

## **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 Management's Discussion and Analysis (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 Almet'yevsk, 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.

As of September 30, 2011 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, refining capacity 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.

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**Key financial and operational results**

	<b>9 months of 2011</b>	<b>Change, %</b>	<b>9 months of 2010</b>
Sales (millions of RR)	447,806	32.4	338,230
Net income attributable to Group shareholders (millions of RR)	45,092	48.5	30,370
EBITDA <sup>(1)</sup> (millions of RR)	72,823	37.5	52,967
Basic and Diluted net income per share of common stock (RR)			
Common.....	19.87	48.1	13.42
Preferred.....	19.85	48.7	13.35
Crude oil production by the Group (thousands of tonnes)	19,588	0.3	19,532
Crude oil production by the Group (thousands of barrels)	139,524	0.3	139,129
Refined products produced (thousands of tonnes)	754.9	451.0	137.0
Gas production by the Group (millions of cubic meters)	688.7	13.4	607.5

<sup>(1)</sup> As defined on page 14

Our net income in the nine months of 2011 was RR 45,092 million, which is RR 14,722 million, or 48.48%, more than in the corresponding period of 2010. Our net income grew mostly due to higher crude oil market prices, however it 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), OAO TANECO (“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, OOO Nizhnekamskiy Zavod Gruzovoykh Shin 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.

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**Operational highlights**

**Crude oil and gas production**

Tatneft carries out exploration and production activities in Tatarstan and outside of Tatarstan in other parts of 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):

	<b>9 months of 2011</b>	<b>9 months of 2010</b>
Crude oil daily production (thousands bbl per day)	511.1	509.6
Gas daily production (thousands boe per day)	14.8	13.1
Crude oil extraction expenses (RR per bbl)	186.1	167.4
	(RR millions)	
Sales of crude oil	363,370	271,525
Crude oil extraction expenses	25,960	23,296
Exploration expenses	1,427	1,487
Unified production tax	70,995	50,229

Crude oil production of the Group (including production of consolidated subsidiaries OAO Ilekneft, OOO Tatneft-Samara, ZAO Tatneft-Severnoy) increased by 0.3% to 19.6 million metric tonnes in the nine months of 2011 compared to the nine months of 2010. Our gas production increased by 13.4% to 688.7 million cubic meters in the nine months of 2011 from 607.5 million cubic meters in the corresponding period of 2010.

**Refining and marketing**

	<b>9 months of 2011</b>	<b>9 months of 2010</b>
Refining throughput (thousands bbl per day)	26.36	9.97
Refined products produced (thousands of tonnes)	754.9	137.0
Gas products produced (thousands of tonnes)	825.6	804.3
Number of petrol (gas) stations in Russia <sup>(1)</sup>	506	494
Number of petrol (gas) stations outside of Russia <sup>(1)</sup>	128	136

<sup>(1)</sup>Including rented stations

Increase of refining throughput in the nine months of 2011 compared to the corresponding period of 2010 was due to the start of the production testing at the Nizhnekamskiy refinery (TANECO).

**Export of crude oil from Russia**

The Group is using transportation services of OAO AK Transneft (“Transneft”), the state-owned monopoly owner and operator of Russia’s trunk crude oil pipelines, upon export of its crude oil. During the nine months of 2011, the Group exported from Russia approximately 71% of all its crude oil sold compared to approximately 69% in the corresponding period of 2010.

In the nine months of 2011 the Company delivered 56% (53% in the corresponding period of 2010) of its own crude oil for export through Transneft’s Druzhba pipeline (mainly to Poland, Hungary and Germany); 35% (32% in the corresponding period of 2010) of crude oil was shipped through Russian Black Sea ports (mainly Novorossiysk) and 9% (12% in the corresponding period of 2010) of crude oil exported through Baltic Sea port Primorsk.

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**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 nine months 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 demand expectations. During the nine months of 2011, Brent crude oil price fluctuated between \$93 and \$127 per barrel and averaged \$111.9 per barrel.

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

	Average for 9 months of		Change, %	At September 30		Change, %
	2011	2010		2011	2010	
(in US Dollars per barrel, except for figures in percent)						
Brent crude	111.9	77.1	45.1	105.2	81.0	30.0
Urals crude (CIF Mediterranean) <sup>(1)</sup>	109.2	75.9	43.8	102.4	79.8	28.3
Urals crude (CIF Rotterdam) <sup>(1)</sup>	109.2	75.9	43.8	102.2	80.1	27.7

Source: Platts

<sup>(1)</sup> 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

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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.

	<b>9 months of 2011</b>	<b>9 months of 2010</b>
Ruble inflation, %	4.7	6.2
Period-end exchange rate (Ruble to US\$)	31.88	30.40
Average exchange rate (Ruble to US\$)	28.77	30.25
Nominal (devaluation)/ appreciation of the Ruble, %	(4.6)	(0.5)
Real Ruble appreciation, %	0.1	5.6

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

	<b>9 months of 2011</b>	<b>9 months of 2010</b>	<b>Change, %</b>	<b>Taxable base</b>
Income tax – maximum rate	20%	20%	-	Taxable income
Value Added Tax (VAT)	18%	18%	-	Price of goods/services sold
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 <sup>(1)</sup>	4,368	2,948	48.1	Metric tonne produced (crude oil)
	(in US \$ per metric tonne, except for figures in percent)			
Crude oil export duty, average rates	410.7	269.2	52.6	Metric tonne exported
<i>Refined products export duty average rates:</i>				
Gasoline <sup>(2)</sup>	334.0	193.6	72.5	
Straight-run gasoline <sup>(2)</sup>	322.4	193.6	66.5	
Light and middle distillates, gasoils	276.6	193.6	42.9	Metric tonne exported
Fuel oil ( <i>mazut</i> )	188.8	104.3	81.0	

<sup>(1)</sup> Without taking into account differentiated taxation

<sup>(2)</sup> 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-run gasoline.

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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.

	9 months of 2011	9 months of 2010	Change, %	Taxable base
(in RR per metric tonne, except for figures in percent)				
<i>Gasoline:</i>				
Low octane gasoline below Euro-3	5,995	2,923	105.1	
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-run gasoline	6,089	4,290	41.9	Metric tonne produced and sold domestically ( <sup>1</sup> )
<i>Diesel fuel:</i>				
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	

<sup>(1)</sup> The responsibility to pay excise taxes on refined products in Russia is imposed on refined product producers (except for straight-run 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-run gasoline equivalent to 90% of the export duty on crude oil.

Due to increase in international crude oil prices the tax rates specific to the oil industry increased substantially during the nine months of 2011 compared to the corresponding period of 2010. Unified production tax rate increased by 48%, average crude oil export duty rate by 53% and average refined products export duty rate by 64%.

The increase in unified production tax rate and crude oil and refined products export duties in the nine months of 2011 was a result of increase in the average Urals crude price by 44%. Excise taxes on refined products increased in the nine months of 2011 by 58% on average.

**Unified production tax rate.** The base tax rate for the production of oil until 2012 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.

The base rate for 2012 and 2013 is currently set at 446 Rubles and 470 Rubles per metric tonne extracted, respectively.

This tax rate is applied with a discount based on the level 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 nine months of 2011 of RR 12.3 billion (RR 7.5 billion in the nine months 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

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produced oil is used. Since April 2007, the Company's production of highly viscous crude oil (bitumen) from the Ashalchinskoye, Mordovo-Karmalskoye, Chernoozerskoye and Vishnyevo-Polyanskoye fields was subject to a zero unified production tax rate, resulting in tax benefit during the nine months of 2011 attributed to that production of RR 468 million (RR 56 million in the nine months 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)

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 15<sup>th</sup> day of each calendar month and the 14<sup>th</sup> day of the following calendar month (inclusive).

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

The export duty rate on crude oil increased by 53% in the nine months of 2011 to US\$ 410.7 per tonne (US\$ 56.3 per barrel) from US\$ 269.2 per tonne (US\$ 36.9 per barrel) in the corresponding period of 2010. The increase was associated with the rise of the average Urals crude oil prices by 44% to US\$ 109.2 per barrel in the nine months of 2011 compared to US\$ 75.9 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 heavy (fuel oil, etc.).

Prior to 2011, export customs duty on light refined products was calculated using the following formula:  $0.438 * (\text{Price} * 7.3 - 109.5)$ , where Price is the average Urals price in the US Dollar per barrel. Export customs duty on heavy refined products was calculated using the following formula:  $0.236 * (\text{Price} * 7.3 - 109.5)$ .

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

On August 26, 2011, The Government issued a decree No. 716 introducing new maximum coefficients applied to each type of refined 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 fuel	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.

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**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%.



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**Nine months ended September 30, 2011 compared to the nine months ended September 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	9 months of 2011	9 months of 2010	Change, %
<b>Sales and other operating revenues</b>	<b>447,806</b>	<b>338,230</b>	<b>32.4</b>
<b>Costs and other deductions</b>			
Operating	54,840	46,809	17.2
Purchased oil and refined products	53,872	41,834	28.8
Exploration	1,427	1,487	(4.0)
Transportation	14,359	12,745	12.7
Selling, general and administrative	22,028	20,560	7.1
Depreciation, depletion and amortization	10,053	10,086	(0.3)
Loss/ (gain) on disposals of property, plant and equipment and investments and impairments	1,696	(100)	-
Taxes other than income taxes	221,702	157,711	40.6
Maintenance of social infrastructure and transfer of social assets	2,733	2,745	(0.4)
<b>Total costs and other deductions</b>	<b>382,710</b>	<b>293,877</b>	<b>30.2</b>
Earnings from equity investments	744	235	216.6
Foreign exchange loss	(2,541)	(1,448)	75.5
Interest income	2,195	2,889	(24.0)
Interest expense, net of amounts capitalized	(648)	(344)	88.4
Other expense, net	(529)	(259)	104.2
<b>Total other (expenses)/ income</b>	<b>(779)</b>	<b>1,073</b>	<b>(172.6)</b>
<b>Income before income taxes and non- controlling interest</b>	<b>64,317</b>	<b>45,426</b>	<b>41.6</b>
Current income tax expense	(16,065)	(11,346)	41.6
Deferred income tax (expense)/ benefit	(1,202)	15	-
<b>Total income tax expense</b>	<b>(17,267)</b>	<b>(11,331)</b>	<b>52.4</b>
<b>Net income</b>	<b>47,050</b>	<b>34,095</b>	<b>38.0</b>
Less: net income attributable to non- controlling interest	(1,958)	(3,725)	(47.4)
<b>Net income attributable to Group shareholders</b>	<b>45,092</b>	<b>30,370</b>	<b>48.5</b>

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

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**Sales and other operating revenues**

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

<b>RR millions</b>	<b>9 months of 2011</b>	<b>9 months of 2010</b>
Crude oil	363,370	271,525
Refined products	46,342	36,659
Petrochemicals	23,296	16,891
Corporate and other sales	14,798	13,155
<b>Total sales and other operating revenues</b>	<b>447,806</b>	<b>338,230</b>

Sales and other operating revenues increased in the nine months of 2011 by 32.4% to RR 447,806 million from RR 338,230 million in the corresponding period of 2010. The increase was mainly attributed to an overall increase in crude oil and refined products prices.

***Sales of crude oil***

Sales of crude oil increased by 33.8% to RR 363,370 million in the nine months of 2011 from RR 271,525 million in the corresponding period of 2010. The table below provides an analysis of the changes in sales of crude oil:

	<b>9 months of 2011</b>	<b>Change, %</b>	<b>9 months of 2010</b>
<b>Domestic sales of crude oil</b>			
Revenues (RR millions)	55,509	16.4	47,677
Volume (thousands tonnes)	5,934	(9.9)	6,589
Realized price (RR per tonne)	9,354.6	29.3	7,235.8
<b>CIS export sales of crude oil <sup>(1)</sup></b>			
Revenues (RR millions)	17,265	16.4	14,835
Volume (thousands tonnes)	1,569	(8.9)	1,722
Realized price (RR per tonne)	11,004.5	27.7	8,615
<b>Non-CIS export sales of crude oil</b>			
Revenues (RR millions)	290,596	39	209,013
Volume (thousands tonnes)	12,927	(0.2)	12,952
Realized price (RR per tonne)	22,479.8	39.3	16,137.5

<sup>(1)</sup> CIS is an abbreviation for Commonwealth of Independent States

***Sales of refined products***

Sales of refined products increased by 26.4% to RR 46,342 million in the nine months of 2011 from RR 36,659 million in the corresponding period of 2010. The table below provides an analysis of the changes in sales of refined products:

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	9 months of 2011	Change, %	9 months of 2010
<b>Domestic sales of refined products</b>			
Revenues (RR millions)	35,362	17.1	30,210
Volume (thousands tonnes)	1,899	(0.5)	1,908
Realized price (RR per tonne)	18,621.4	17.6	15,833.3
<b>CIS export sales of refined products</b>			
Revenues (RR millions)	1,798	0.1	1,797
Volume (thousands tonnes)	91	9.6	83
Realized price (RR per tonne)	19,758.2	(8.7)	21,650.6
<b>Non-CIS export sales of refined products</b>			
Revenues (RR millions)	9,182	97.4	4,652
Volume (thousands tonnes)	401	35.9	295
Realized price (RR per tonne)	22,897.8	45.2	15,769.5

***Sales of petrochemical products***

The table below provides an analysis of petrochemical products sales.

RR millions	9 months of 2011	Change, %	9 months of 2010
Tires sales	22,348	38.9	16,085
Other petrochemicals sales	948	17.5	806
<b>Total sales of petrochemical products</b>	<b>23,296</b>	<b>37.9</b>	<b>16,891</b>

The increase in sales of petrochemical products was primarily due to the higher prices of tires sold. The Group's production of tires in the nine months of 2011 increased by 2.5% compared to the corresponding period of 2010 and amounted to 8.3 million tires.

***Other sales***

Other sales increased by 12.5% to RR 14,798 million in the nine months of 2011 from RR 13,155 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.

**Costs and other deductions**

**Operating expenses.** Operating expenses include the following costs:

RR millions	9 months of 2011	9 months of 2010
Crude oil extraction expenses	25,960	23,296
Petrochemical production expenses	19,626	15,571
Other operating expenses	9,556	7,802
Operating expenses not attributed to the revenue in the current period <sup>(1)</sup>	(302)	140
<b>Total operating expenses</b>	<b>54,840</b>	<b>46,809</b>

<sup>(1)</sup> 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.

**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

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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, 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 186.1 per barrel in the nine months of 2011 compared to RR 167.4 per barrel in the corresponding period of 2010. Higher electricity and other energy costs were the primary reasons for an 11.1% increase in lifting expenses in the nine months 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 19,626 million by 26% in the nine months 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 9,556 million, or by 22.5%, compared to the corresponding period of 2010.

**Cost of purchased crude oil and refined products.** A summary of purchased oil and refined products in the nine months of 2011 and 2010, respectively, is as follows:

RR millions	9 months of 2011	9 months of 2010
Purchased crude oil (RR millions)	28,235	17,482
Volume (thousands tonnes)	1,994	2,072
Average price per tonne (RR)	14,160	8,437
Purchased refined products (RR millions)	25,637	24,352
Volume (thousands tonnes)	1,159	1,516
Average price per tonne (RR)	22,120	16,063
<b>Total purchased oil and refined products</b>	<b>53,872</b>	<b>41,834</b>

Purchases of crude oil increased in the nine months of 2011 compared to the corresponding period of 2010 due to higher crude oil market prices.

Purchases of refined products increased by 5% to RR 25,637 million in the nine months of 2011 from RR 24,352 million in the corresponding period of 2010 due to increase in average purchase price per tonne by 38% partly offset by decrease in volumes of purchased refined products for trading by 24%.

**Exploration expenses.** Exploration expenses consist primarily of exploratory drilling, geological and geophysical costs, and the costs of carrying and retaining undeveloped properties. Exploration expenses decreased to RR 1,427 million in the nine months of 2011 from RR 1,487 million in the corresponding period of 2010.

**Transportation expenses.** Transportation expenses relate to the delivery of the Group's crude oil and refined products, including purchased crude oil and refined products, which are mostly carried out using the Transneft trunk pipeline system. Transportation costs increased by 12.7% to RR 14,359 million in the nine months of 2011 from RR 12,745 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

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provisions. Selling, general and administrative expenses increased by RR 1,468 million to RR 22,028 million in the nine months of 2011 compared to the corresponding period of 2010.

**Loss/ (gain) on disposals of property, plant and equipment and impairment of investments.** In the nine months of 2011 we recorded a loss on disposals of property, plant and equipment and impairment of investments amounted to RR 1,696 million compared to a RR 100 million gain in the corresponding period of 2010. The loss in the nine months of 2011 primarily included a loss from impairment of assets of one of our equity investments in the amount of RR 1,476 million.

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

	<b>9 months of 2011</b>	<b>9 months of 2010</b>
Export duties	147,677	104,517
Unified production tax	70,995	50,229
Property tax	1,518	1,458
Excise taxes	459	284
Penalties and interest	4	(110)
Other	1,049	1,333
<b>Total taxes other than income taxes</b>	<b>221,702</b>	<b>157,711</b>

Taxes other than income taxes increased by 40.6% to RR 221,702 million in the nine months of 2011 from RR 157,711 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 nine months of 2011 compared to the corresponding period of 2010, export duties, paid by the Group, increased by 41.3%. The Group's unified production tax expense increased by 41.3%. Our expenses on excise taxes increased to RR 459 million from RR 284 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 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 nine months of 2011 of RR 12.3 billion in comparison to RR 7.5 billion in the corresponding period of 2010, driven mainly by 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 Vishnyevo-Polyanskoye fields, resulting in the nine months of 2011 in tax benefit of RR 468 million in comparison to RR 56 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 2,733 million in the nine months of 2011 from RR 2,745 million in the corresponding period of 2010.

**Earnings from equity investments.** The Group recorded a gain from equity investments amounted to RR 744 million in the nine months of 2011 compared to RR 235 million gain in the corresponding period of 2010. The increase was due to the gain from equity participation in crude oil producing entities, RR 503 million, which was attributed to the Group in the nine months of 2011 in comparison to RR 29 million gain in the nine-month 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.

**Foreign exchange loss.** The Group recorded a foreign exchange loss amounted to RR 2,541 million in the nine months of 2011 compared to a foreign exchange gain of RR 4,377 million in the first half of 2011, and a foreign exchange loss of RR 1,448 million in the nine months of 2010, which was due to volatility of Ruble to US Dollar exchange rate

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during the nine months of 2011, resulting to the corresponding revaluation of US Dollars denominated debt under the long-term credit facilities of the Group. The foreign exchange loss on the debt under the Group's US Dollar denominated credit facilities in the nine months of 2011 was RR 3,826 million.

**Interest income** decreased by 24% to RR 2,195 million in the nine months of 2011 compared to the corresponding period of 2010.

**Interest expense**, net of amounts capitalized, increased from RR 344 million to RR 648 million in the nine months of 2011 in comparison to the same period of 2010, which was a result of interest accrued on our Ruble exchange bonds, issued in September 2010.

**Other expense, net**, in the nine months of 2011 amounted to RR 529 million compared with RR 259 million of other expense, net, in the corresponding period of 2010.

#### **Income taxes**

The effective income tax rate in the nine months of 2011 was 26.8%, 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)**

<b>RR millions</b>	<b>9 months of 2011</b>	<b>9 months of 2010</b>
Net income attributable to Group shareholders	45,092	30,370
Add back:		
Non-controlling interest	1,958	3,725
Income tax expense	17,267	11,331
Depreciation, depletion and amortization	10,053	10,086
Interest expense	648	344
Interest income	(2,195)	(2,889)
<b>EBITDA</b>	<b>72,823</b>	<b>52,967</b>

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.

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**Financial Condition Summary Information**

The following table shows certain key financial indicators:

<b>RR millions</b>	<b>At September 30, 2011</b>	<b>At December 31, 2010</b>
Current assets	137,789	132,557
Long-term assets	463,344	434,622
<b>Total assets</b>	<b>601,133</b>	<b>567,179</b>
Current liabilities	89,753	80,836
Long-term liabilities	124,596	135,797
<b>Total liabilities</b>	<b>214,349</b>	<b>216,633</b>
<b>Shareholders' equity</b>	<b>386,784</b>	<b>350,546</b>
Working capital	48,036	51,721

**Working capital position**

As of September 30, 2011 working capital of the Group amounted to RR 48,036 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 current portion of long-term debt.

**Liquidity and Capital Resources**

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

<b>RR millions</b>	<b>9 months of 2011</b>	<b>9 months of 2010</b>
Net cash provided by operating activities	67,677	43,361
Net cash used for investment activities	(36,424)	(53,285)
Net cash (used for) /provided by financing activities	(23,105)	17,931
Increase in cash and cash equivalents	8,148	8,007

**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 56.1% to RR 67,677 million in the nine months of 2011 from RR 43,361 million in the corresponding period of 2010 which is explained primarily through higher net income earned in the nine months of 2011.

**Net cash used for investing activities**

Net cash used for investing activities decreased by 31.6% to RR 36,424 million in the nine months of 2011 from RR 53,285 million in the corresponding period of 2010, which was primarily due to lower 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 23,105 million in the nine months of 2011 compared to RR 17,931 million provided by financing activities in the corresponding period of 2010. This was primarily due to net debt repayments of RR 11,536 million in the nine months of 2011 compared with net debt proceeds of RR 24,305 million in the corresponding period of 2010.

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**Additions to property, plant and equipment**

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

<b>RR millions</b>	<b>9 months of 2011</b>	<b>9 months of 2010</b>
Exploration and production	14,523	13,759
Refining and marketing	25,617 <sup>(1)</sup>	43,768
Petrochemicals	283	1,326
Corporate and other	1,386	814
<b>Total additions to property, plant and equipment</b>	<b>41,809</b>	<b>59,667</b>

<sup>(1)</sup> Includes RR 23,692 million expenditures related to the refinery construction in Nizhnekamsk (TANECO)

**Analysis of Debt**

At September 30, 2011, long-term debt, including the current portion of long-term debt, amounted to RR 100,420 million as compared to RR 105,294 million at December 31, 2010.

In June 2011, the Company entered into a US \$550 million unsecured credit facility with a fixed rate of 3.50% per annum with bullet repayment in three years, arranged by BNP Paribas (Suisse) SA, The Bank Of Tokyo Mitsubishi UFJ, Ltd., Commerzbank Aktiengesellschaft, ING Bank N.V., Natixis, Open Joint Stock Company Nordea Bank, Sumitomo Mitsui Banking Corporation and WestLB AG, London Branch. The amount outstanding under this credit facility as of September 30, 2011 was RR 11,156 million (US \$350 million).

The decrease in the current period's amount of total debt outstanding was mainly attributed to 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, partly offset by the foreign exchange loss incurred due to the devaluation of Ruble against US Dollar in the respective period. The amounts outstanding, including the current portion, as of September 30, 2011 and December 31, 2010 were RR 25,137 million (US\$ 789 million) and RR 37,043 million (US\$ 1,215 million), respectively, under the US\$ 1.5 billion facility, and RR 56,719 million (US\$ 1,779 million) and RR 60,954 million (US\$ 2,000 million), respectively, under the USD 2 billion facility.

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's 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 September 30, 2011 were as follows:

<b>RR millions</b>	<b>At September 30, 2011</b>
September 2011- September 2012	40,471
September 2012- September 2013	26,991
September 2013- September 2014	11,487
September 2014- September 2015	18,498
September 2015- September 2016	1,079
Thereafter	1,894
<b>Total long-term debt</b>	<b>100,420</b>