a field by field basis. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per cubic meter. Translations of barrels of crude oil into barrels of oil equivalent ("BOE") were made at the rate of 1 barrel per BOE and of cubic feet into BOE at the rate of 6 thousand cubic feet per BOE.

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 involved in petrochemical (tires) production and expanding its activities to further develop its refining segment.

As of June 30, 2011 and December 31, 2010 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.

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.

Key financial and operational results

	Six months ended June 30, 2011	Change	Six months ended June 30, 2010
Sales (millions of RR)	293,990	36.99%	214,611
Net income attributable to Group shareholders (millions of RR)	39,467	148.85%	15,860
EBITDA (*) (millions of RR)	58,525	96.67%	29,758
Basic and Diluted net income per share of common stock (RR)			
Common…………….	17.40	148.2%	7.01
Preferred……………...	17.37	149.9%	6.95
Crude oil production by the Group (thousands of tonnes)	12,983	0.3%	12,939
Crude oil production by the Group (thousands of barrels)	92,476	0.3%	92,162
Gas production by the Group (millions of cubic meters)	459.7	14.2%	402.5
Refined gas products produced (thousands of tonnes)	549.9	4.8%	524.8

(*) *As defined on page 14*

Our net income for the first half of 2011 was RR 39,467 million, which is RR 23,607 million, or more than two times higher compared to the corresponding period of 2010. Our net income grew mostly due to higher crude oil market prices, however was affected by increased costs, mainly taxes other than income tax.

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 the Company.

- **Refining and marketing** – consists of the Company's sales and marketing division (URNIN), our participation in OAO TANECO, a company established to build and operate a refining and petrochemical complex in Nizhnekamsk, Tatarstan; our gas production, transportation and refining division Tatneftegaspererabotka; OOO Tatneft-AZS-Center, OOO Tatneft-AZS-Zapad, OOO Tatneft-AZS-Sibir and OOO Tatneft-AZS-Yug, which manage the Tatneft branded gas stations network in Russia and carry out refined products wholesale sales; 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.

Operational highlights

Crude oil and gas production

Tatneft undertakes exploration and production activities in Tatarstan and outside of Tatarstan in Russia: in Samara, Orenburg and Ulyanovsk regions, in the Kalmyk Republic, and Nenets Autonomous District. The table below summarizes key results of our exploration and production activities (daily volumes represent year average):

	Six months ended June 30, 2011	Six months ended June 30, 2010
Crude oil daily production (thousand bbl per day)	510.9	509.2
Gas daily production (thousand boe per day)	14.9	13.1
Crude oil extraction expenses (RR per bbl)	175.5	151.9
	(RR millions)	
Sales of crude oil	243,826	173,483
Crude oil extraction expenses	16,230	13,996
Exploration expenses	999	941
Unified production tax	46,245	32,766

Crude oil production of the Group (including production of consolidated subsidiaries OAO Ilekneft, OOO Tatneft-Samara, ZAO Tatneft-Severny) increased by 0.3% to 12.98 million metric tonnes in the first half of 2011 compared to the first half of 2010. Our gas production increased by 14.2% to 459.7 million cubic meters in the first half of 2011 from 402.5 million cubic meters in the corresponding period of 2010.

Refining and marketing

	Six months ended June 30, 2011	Six months ended June 30, 2010
Refining of crude oil throughput (thousand bbl per day)	13.18	10.03
Refining of gas products throughput (thousand boe per day)	11.28	10.82
Number of petrol (gas) stations in Russia*	506	490
Number of petrol (gas) stations outside of Russia*	128	136

** including rented stations*

Export of crude oil from Russia

The Group is using transportation services of Transneft, the state-owned monopoly owner and operator of Russia's trunk crude oil and export pipelines, upon export of its crude oil. During the first half of 2011, the Group exported from Russia approximately 71% of all its crude oil sold compared to approximately 68% in the corresponding period of 2010.

In the first half of 2011 the Company delivered 58% (52% in the first half of 2010) of its own crude oil for export through Transneft's Druzhba pipeline (mainly to Poland, Hungary and Germany); 34% (31% in the first half of 2010) of crude oil was shipped through Russian Black Sea ports (mainly Novorossiysk) and 8% (14% in the first half of 2010) of crude oil exported through Baltic Sea port Primorsk.

Certain Macroeconomic and Other 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 impacted by various factors outlined below.

Crude oil prices

The primary driver of our revenue is the selling price of crude oil and refined products. In the first half of 2011 growth of crude oil prices in comparison to the corresponding period of 2010 was caused mainly by speculative factors as market reaction to the political instability in the Middle East and Northern Africa as well as expectations relating to the growth of world economy. During the first half of 2011, Brent crude oil price fluctuated between $93 and $127 per barrel and averaged U.S. $111.2 per barrel.

Substantially all the crude oil we sell on export and domestic markets is Urals blend. The table below shows average and the end of the period crude oil prices for the first six months of 2011 and 2010, respectively.

	Average for the six months ended June 30		Change	At June 30		Change
	2011	2010		2011	2010	
	(in US dollars per barrel, except for figures in percent)					
Brent crude	111.2	77.3	*43.9%*	114.5	75.0	*52.8%*
Urals crude (*CIF Mediterranean*)*	108.1	76.1	*42.0%*	110.0	73.7	*49.3%*
Urals crude (*CIF Rotterdam*)*	108.1	76.1	*42.1%*	110.2	74.9	*47.2%*

Source: Platts

* The Company sells crude oil for export on various delivery terms. Therefore, our average realized sales prices differ from average reported market prices.

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 sold on previously agreed terms, offered for sale in the domestic market at prices determined on a transaction-by-transaction basis. However, there may be significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions.

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 oil companies are dependent on the extent of diversification of transport infrastructure and access to it. Thus, transportation cost is an important 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 some 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 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.

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 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 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 in the inflatory economy 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 or devaluation 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.

	Six months ended June 30, 2011	**Six months ended June 30, 2010**
Ruble inflation	5.0%	4.4%
Period-end exchange rate (Ruble to US$)	28.08	31.20
Average exchange rate (Ruble to US$)	28.62	30.07
Nominal appreciation (devaluation) of the Ruble	7.9%	(3.1)%
Real Ruble appreciation	14.0%	1.2%

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

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

Taxation

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

	Six months ended June 30, 2011	**Six months ended June 30, 2010**	**Change**	**Taxable base**
Income tax – maximum rate	20%	20%	-	Taxable income
VAT	18%	18%	-	Added value
Property tax – maximum rate	2.2%	2.2%	-	Taxable property
	(in RR per metric tonne, except for figures in percent)			
Unified production tax, average rates[(1)]	4,278	2,928	*46.1%*	Metric tonne produced (crude oil)
	(in US $ per metric tonne, except for figures in percent)			
Crude oil export duty, average rates	394.8	272.7	*44.8%*	Metric tonne exported
Refined products export duty average rates:				
Gasoline[(2)]	301.8	196.1	*53.9%*	
Straight-line gasoline[(2)]	284.6	196.1	*45.1%*	
Light and middle distillates, gasoils	266.8	196.1	*36.0%*	Metric tonne exported
Fuel oil *(mazut)*	179.9	105.6	*70.3%*	

[(1)] *Without taking into account differentiated taxation*
[(2)] *Starting from May 1, 2011 the Russian Government introduced a special export duty on gasoline. Starting from June 1, 2011 the Russian Government introduced a special export duty on straight-line gasoline.*

According to the legislation introduced at the end of 2010 the excise tax rates on the refined products were increased and linked to the environmental characteristics of the products.

	Six months ended June 30, 2011	Six months ended June 30, 2010	Change	Taxable base
(in RR per metric tonne, except for figures in percent)				
Gasoline:				
Low octane gasoline below Euro-3	5,995	2,923	*105.1%*	Metric tonne produced and sold domestically [1]
High octane gasoline below Euro-3	5,995	3,992	*50.2%*	
High octane gasoline Euro-3	5,672	3,992	*42.1%*	
High octane gasoline Euro-4,5	5,143	3,992	*28.8%*	
Straight-line gasoline	6,089	4,290	*41.9%*	
Diesel fuel:				
Diesel below Euro- 3	2,753	1,188	*131.7%*	
Diesel Euro-3	2,485	1,188	*109.2%*	
Diesel Euro-4,5	2,247	1,188	*89.1%*	
Motor oils	4,681	3,246	*44.2%*	

(1) *The responsibility to pay excise taxes on refined products in Russia is imposed on refined product producers (except for straight-line gasoline).*

Starting from May 1, 2011 the Russian Government introduced a special export duty on gasoline equivalent to 90% of the export duty on crude oil. Starting from June 1, 2011 the Russian Government introduced a special export duty on straight-line gasoline equivalent to 90% of the export duty on crude oil. As of the date of this report there was no guidance on how long the increased rates will be in place.

Due to increase in international crude oil prices the tax rates specific to the oil industry increased substantially during the first half of 2011 compared to the corresponding period of 2010. Unified production tax rate increased by 46%, average crude oil export duty rate by 45% and average refined products export duty rate by 62%.

The increase in unified production tax rate and crude oil and refined products export duties in the first half of 2011 was a result of increase in the average Urals crude price by 42%. Excise taxes on refined products increased in the first half of 2011 by 58% on average.

Unified production tax rate. The base tax rate for the production of oil was set at RR 419 per metric tonne and is adjusted depending on the international market price of Urals blend and the ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period is less than or equal to $15.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($15.00 per barrel) results in an increase of the tax rate by $1.61 per tonne extracted (or $0.22 per barrel extracted using a barrels per tonne conversion factor of 7.33).

The base rate for 2012 and 2013 is currently set at 446 rubles and 470 rubles per metric tonne extracted, respectively. However, the rate may be amended by the authorities later on.

This tax rate is applied with a discount based on the levels of international oil prices and the levels of depletion of the related oil fields as determined under Russian reserves classification guidelines. Such formula benefits producers with oil fields having a depletion level 80% and above as determined by the Russian reserves classification. 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 the first half of 2011 of RR 8.0 billion (RR 4.9 billion in the first half of 2010).

Effective from January 1, 2009, the list of regions where, depending on the period and volume of production, a zero crude oil production tax rate applies has been extended. In particular, it now includes Caspian offshore and the Nenets Autonomous District (the Company has operations in the latter).

Also a zero unified production tax rate applies to the production of highly viscous crude oil (defined as crude oil of more than 200 Megapascal second in 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 (bitumen) from the Ashalchinskoye, Mordovo-Karmalskoye, Chernoozerskoye and Vishyevo-Polyanskoye fields was subject to a zero unified production tax rate, resulting in tax benefit during the first half of 2011 attributed to that production of RR 300 million (RR 34 million in the first half of 2010).

Crude oil export duties. The Government determines the export duty rate, which is dependent on the average Urals price for the monitoring period and cannot exceed the following levels:

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

Effective from October 1, 2011 the Government sets the export duty for crude oil at a marginal rate of 60%.

The crude oil export duty rate is revised monthly on the basis of monitoring of crude oil prices for preceding one-month period between the 15th day of each calendar month and the 14th day of the following calendar month (inclusive).

The export duty rate on crude oil increased by 45% in the first half of 2011 to US$ 394.8 per tonne (US$ 54.1 per barrel) from US$ 272.7 per tonne (US$ 37.4 per barrel) in the corresponding period of 2010. The increase in these comparative periods was associated with the increase of Urals prices by 42% to US$ 108.1 per barrel in the first half of 2011 compared to US$ 76.1 per barrel in the corresponding period of 2010.

Refined products export duties. Export customs duty on refined products is set every month by the Government simultaneously with the export customs duty on crude oil and is denominated in US$ per tonne. The rate of the export customs duty on refined products is linked to the crude oil export duty rate. At the moment, the rate of the export customs duty depends on the type of the product: light (gasoline, diesel, jet fuel, etc.) or dark (fuel oil, etc.).

Prior to 2011, export customs duty on light refined products was calculated using the following formula: 0.438 * (Price * 7.3 – 109.5), where Price is the average Urals price in the US dollar per barrel. Export customs duty on dark refined products was calculated using the following formula: 0.236 * (Price * 7.3 – 109.5).

Starting from February 2011, the export duty rate on oil products is determined by the Government by applying a coefficient to the rate on crude oil.

On August 26, 2011, The Government issued a decree No. 716 introducing new maximum coefficients applied to each type of oil product which took effect on October 1, 2011.

	The current maximum coefficients (effective until October 1, 2011)	Maximum coefficients effective from October 1, 2011 (per Decree No. 716 of August 26, 2011)
Diesel and Jet oil	0.670	0.660
Fuel oil	0.467	0.660
Oil lubricants	0.467	0.660
Gasoline	0.900	0.900

Property tax. The maximum property tax rate in Russia is 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. Starting from January 1, 2009, the total income tax rate was decreased to 20%, including federal part which decreased to 2.0% and the regional part which varies between 13.5% and 18.0%.

Six months ended June 30, 2011 compared to the six months ended June 30, 2010

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

RR millions	Six months ended June 30, 2011 (unaudited)	Six months ended June 30, 2010 (unaudited)	Change
Sales and other operating revenues	**293,990**	**214,611**	**37%**
Costs and other deductions			
Operating	33,317	28,184	18.2%
Purchased oil and refined products	34,377	27,309	25.9%
Exploration	999	941	6.2%
Transportation	8,863	8,004	10.7%
Selling, general and administrative	14,515	13,031	11.4%
Depreciation, depletion and amortization	6,561	6,671	(1.6)%
Loss/ (gain) on disposals of property, plant and equipment and investments and impairments	594	(336)	276.8%
Taxes other than income taxes	145,348	101,272	43.5%
Maintenance of social infrastructure and transfer of social assets	1,753	1,956	(10.4)%
Total costs and other deductions	**246,327**	**187,032**	**31.7%**
Earnings from equity investments	304	28	985.7%
Foreign exchange gain / (loss)	4,377	(3,539)	223.7%
Interest income	1,518	2,006	(24.3)%
Interest expense, net of amounts capitalized	(457)	(215)	112.6%
Other expenses, net	(380)	(981)	(61.3)%
Total other income / (expense)	**5,362**	**(2,701)**	**298.5%**
Income before income taxes and non-controlling interest	**53,025**	**24,878**	**113.1%**
Current income tax expense	(11,357)	(6,824)	66.4%
Deferred income tax expense	(970)	97	(1,100)%
Total income tax expense	**(12,327)**	**(6,727)**	**83.2%**
Net income	**40,698**	**18,151**	**124.2%**
Less: net income attributable to non-controlling interest	(1,231)	(2,291)	(46.3)%
Net income attributable to Group shareholders	**39,467**	**15,860**	**148.8%**

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 type) is provided in the following table:

RR millions	Six months ended June 30, 2011	Six months ended June 30, 2010
Crude oil	243,826	173,483
Refined products	26,361	22,846
Petrochemicals	13,255	10,475
Corporate and other sales	10,548	7,807
Total sales and other operating revenues	**293,990**	**214,611**

Sales and other operating revenues increased in the first half of 2011 by 37% to RR 293,990 million from RR 214,611 million in the corresponding period of 2010. The increase was mainly attributed to an overall increase in crude oil and refined product prices.

Sales of crude oil

Sales of crude oil increased by 40.5% to RR 243,826 million in the first half of 2011 from RR 173,483 million in the corresponding period of 2010. The table below provides an analysis of the changes in sales of crude oil:

	Six months ended June 30, 2011	Change	Six months ended June 30, 2010
Domestic sales of crude oil			
Revenues (RR millions)	38,074	*19%*	31,985
Volume (thousand tonnes)	*3,950*	*(12)%*	*4,490*
Realized price (RR per tonne)	*9,639*	*35.3%*	*7,124.0*
CIS export sales of crude oil [1]			
Revenues (RR millions)	7,729	*(38.2)%*	12,500
Volume (thousand tonnes)	*708*	*(51.5)%*	*1,459*
Realized price (RR per tonne)	*10,916.7*	*27.4%*	*8,567.5*
Non-CIS export sales of crude oil			
Revenues (RR millions)	198,023	*53.5%*	128,998
Volume (thousand tonnes)	*8,937*	*11%*	*8,051*
Realized price (RR per tonne)	*22,157.7*	*38.3%*	*16,022.6*

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

Sales of refined products

Sales of refined products increased by 15.4% to RR 26,361 million in the first half of 2011 from RR 22,846 million in the corresponding period of 2010. The table below provides an analysis of the changes in sales of refined products:

	Six months ended June 30, 2011	Change	Six months ended June 30, 2010
Domestic sales of refined products			
Revenues (RR millions)	22,268	*18.7%*	18,761
Volume (thousand tonnes)	*1,230*	*1.3%*	*1,214*
Realized price (RR per tonne)	*18,104.1*	*17.1%*	*15,453.9*
CIS export sales of refined products			
Revenues (RR millions)	615	*(43.9)%*	1,096
Volume (thousand tonnes)	*33*	*(34)%*	*50*
Realized price (RR per tonne)	*18,636.4*	*(15)%*	*21,920*
Non-CIS export sales of refined products			
Revenues (RR millions)	3,478	*16.4%*	2,989
Volume (thousand tonnes)	*142*	*(24.5)%*	*188*
Realized price (RR per tonne)	*24,493*	*54.1%*	*15,898.9*

Sales of petrochemical products

The table below provides an analysis of petrochemical products sales.

RR millions	Six months ended June 30, 2011	Change	Six months ended June 30, 2010
Tires sales	12,663	*27%*	9,971
Other petrochemicals sales	592	*17.5%*	504
Total sales of petrochemical products	**13,255**	***26.5%***	**10,475**

The increase in sales of petrochemical products was primarily due to the higher volumes of tires sold. The Group's production of tires in the first half of 2011 increased by 6.4% compared to the corresponding period of 2010 and amounted to 5.6 million tires.

Other sales

Other sales increased by 35.1% to RR 10,548 million in the first half of 2011 from RR 7,807 million in the corresponding period of 2010. Other sales primarily represent sales of materials and equipment, various oilfield services (such as drilling, well construction and repairs, and geophysical works) and sales of energy, water and steam provided by the Group entities to third parties. The increase in the first half of 2011 of other sales was mainly attributable to the increased sales of energy, water and steam.

Costs and other deductions

Operating expenses. Operating expenses include the following costs:

RR millions	Six months ended June 30, 2011	Six months ended June 30, 2010
Crude oil extraction expenses	16,230	13,996
Petrochemical production expenses	10,955	9,324
Other operating expenses	6,412	4,913
Operating expenses not matched to the revenue in the current period *	(280)	(50)
Total operating expenses	**33,317**	**28,183**

** This change includes extraction expenses related to crude oil produced by the Group in one period but sold to third parties in the different reporting period.*

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 maintenance services, repairs and insurance of extraction equipment, labour 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 purchase of services and goods that are unrelated to their core activities (such as electricity, heat, etc.), 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 175.5 per barrel in the first half of 2011 compared to RR 151.9 per barrel in the corresponding period of 2010. Higher electricity and energy costs were the primary reasons for a 15.6% increase in lifting expenses in the first half of 2011 compared to the corresponding period of 2010.

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 to RR 10,955 million by 17.5% in the first half of 2011 compared to the corresponding period of 2010 primarily due to increase in volumes of petrochemicals produced and higher costs of raw materials and electricity.

Other operating expenses include accretion of the asset retirement obligation 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 increased to RR 6,412 million, or by 30.5%, compared to the corresponding period of 2010 which related to the increase of other sales by 35.1%.

Cost of purchased crude oil and refined products. A summary of purchased oil and refined products for the first half of 2011 and 2010, respectively, is as follows:

RR millions	**Six months ended June 30, 2011**	**Six months ended June 30, 2010**
Purchased crude oil (RR millions)	17,521	12,505
Volume (thousand tonnes)	1,203	1,577
Average price per tonne (RR)	*14,564*	*7,930*
Purchased refined products (RR millions)	16,856	14,804
Volume (thousand tonnes)	*797*	*925*
Average price per tonne (RR)	*21,149*	*16,004*
Total purchased oil and refined products	**34,377**	**27,309**

Purchases of crude oil increased in the first half of 2011 compared to the corresponding period of 2010 due to higher market prices for such purchased crude oil.

Purchases of refined products increased by 14% to RR 16,856 million in the first half of 2011 from RR 14,804 million in the corresponding period of 2010 due to increase in average purchase price per tonne by 32% partly offset by decrease in volumes of purchased refined products for trading by 14%.

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 999 million in the first half of 2011 from RR 941 million in the corresponding period of 2010.

Transportation expenses. Transportation expenses relate to the delivery of our own crude oil produced as well as purchased crude oil and refined products, which are mostly carried out using the Transneft trunk pipeline system. Transportation costs increased by 10.7% to RR 8,863 million in the first half of 2011 from RR 8,004 million in the corresponding period of 2010.

Selling, general and administrative expenses. Certain selling, general and administrative expenses are by nature fixed costs, which are not directly related 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 1,484 million to RR 14,515 million in the first half of 2011 compared to the corresponding period of 2010.

Loss/ (gain) on disposals of property, plant and equipment and impairment of investments. In the first half of 2011 we recorded a loss on disposals of property, plant and equipment and impairment of investments amounted to RR 594 million compared to a RR 336 million gain in the corresponding period of 2010. The loss in the first half of 2011 primarily included a loss from disposal of one of our long-term cost investment in the amount of RR 326 million.

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

	Six months ended June 30, 2011	Six months ended June 30, 2010
Export duties	97,152	66,338
Unified production tax	46,245	32,766
Property tax	981	972
Excise taxes	314	165
Penalties and interest	14	12
Other	642	1,019
Total taxes other than income taxes	**145,348**	**101,272**

Taxes other than income taxes increased by 43.5% to RR 145,348 million in the first half of 2011 from RR 101,272 million in the corresponding period of 2010. The increase was primarily a result of higher export duty and unified production tax rates, which are linked to crude oil market prices. In the first half of 2011 compared to the corresponding period of 2010, export duties, paid by the Group, increased by 46.4%. The Group's unified production tax expense increased by 41.1%. Our expenses on excise taxes increased to RR 314 million from RR 165 million in the corresponding period of 2010 due to increase of the statutory excise tax rates. Other taxes include land tax and non-recoverable VAT.

Effective January 1, 2007, the 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 reserves 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 is more than 80% depleted, the Company received a benefit in the first half of 2011 of RR 8.0 billion in comparison to RR 4.9 billion in the corresponding period of 2010, driven mainly by a fluctuation in crude oil prices in the respective periods.

Since April 2007, a zero unified production tax rate is applied to the production of highly viscous crude oil (bitumen) from the Company's Ashalchinskoye, Mordovo-Karmalskoye, Chernoozerskoye and Vishyevo-Polyanskoye fields, resulting in the first half of 2011 in tax benefit of RR 300 million in comparison to RR 34 million in the corresponding period of 2010.

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 decreased to RR 1,753 million in the first half of 2011 from RR 1,956 million in the corresponding period of 2010.

Other income

Changes in other income include mainly changes in earnings (losses) from equity investments and foreign exchange gain.

The Group recorded a gain from equity investments amounted to RR 304 million in the first half of 2011 compared to RR 28 million gain in the corresponding period of 2010. The increase was due to the gain from equity participation in crude oil producing entities, RR 69 million which was attributed to the Group in the first half of 2011 in comparison to RR 29 million losses in the corresponding period of 2010. Also gain in the corresponding period of 2010 was affected by a loss received from the Group's investment in IPCG Fund (RR 362 million) prior to the Group's redemption of its participation shares in the Fund in the first quarter of 2010.

The Group also recorded foreign exchange gain amounted to RR 4,377 million in the first half of 2011 compared to a foreign exchange loss of RR 3,539 million in the corresponding period of 2010. This period's gain was mainly due to foreign exchange gain in the amount of RR 7,349 million on US dollars denominated debt incurred under the long-term credit facilities of the Group, partly offset by foreign exchange loss on dollar denominated sales of crude oil.

Interest income decreased by 24.3% to RR 1,518 million in the first half of 2011 compared to the corresponding period of 2010.

Interest expense, net of amounts capitalized, increased from RR 215 million to RR 457 million in the first half of 2011 in comparison to the same period of 2010, which was a result of interest accrued on our ruble exchange bonds.

Other expense, net, in the first half of 2011 amounted to RR 380 million compared with RR 981 million of other expense, net, in the corresponding period of 2010.

Income taxes

The effective income tax rate in the first half of 2011 was 23.2%, compared to the statutory tax rate of 20% in the Russian Federation. This difference was due to non deductible or partially deductible expenses incurred during the reporting period.

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

RR millions	Six months ended June 30, 2011	Six months ended June 30, 2010
Net income attributable to Group shareholders	39,467	15,860
Add back:		
Non-controlling interest	1,231	2,291
Income tax expense	12,327	6,727
Depreciation, depletion and amortization	6,561	6,671
Interest expense	457	215
Interest income	(1,518)	(2,006)
EBITDA	**58,525**	**29,758**

EBITDA is a non-US GAAP financial measure, defined as net income before interest, taxes, 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 by 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.

Financial Condition Summary Information

The following table shows certain key financial indicators:

RR millions	At June 30, 2011	At December 31, 2010
Current assets	135,549	132,557
Long-term assets	454,592	434,622
Total assets	**590,141**	**567,179**
Current liabilities	94,935	80,836
Long-term liabilities	115,741	135,797
Total liabilities	**210,676**	**216,633**
Shareholders' equity	**379,465**	**350,546**
Working capital	40,614	51,721

Working capital position

As of June 30, 2011 working capital of the Group amounted to RR 40,614 million compared to RR 51,721 million as of December 31, 2010. The decrease in the working capital was attributable to an increase of current liabilities mainly dividends payable.

Liquidity and Capital Resources

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

RR millions	Six months ended June 30, 2011	Six months ended June 30, 2010
Net cash provided by operating activities	43,745	28,379
Net cash used for investment activities	(24,551)	(34,291)
Net cash (used for) /provided by financing activities	(12,916)	16,747
Increase in cash and cash equivalents	6,278	10,835

Net cash provided by operating activities

Our primary source of cash flow is funds generated from our operations. Net cash provided by operating activities increased by 54.1% to RR 43,745 million in the first half of 2011 from RR 28,379 million in the corresponding period of 2010 which is explained primarily through higher net income earned in the first half of 2011.

Net cash used for investing activities

Net cash used for investing activities decreased by 28.4% to RR 24,551 million in the first half of 2011 from RR 34,291 million in the corresponding period of 2010, which was primarily due to decrease in expenditures related to the construction of TANECO's refinery.

Net cash (used for) / provided by financing activities

Cash flow used for financing activities amounted to RR 12,916 million in the first half of 2011 compared to RR 16,747 million provided by financing activities in the corresponding period of 2010. This was primarily due to net debt repayments of RR 12,737 million in the first half of 2011 compared with net debt proceeds of RR 17,028 million in the corresponding period of 2010.

Additions to property, plant and equipment

The following additions to property, plant and equipment (by segment) were made in the first half of 2011, compared to the corresponding period of 2010:

RR millions	Six months ended June 30, 2011	Six months ended June 30, 2010
Exploration and production	9,907	8,080
Refining and marketing	17,607 (1)	29,647
Petrochemicals	149	925
Corporate and other	988	711
Total additions to property, plant and equipment	**28,651**	**39,363**

(1) *Includes RR* 16,240 *million expenditures related to the refinery construction in Nizhnekamsk*

Analysis of Debt

At June 30, 2011, long-term debt, including the current portion of long-term debt, amounted to RR 87,948 million as compared to RR 105,294 million at December 31, 2010. The decrease was mainly attributed to foreign exchange gain due to appreciation of Ruble against US Dollar as well as scheduled repayments under a dual (3 and 5 year) tranches secured syndicated pre-export credit facility for up to US$ 1.5 billion arranged in October 2009 and a triple (3, 5 and 7 year) tranches secured credit facility for up to USD 2 billion arranged in June 2010. The amounts outstanding, including the current portion, under these loans as of June 30, 2011 and December 31, 2010 were RR 26,135 million (US$ 931 million) and RR 37,043 million (US$ 1,215 million), respectively, for the facility arranged in 2009, and RR 54,603 million (US$ 1,945 million) and RR 60,954 million (US$ 2,000 million), respectively, for the facility, arranged in 2010.

In February 2011 the Company reached an agreement with the lenders under the US$ 2 billion 2010 Facility to decrease the margins. The margins were decreased to LIBOR plus 2.40% and 3.40% for the 3 and 5 year tranches, respectively.

In February 2011 the Company also reached an agreement with the lenders under the US$ 1.5 billion 2009 Facility to substantially decrease the amount of crude oil volumes used as collateral for this facility. The crude oil volumes used as collateral decreased from 480,000 to 360,000 metric tons of oil in a calendar quarter.

The aggregate maturities of total long-term debt, including current portion as of June 30, 2011 were as follows:

RR millions	At June 30, 2011
June 2011 - June 2012	35,645
June 2012- June 2013	25,452
June 2013- June 2014	15,118
June 2014- June 2015	8,765
June 2015- June 2016	954
Thereafter	2,014
Total long-term debt	**87,948**