



**OAO TATNEFT**  
**INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**(PREPARED IN ACCORDANCE WITH U.S. GAAP)**  
**SIX MONTHS, ENDED JUNE 30, 2003**  
**(UNAUDITED)**

The interim consolidated financial statements were prepared by OAO TATNEFT in accordance with U.S. GAAP and have not been audited by our independent auditor.

**ОАО ТАТНЕФТ**
**Interim Consolidated Balance Sheets, Unaudited**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except share information)

|   | Notes | At June 30, 2003 | At December 31, 2002 |
|---|-------|------------------|----------------------|
| <b>Assets</b>   |       |                  |                      |
| Cash and cash equivalents   | 4     | 10,301           | 7,070                |
| Accounts receivable, net  | 5     | 18,720           | 15,077               |
| Short-term investments  | 6     | 4,425            | 3,477                |
| Current portion of loans receivable and advances, net   | 9     | 11,730           | 10,494               |
| Inventories, net  | 7     | 11,413           | 9,962                |
| Prepaid expenses and other current assets   | 8     | 20,682           | 19,163               |
| <b>Total current assets</b>   |       | <b>77,271</b>    | <b>65,243</b>        |
| Restricted cash   | 4     | 1,624            | 1,756                |
| Long-term loans receivable and advances, net  | 9     | 3,950            | 2,751                |
| Long-term investments   | 6     | 3,787            | 4,203                |
| Property, plant and equipment, net  | 10    | 164,254          | 154,047              |
| <b>Total assets</b>   |       | <b>250,886</b>   | <b>228,000</b>       |
| <b>Liabilities and shareholders' equity</b>   |       |                  |                      |
| Short-term debt and current portion of long-term debt   | 11    | 18,662           | 16,618               |
| Notes payable   | 12    | 5,536            | 3,482                |
| Banking customer deposits   | 12    | 15,329           | 11,992               |
| Trade accounts payable  |       | 6,426            | 6,548                |
| Other accounts payable and accrued liabilities  | 13    | 7,839            | 5,571                |
| Taxes payable   |       | 4,903            | 3,759                |
| Current deferred tax liability  | 14    | -                | -                    |
| <b>Total current liabilities</b>  |       | <b>58,695</b>    | <b>47,970</b>        |
| Long-term debt  | 11    | 14,488           | 14,622               |
| Notes payable   | 12    | 1,050            | 866                  |
| Banking customer deposits   | 12    | 355              | 1,152                |
| Asset retirement obligations  | 10    | 4,912            | -                    |
| Deferred tax liability  | 14    | 21,663           | 19,943               |
| <b>Total liabilities</b>  |       | <b>101,163</b>   | <b>84,553</b>        |
| <b>Minority interest</b>  |       | <b>5,168</b>     | <b>5,069</b>         |
| <b>Shareholders' equity</b>   |       |                  |                      |
| Preferred shares (authorized and issued at June 30, 2003 and December 31, 2002 – 147,508,500 shares; nominal value at June 30, 2003 and December 31, 2002 - RR1.00) | 15    | 148              | 148                  |
| Common shares (authorized and issued at June 30, 2003 and December 31, 2002 - 2,178,690,700 shares; nominal value at June 30, 2003 and December 31, 2002 - RR1.00)  | 15    | 2,179            | 2,179                |
| Additional paid in capital  | 15    | 88,863           | 88,863               |
| Accumulated other comprehensive income  |       | 81               | 176                  |
| Retained earnings   |       | 57,068           | 51,002               |
| Common shares held in treasury, at cost (188,673,992 shares and 200,288,000 shares at June 30, 2003 and December 31, 2002, respectively)                            |       | (3,784)          | (3,990)              |
| <b>Total shareholders' equity</b>   |       | <b>144,555</b>   | <b>138,378</b>       |
| Commitments and contingent liabilities  | 20    |                  |                      |
| <b>Total liabilities and shareholders' equity</b>   |       | <b>250,886</b>   | <b>228,000</b>       |

The accompanying notes are an integral part of these interim consolidated financial statements.

**OAOTATNEFT**
**Interim Consolidated Statements of Operations and Comprehensive Income, Unaudited**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

|  | Notes | Six months ended<br>June 30, 2003 | Six months ended<br>June 30, 2002 | Six months ended<br>June 30, 2001 |
|--|-------|-----------------------------------|-----------------------------------|-----------------------------------|
| <b>Sales and other operating revenues</b>                                    | 17    | <b>70,715</b>                     | <b>66,661</b>                     | <b>79,459</b>                     |
| <b>Costs and other deductions</b>  |       |                                   |                                   |                                   |
| Operating  |       | 14,875                            | 16,980                            | 17,606                            |
| Purchased oil and refined products   |       | 14,857                            | 14,026                            | 13,116                            |
| Exploration  |       | 440                               | 411                               | 172                               |
| Transportation   |       | 3,115                             | 2,244                             | 2,094                             |
| Selling, general and administrative  |       | 6,444                             | 7,798                             | 6,995                             |
| Depreciation, depletion and amortization                                     | 17    | 3,755                             | 3,599                             | 3,261                             |
| Loss on disposals and impairment   |       | 272                               | 238                               | 788                               |
| Taxes other than income taxes  | 14    | 20,779                            | 13,914                            | 15,979                            |
| Maintenance of social infrastructure   | 10    | 126                               | 43                                | 195                               |
| Transfer of social assets constructed after privatization                    | 10    | 878                               | 217                               | 560                               |
| <b>Total costs and other deductions</b>                                      |       | <b>65,541</b>                     | <b>59,470</b>                     | <b>60,766</b>                     |
| <b>Other income (expenses)</b>   |       |                                   |                                   |                                   |
| Earnings from equity investments   | 6     | 32                                | 138                               | 62                                |
| Foreign exchange gain / (loss)   |       | 271                               | (579)                             | (607)                             |
| Monetary gain  | 2     | -                                 | 693                               | 722                               |
| Net interest income - banking  |       | 566                               | 245                               | 420                               |
| Other net - banking  |       | (627)                             | (187)                             | (307)                             |
| Interest income  |       | 263                               | 435                               | 321                               |
| Interest expense   |       | (1,210)                           | (1,239)                           | (1,451)                           |
| Other income, net  |       | 569                               | 574                               | 60                                |
| <b>Total other income (expenses)</b>   |       | <b>(136)</b>                      | <b>80</b>                         | <b>(780)</b>                      |
| <b>Income before income taxes and minority interest</b>                      |       | <b>5,038</b>                      | <b>7,271</b>                      | <b>17,913</b>                     |
| <b>Income taxes</b>  |       |                                   |                                   |                                   |
| Current  |       | (2,393)                           | (2,179)                           | (4,816)                           |
| Deferred (expense) / benefit   |       | (1,055)                           | 2,222                             | 5,462                             |
| <b>Total income tax (expense) / benefit</b>                                  | 14    | <b>(3,448)</b>                    | <b>43</b>                         | <b>646</b>                        |
| <b>Income before minority interest</b>                                       |       | <b>1,590</b>                      | <b>7,314</b>                      | <b>18,559</b>                     |
| Minority interest  |       | (70)                              | (233)                             | (783)                             |
| <b>Income before cumulative effect of change in accounting principle</b>     |       | <b>1,520</b>                      | <b>7,081</b>                      | <b>17,776</b>                     |
| Cumulative effect of change in accounting principle, net of tax              |       | 4,815                             | -                                 | -                                 |
| <b>Net income</b>  |       | <b>6,335</b>                      | <b>7,081</b>                      | <b>17,776</b>                     |
| Foreign currency translation adjustments                                     |       | (95)                              | 82                                | (45)                              |
| Unrealized holding gains on available-for-sale securities, net of RR nil tax |       | -                                 | 362                               | 18                                |
| <b>Comprehensive income</b>  |       | <b>6,240</b>                      | <b>7,525</b>                      | <b>17,749</b>                     |
| <b>Basic net income per share (RR)</b>                                       |       |                                   |                                   |                                   |
| Common   | 15    | 0.65                              | 3.18                              | 7.94                              |
| Preferred  |       | 1.54                              | 4.15                              | 8.04                              |
| <b>Diluted net income per share (RR)</b>                                     |       |                                   |                                   |                                   |
| Common   | 15    | 0.65                              | 3.14                              | 7.94                              |
| Preferred  |       | 1.54                              | 4.11                              |                                   |
| <b>Weighted average common shares outstanding (millions of shares)</b>       |       |                                   |                                   |                                   |
| Basic  | 15    | 1,984                             | 2,035                             | 2,090                             |
| Diluted  |       | 1,993                             | 2,062                             | 2,090                             |
| <b>Weighted average preferred shares outstanding (millions of shares)</b>    |       |                                   |                                   |                                   |
| Basic  | 15    | 148                               | 148                               | 148                               |
| Diluted  |       | 148                               | 148                               | 148                               |

The accompanying notes are an integral part of these interim consolidated financial statements.

**OA0 TATNEFT**
**Interim Consolidated Statements of Cash Flows, Unaudited**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

|   | Notes | Six months<br>ended<br>June 30, 2003 | Six months<br>ended<br>June 30, 2002 | Six months<br>ended<br>June 30, 2001 |
|---|-------|--------------------------------------|--------------------------------------|--------------------------------------|
| <b>Operating activities</b>                                       |       |                                      |                                      |                                      |
| Income before cumulative effect of change in accounting principle |       | 1,520                                | 7,081                                | 17,776                               |
| Adjustments:  |       |                                      |                                      |                                      |
| Minority interest   |       | 70                                   | 113                                  | 729                                  |
| Depreciation, depletion and amortization                          |       | 3,755                                | 3,599                                | 3,261                                |
| Net barter settlements  | 4     | 145                                  | (1,234)                              | (4,290)                              |
| Deferred income tax expense (benefit)                             |       | 1,055                                | (2,222)                              | (5,462)                              |
| Disposals and impairments   |       | -                                    | 237                                  | 788                                  |
| Effects of foreign exchange                                       |       | (271)                                | 904                                  | 385                                  |
| Monetary gain   |       | -                                    | (693)                                | (722)                                |
| Undistributed earnings of equity investments                      |       | 32                                   | (107)                                | (14)                                 |
| Transfer of social assets constructed after privatization         |       | 878                                  | 217                                  | 559                                  |
| Other   |       | 977                                  | (521)                                | (45)                                 |
| Changes in operational working capital, excluding cash:           |       |                                      |                                      |                                      |
| Accounts receivable   |       | (2,061)                              | (1,506)                              | (9,923)                              |
| Inventories   |       | (1,251)                              | 2,133                                | 255                                  |
| Prepaid expenses and other current assets                         |       | (926)                                | (41)                                 | (2,361)                              |
| Trade accounts payable  |       | (611)                                | 129                                  | 9,403                                |
| Other accounts payable and accrued liabilities                    |       | 4,225                                | 3,007                                | (89)                                 |
| Taxes payable   |       | 1,148                                | (113)                                | 1,878                                |
| <b>Net cash provided by operating activities</b>                  |       | <b>8,685</b>                         | <b>10,983</b>                        | <b>12,128</b>                        |
| <b>Investing activities</b>                                       |       |                                      |                                      |                                      |
| Additions to property, plant and equipment                        |       | (5,176)                              | (7,342)                              | (6,435)                              |
| Proceeds from disposals of property, plant and equipment          |       | 26                                   | 54                                   | 23                                   |
| Purchase of investments and net increase in loans receivable      |       | (4,126)                              | (1,489)                              | (738)                                |
| Proceeds from disposal/ maturity of investments                   |       | 708                                  | 520                                  | 414                                  |
| Purchase of long-term investments                                 |       | 395                                  | 4                                    | 24                                   |
| Change in restricted cash   |       | 132                                  | 107                                  | (698)                                |
| <b>Net cash used for investing activities</b>                     |       | <b>(8,041)</b>                       | <b>(8,146)</b>                       | <b>(7,410)</b>                       |
| <b>Financing activities</b>                                       |       |                                      |                                      |                                      |
| Proceeds from issuance of short-term debt                         |       | 9,078                                | 9,799                                | 1,895                                |
| Repayment of short-term debt                                      |       | (6,404)                              | (4,048)                              | (940)                                |
| Proceeds from issuance of long-term debt                          |       | 3,368                                | 8,947                                | 1,511                                |
| Repayment of long-term debt                                       |       | (3,056)                              | (9,511)                              | (3,396)                              |
| Issuance of loans receivable                                      |       | (700)                                | (209)                                | (106)                                |
| Dividends paid  |       | -                                    | (14)                                 | (394)                                |
| Purchase of treasury shares                                       |       | (1,417)                              | (859)                                | (1,034)                              |
| Proceeds from sale of treasury shares                             |       | 1,719                                | 719                                  | 183                                  |
| <b>Net cash provided by (used for) financing activities</b>       |       | <b>2,588</b>                         | <b>4,824</b>                         | <b>(2,281)</b>                       |
| Effect of foreign exchange on cash and cash equivalents           |       | (1)                                  | 15                                   | 70                                   |
| Effect of inflation accounting                                    |       | -                                    | (683)                                | (585)                                |
| <b>Net change in cash and cash equivalents</b>                    |       | <b>3,231</b>                         | <b>6,993</b>                         | <b>1,922</b>                         |
| Cash and cash equivalents at beginning of period                  |       | 7,070                                | 4,871                                | 3,531                                |
| <b>Cash and cash equivalents at end of period</b>                 |       | <b>10,301</b>                        | <b>11,864</b>                        | <b>5,453</b>                         |

The accompanying notes are an integral part of these interim consolidated financial statements.

**ОАО ТАТНЕФТ**
**Interim Consolidated Statements of Shareholders' Equity, Unaudited**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

|  | 2003    |        | 2002     |        | 2001   |        |
|--|---------|--------|----------|--------|--------|--------|
|  | Shares  | Amount | Shares   | Amount | Shares | Amount |
| <b>Preferred shares:</b>   |         |        |          |        |        |        |
| <b>Balance at January 1 and June 30</b><br>(shares in thousands)   | 147,50  | 148    | 147,50   | 148    | 147,5  | 148    |
| <b>Common shares:</b>  |         |        |          |        |        |        |
| <b>Balance at January 1 and June 30</b><br>(shares in thousands)   | 2,17    | 2,17   | 2,17     | 2,17   | 2,1    | 2,17   |
| <b>Treasury shares, at cost:</b>                                   |         |        |          |        |        |        |
| <b>Balance at January 1</b>  | 200,28  | (3,99) | 176,13   | (2,5)  | 66,5   | (787)  |
| Purchases  | 52,31   | (1,49) | 195,63   | (5,0)  | 131,8  | (2,11) |
| Reissuances / (disposal)   | (63,93) | 1,70   | (171,50) | 3,60   | (22,3) | 395    |
| <b>Balance at June 30 and December 31</b><br>(shares in thousands) | 188,67  | (3,78) | 200,23   | (3,9)  | 176,1  | (2,51) |
| <b>Additional paid in capital</b>                                  |         |        |          |        |        |        |
| <b>Balance at January 1</b>  |         | 88,86  |          | 89,0   |        | 88,86  |
| Stock-based compensation   |         | -      |          | -      |        | 163    |
| Stock-options redeemed   |         | -      |          | (163)  |        | -      |
| <b>Balance at June 30 and December 31</b>                          |         | 88,86  |          | 88,8   |        | 89,02  |
| <b>Accumulated other comprehensive income</b>                      |         |        |          |        |        |        |
| <b>Balance at January 1</b>  |         | 176    |          | 3,1    |        | 1,27   |
| Change during period   |         | (95)   |          | (2,9)  |        | 1,87   |
| <b>Balance at June 30 and December 31</b>                          |         | 81     |          | 176    |        | 3,14   |
| <b>Retained earnings (accumulated deficit)</b>                     |         |        |          |        |        |        |
| <b>Balance at January 1</b>  |         | 51,00  |          | 36,0   |        | 12,10  |
| Net income   |         | 6,33   |          | 15,7   |        | 24,35  |
| Dividends  |         | (364)  |          | (387)  |        | (306)  |
| Treasury share transactions  |         | 95     |          | (502)  |        | (50)   |
| <b>Balance at June 30 and December 31</b>                          |         | 57,06  |          | 51,0   |        | 36,09  |
| <b>Total shareholders' equity at June 30 and December 31</b>       |         | 144,55 |          | 138,3  |        | 128,08 |

The accompanying notes are an integral part of these interim consolidated financial statements.

## **Note 1: Organization**

OAO Tatneft (the "Company") and its subsidiaries (jointly referred to as "the Group") are engaged in crude oil exploration, development and production principally in the Republic of Tatarstan ("Tatarstan"), an autonomous republic within the Russian Federation. The Group also engages in refining and marketing of crude oil and refined products, petrochemical and banking activities (Note 17). The Group's banking activities comprise the operations of Zenit Bank and Devon Credit Bank.

The Company was incorporated as an open joint stock company effective January 1, 1994 (the "privatization date") pursuant to the approval by the State Property Management Committee of the Republic of Tatarstan (the "State"). All assets and liabilities previously managed by the production association Tatneft, Bugulminsky Mechanical Plant, Menzelinsky Exploratory Drilling Department and Bavlinsky Drilling Department were transferred to the Company at their book value at the privatization date in accordance with Decree No. 1403 on Privatization and Restructuring of Enterprises and Corporations into Joint-Stock Companies. Such transfers are considered transfers between entities under common control at the privatization date, and have been recorded at book value. Effective January 1, 2003, the Russian economy ceased to be considered hyperinflationary in accordance with the provisions of Statement of Financial Accounting Standards ("SFAS").

At June 30, 2003, the State held 33% common shares of the Company. As further described in Note 15, the State owns one "Golden Share" which carries the right to veto certain decisions taken at meetings of the shareholders and the Board of Directors. The Government of Tatarstan is able to exercise considerable influence through its ownership interest in the Company, its legislative, taxation and regulatory powers, its representation on the Board of Directors and informal influence. Additionally, the Government of Tatarstan also controls a number of the Group's suppliers, such as OAO Tatenergo, the supplier of electricity to the Group, and a number of the Group's ultimate customers, such as OAO Nizhnekamskneftekhim ("Nizhnekamskneftekhim"), the principal petrochemical company in Tatarstan. Related party transactions are further disclosed in Note 18.

## **Note 2: Basis of Presentation**

The Group maintains its accounting records and prepares its statutory financial statements in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR"). The accompanying financial statements have been prepared from these accounting records and adjusted as necessary to comply with accounting principles generally accepted in the United States of America ("US GAAP").

The accounting interim consolidated financial statements and notes thereto of the Group have not been audited by independent accountants, except for the balance sheet at December 31, 2002. In the opinion of the Company's management, the interim financial information includes all adjustments and disclosures necessary to present fairly the Group's financial position, results of operations and cash flows for the interim periods reported herein. These adjustments were of a normal recurring nature, except for the cumulative effect of change in accounting principle described in Note 10. Except as disclosed in Note 10, the interim consolidated financial statements have been prepared following the accounting policies applied and disclosed in the December 31, 2002 consolidated financial statements. Prior period amounts have been reclassified, where applicable, to conform with current period presentation.

**Use of estimates in the preparation of financial statements.** The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the assets, liabilities, revenues and expenses reported in the financial statements, as well as amounts included in the notes thereto, including the discussion and disclosure of contingent assets and liabilities. While management uses its best estimates and judgments, actual results may vary from those estimates as future confirming events occur.

**Foreign currency transactions and translation.** The Russian Rouble is the functional currency for the Group's operations. Balance sheet items denominated in foreign currencies have been translated using the exchange rate at the balance sheet date June 30, 2003. The related foreign exchange gains and losses are included in earnings. The Russian economy ceasing to be hyperinflationary did not change the foreign currency translation accounting from that applied in previous periods of hyperinflation.

**ОАО ТАННЕФТ****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)****(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)****Note 2: Basis of Presentation (continued)**

**Exchange rates, restrictions and controls.** The official rate of exchange of the Russian Rouble (“RR”) to the US Dollar (“US \$”) at June 30, 2003 and December 31, 2002 was RR 30.35 and RR 31.78 to US \$1.00, respectively. Exchange restrictions and controls exist relating to converting Russian Roubles into other currencies. At present, the Russian Rouble is not a convertible currency outside of the Russian Federation and, further, the Company is required to sell up to 50% (25% from July 9, 2003) of its hard currency earnings for Russian Roubles. Accordingly, any translation of Russian Rouble amounts to US Dollars should not be construed as a representation that such Russian Rouble amounts have been, could be, or will in the future be converted into US Dollars at the exchange rate shown or at any other exchange rate.

**Inflation accounting.** Prior to January 1, 2003 the adjustments and reclassifications made to statutory records for the purpose of US GAAP presentation included the restatement of balances and transactions for the changes in the general purchasing power of the RR in accordance with Accounting Principles Board Statement 3, *Financial Statements Restated for General Price-Level Changes*. As the characteristics of the economic environment of the Russian Federation indicate that hyperinflation has ceased, effective from January 1, 2003 the Group no longer measures the impact of general price inflation. Accordingly, the amounts expressed in the measuring unit current at December 31, 2002 are treated as the basis for the carrying amounts in these financial statements.

Corresponding figures, for the year ended December 31, 2002, were restated for the changes in the general purchasing power of the RR at December 31, 2002. The restatement was calculated using the conversion factors derived from the Russian Federation Consumer Price Index, an historical price index published by the Russian State Committee on Statistics (“Goskomstat” prior to October 1999 and “Russian Statistics Agency” since October 1999), and from indices obtained from other sources for years prior to 1992.

The indices used to restate corresponding figures, based on 1988 prices (1988 = 100) for the three periods ended December 31, 2002, and respective conversion factors, are as follows:

| <b>Period ended</b> | <b>Index</b> | <b>Conversion factor</b> |
|---------------------|--------------|--------------------------|
| December 31, 2001   | 2,371.4      | 1.15                     |
| June 30, 2002       | 2,587.4      | 1.06                     |
| December 31, 2002   | 2,730.1      | 1.00                     |

The main guidelines followed in restating the corresponding figures were:

- All corresponding amounts, were stated in terms of the measuring unit current at December 31, 2002;
- Monetary assets and liabilities held at December 31, 2002 were not restated because they were already expressed in terms of the monetary unit current at December 31, 2002.
- Non-monetary assets and liabilities (those balance sheet items that were not expressed in terms of the monetary unit current at December 31, 2002) and components of shareholders’ equity were restated from their historical cost by applying the change in the general price index from the date the non-monetary item originated to December 31, 2002;
- All items in the statement of operations and cash flows were restated by applying the change in the general price index from the dates when the items were initially transacted to December 31, 2002.
- Gains or losses that arose as a result of holding monetary assets and liabilities for the reporting period ended June 30, 2002 were included in the statement of operations as a monetary gain or loss.

The accompanying notes are an integral part of these consolidated financial statements.

## OAOTATNEFT

### Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

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#### Note 2: Basis of Presentation (continued)

**Russian Rouble purchasing power gains and losses.** The accompanying interim consolidated financial statements include certain Russian Rouble amounts which represent underlying US Dollar balances. In the periods ended June 30, 2003, December 31, 2002 and 2001, the Consumer Price Index in the Russian Federation increased by 8%, 15%, 19%, respectively, while the US Dollar has (fallen) /gained in value with respect to the Russian Rouble by (5%), 5% and 7%, respectively.

For US Dollar balances other than those existing at June 30, 2003, differences between the rate of devaluation of the Russian Rouble and Russian Rouble inflation result in inconsistencies between disclosed Russian Rouble amounts and amounts obtained from converting US Dollar denominated items to Russian Roubles based on June 30, 2003 exchange rates. The disclosed Russian Rouble amounts, however, represent the June 30, 2003 purchasing power amounts in accordance with US GAAP.

**Barter transactions.** Transactions settled by barter are included in the accompanying interim consolidated balance sheets and statements of operations on the same basis as cash transactions.

Barter transactions relate to sales of crude oil and refined products and are generally either in the form of direct settlement by crude oil and refined products to the final customer, or through a chain of non-cash transactions involving several companies. In such cases, both sales and purchases are recorded as a result of the barter transaction. Barter sales are recognized at the fair value which is the market price of the crude oil and refined products exchanged.

**Reclassifications.** For comparative purposes, certain prior year amounts have been reclassified to conform to the current period's presentation.

#### Note 3: Summary of Significant Accounting Policies

**Principles of consolidation.** The accompanying interim consolidated financial statements include the operations of all subsidiaries in which the Group directly or indirectly owns or controls more than 50 percent of the voting stock. Joint ventures and affiliates in which the Group has significant influence but not control (generally 20 percent to 50 percent) are accounted for using the equity method. Investments in other companies are accounted for at cost and adjusted for estimated impairment.

**Cash equivalents.** Cash equivalents include all liquid securities with original maturities of three months or less when acquired, as well as amounts due from banks to the Group's banking subsidiaries.

**Inventories.** Crude oil, refined oil product inventories and materials, supplies and finished goods inventories are valued at the lower of cost or net realizable value using the weighted-average method.

**Investments.** Investments include securities classified as available-for-sale, held-to-maturity, or trading. Securities are classified as available-for-sale when, in management's judgment, they may be sold in response to or in anticipation of changes in market conditions. Available-for-sale securities are carried at fair value on the consolidated balance sheet. Unrealized gains and losses for available-for-sale securities are reported net as increases or decreases to accumulated other comprehensive income. The specific identification method is used to determine realized gains and losses on available-for-sale securities. Securities that management have the positive intent and ability to hold to maturity are classified as held-to-maturity and are carried at amortized cost on the consolidated balance sheet. Securities classified as trading are bought and held principally for the purpose of selling them in the near term. Trading securities are carried at fair value on the consolidated balance sheet. Unrealized gains and losses on trading securities are included in earnings.

**Loans receivable and advances to customers.** Loans receivable and advances to customers, which primarily relate to the Group's banking operations, are stated at their principal amounts outstanding net of provisions for losses. Provisions for losses on loans and advances to customers are based on the evaluation by management of their collectibility. Specific provisions are recorded against debts whose recovery has been identified as doubtful. A general provision is recorded against the doubtful loans and advances to customers, which are inherent in the portfolio but which at the date of preparing the financial statements have not been specifically identified. Estimates of losses require the exercise of judgment and the use of assumptions.

The accompanying notes are an integral part of these consolidated financial statements.



**ОАО ТАТНЕФТ****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)****(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)****Note 3: Summary of Significant Accounting Policies (continued)**

**Property, plant and equipment.** The Group follows the successful efforts method of accounting for its oil and gas properties, whereby property acquisitions, successful exploratory wells, all development costs (including development of dry holes), and support equipment and facilities are capitalized. Unsuccessful exploratory wells are charged to expense at the time the wells are determined to be non-productive. Production costs, overheads and all exploration costs other than exploratory drilling are charged to expense as incurred. Acquisition costs of unproved properties are evaluated periodically and any impairment assessed is charged to expense.

Depreciation, depletion and amortization of capitalized costs of proved oil and gas properties is calculated using the unit-of-production method for each field based upon proved reserves. Estimated costs of dismantling oil and gas production facilities, including abandonment and site restoration costs, are capitalized and discounted to date of put into production in accordance with SFAS No. 143.

Gains or losses are not recognized for retirements of oil and gas producing properties which are subject to composite depreciation, depletion and amortization. Gains or losses on retirements of other than oil and gas producing properties are included in earnings.

Other property, plant and equipment not associated with oil and gas properties are recorded at cost less accumulated depreciation. Depreciation of these assets, including social assets, is calculated on a straight-line basis as follows:

|                             | <b>Years</b> |
|-----------------------------|--------------|
| Buildings and constructions | 25 - 33      |
| Machinery and equipment     | 5 - 15       |

Long-lived assets, including proved oil and gas properties, are assessed for possible impairment in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). SFAS 144 requires long-lived assets with recorded values that are not expected to be recovered through undiscounted future cash flows to be written down to current fair value. Fair value is generally determined from estimated future discounted net cash flows.

Maintenance and repairs and minor renewals are expensed as incurred. Major renewals and improvements are capitalized and any assets replaced are retired.

Social assets constructed prior to privatization, and the related deferred income tax balances, were charged to additional capital as a distribution of capital when the assets were permanently transferred to government authorities. Social assets constructed subsequent to privatization are charged to expense when the assets are permanently transferred to government authorities.

The accompanying notes are an integral part of these consolidated financial statements.

## OAo TATNEFT

### Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

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#### Note 3: Summary of Significant Accounting Policies (continued)

**Derivative instruments.** The Group recognizes all derivatives as either assets or liabilities in the consolidated balance sheet and measures those instruments at fair value. Derivative instruments primarily represent foreign exchange and commodity forwards associated with the Group's banking operations. The accounting for changes in fair value depends on the derivatives' intended use and designation and could entail recording the gain or loss through earnings of the current period, or as part of comprehensive income and subsequently reclassifying into earnings when the gain or loss is realized.

**Environmental liabilities.** Liabilities for environmental remediation are recorded when it is probable that obligations have been incurred and the amounts can be reasonably estimated.

**Pension and post-employment benefits.** The Group's mandatory contributions to the governmental pension scheme are expensed when incurred. Discretionary pension and other post-employment benefits are not material.

**Revenue recognition.** Revenues from the production and sale of crude oil and petroleum products are recognized when deliveries of products to final customers are made and title passes to the customer and collectibility is reasonably assured.

**Stock-based compensation.** The Group's stock-based compensation is accounted for in accordance with the intrinsic value method established by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. Compensation expense is recognized for stock options granted when the exercise price of the options granted is below the fair market value of the Group's stock at the date of grant.

**Income taxes.** Deferred income tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in the periods in which these temporary differences are expected to reverse. Valuation allowances are provided for deferred income tax assets when management believes that it is more likely than not that the assets will not be realized.

**Comprehensive income.** Comprehensive income includes all changes in equity during the period from non-owner sources and is detailed in the consolidated statement of operations and comprehensive income.

**Net income per share.** Basic income per share is calculated using the two class method of computing earnings per share. Under this method, net income is reduced by the amount of dividends declared in the current period for each class of shares, and the remaining income is allocated to common and preferred shares to the extent that each class may share in income if all income for the period had been distributed. Diluted income per share reflects the potential dilution that was exercised using the treasury stock method.

**Treasury shares.** Common shares of OAO Tatneft owned by the Group at the balance sheet date are designated as treasury shares and are recorded at cost. Any gain or loss on the resale of treasury shares is recorded as a component of equity.

**Accounting changes.** Effective January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* ("SFAS 143"). This new statement applies to legal obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Adoption of SFAS 143 primarily affects the Group's accounting for oil and gas producing assets and differs in several significant respects from the preceding accounting under Statement of Financial Accounting Standards No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*. Upon initial recognition of a liability for an asset retirement obligation, the Group capitalizes an asset retirement cost by increasing the carrying value of the related long-lived asset by the same amount. Legal obligations, if any, to retire refining and marketing and distribution assets are generally not recognized because of the indeterminable settlement date of these obligations.

**OAOTATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 3: Summary of Significant Accounting Policies (continued)**

**Recent accounting pronouncements.** Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure - an amendment of FAS 123* ("SFAS 148") provides alternative methods for the transition of the accounting for stock-based compensation from the intrinsic value method to the fair value method. The Group is yet undecided which accounting standard APB 25 or SFAS 148 to apply effective January 1, 2003 in accounting for Stock-Based Compensation. The estimated impact on the Company's 2003 earnings would not be materially different under SFAS 148 than under previous accounting standards.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"). FIN 46 amended ARB 51, *Consolidated Financial Statements*, and established standards for determining under what circumstances a variable interest entity (VIE) should be consolidated with its primary beneficiary. FIN 46 also requires disclosures about VIEs that the Group is not required to consolidate but in which it has a significant variable interest. The consolidation requirements of FIN 46 apply immediately to VIEs created after January 31, 2003, while earlier formed entities must be consolidated in the first fiscal year or interim period ending after December 15, 2003. The Group does not expect the initial adoption of FIN 46 to have a significant impact on its results of operations, financial position or liquidity.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities.* SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133 *Accounting for Derivative Instruments and Hedging Activities.* The Statement is effective for contracts entered into or modified after June 30, 2003, except for the provisions that relate to previously effective SFAS No. 133 Implementation issues, and for hedging relationships designated after June 30, 2003. The Group does not expect any material impact of adopting SFAS No. 149.

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* ("SFAS 150"). SFAS 150 establishes standards for classification and measurement of certain financial instruments with characteristics of both liabilities and equity and is effective for financial instruments entered into or modified after May 31, 2003. The Group does not expect the initial adoption of SFAS 150 to have a significant impact on its results of operations, financial position or liquidity.

**Note 4: Cash and Cash Equivalents, Restricted Cash, and Cash Flow Information**

The interim consolidated statements of cash flows provide information about changes in cash and cash equivalents. At June 30, 2003, December 31, 2002 and December 31, 2001, cash holdings of the Group, consisting of cash, cash equivalents and restricted cash, include US Dollar denominated amounts of RR 3,074 million (US \$101 million), RR 4,150 million (US \$131 million) and RR 3,295 million (US \$95 million), respectively, of which RR nil, RR 178 million (US \$6 million), RR 727 million (US \$21 million) respectively, is restricted. Restricted cash primarily consists of mandatory deposits with the Central Bank of Russia and deposits with lending institutions. Deposits with lending institutions are held over the life of the respective loans.

Net cash provided by operating activities reflects payments of interest and income taxes as follows:

|                   | Six months ended<br>June 30,<br>2003 | Six months ended<br>June 30,<br>2002 | Six months ended<br>June 30,<br>2001 |
|-------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Interest paid     | 1,14'                                | 1,09'                                | 1,50'                                |
| Income taxes paid | 2,60'                                | 3,25'                                | 5,9'                                 |

The accompanying notes are an integral part of these consolidated financial statements.

**OA O TATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 5: Accounts Receivable**

Accounts receivable are as follows:

|  | <b>At June 30,<br/>2003</b> | <b>At December 31,<br/>2002</b> |
|--|-----------------------------|---------------------------------|
| Trade – domestic sales   | 9,269                       | 8,82                            |
| Trade – export sales (US \$311 million and US \$197 million at<br>June 2003 and December 31, 2002, respectively) | 9,451                       | 6,25                            |
| <b>Total accounts receivable, net</b>  | <b>18,720</b>               | <b>15,07</b>                    |

Trade receivables are presented net of an allowance for doubtful accounts of RR 1,318 million and RR 1,073 million at June 30, 2003 and December 31, 2002, respectively.

**Note 6: Short and Long-Term Investments**

Short-term investments are classified both as available-for-sale and trading securities:

|                                     | <b>At June 30,<br/>2003</b> | <b>At December 31,<br/>2002</b> |
|-------------------------------------|-----------------------------|---------------------------------|
| Available-for-sale securities       | 1,009                       | 944                             |
| Trading securities                  | 3,416                       | 2,53                            |
| <b>Total short-term investments</b> | <b>4,425</b>                | <b>3,47</b>                     |

Trading securities are those securities which are actively managed in a trading account with the objective of profiting from short-term price changes. These securities are held in Group's banks and insurance company, which frequently buy and sell securities with the objective of earning profits on short-term differences in price. All other investments in debt and equity securities are classified as available-for-sale.

The accompanying notes are an integral part of these consolidated financial statements.

**OA O TATNEFT**

**Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 6: Short and Long-Term Investments (continued)**

Short-term investments classified as available-for-sale are as follows:

|   | Cost       | Gross<br>unrealized<br>holding<br>gains | Fair value<br>(carrying<br>value) |
|---|------------|---|-----------------------------------|
| Bonds and other Russian government securities                   | 1          | -                                       | 1                                 |
| Corporate debt securities                                       | 721        | -                                       | 721                               |
| Equity securities   | 254        | 33                                      | 287                               |
| <b>Total available-for-sale securities at June 30, 2003</b>     | <b>976</b> | <b>33</b>                               | <b>1,009</b>                      |
| Corporate debt securities                                       | 50         | -                                       | 50                                |
| Equity securities   | 861        | 33                                      | 894                               |
| <b>Total available-for-sale securities at December 31, 2002</b> | <b>911</b> | <b>33</b>                               | <b>944</b>                        |

Short-term investments classified as trading securities are as follows:

|   | At June 30,<br>2003 | At December 31,<br>2002 |
|---|---------------------|-------------------------|
| Bonds and other Russian government securities | 699                 | 1,110                   |
| Corporate debt securities                     | 2,543               | 1,259                   |
| Equity securities                             | 174                 | 164                     |
| <b>Total trading securities</b>               | <b>3,416</b>        | <b>2,533</b>            |

Bonds and other Russian government securities at June 30, 2003 and December 31, 2002, include mainly Federal Currency Bonds (OVVZ) with a carrying value of RR 54 million, RR 712 million respectively.

At June 30, 2003, total debt securities with fair values totaling RR 1,460 million mature during July 2003 – June 2004, and with fair values totaling RR 2,504 million mature between July 2004 and June 2030.

Net realized gains on trading and available-for-sale securities for the six months ended June 30, 2003, 2002 and 2001 were RR 349 million, RR 518 million, RR 110 million, respectively.

The accompanying notes are an integral part of these consolidated financial statements.

**OAo TATNEFT**

**Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 6: Short and Long-Term Investments (continued)**

Long-term investments are as follows:

|  | Percentage holding at<br>June 30,<br>2003 | Net book value at |                      | Income for the six months ended June 30, |            |           |
|--|---|-------------------|----------------------|--|------------|-----------|
|  |   | June 30,<br>2003  | December<br>31, 2002 | 2003                                     | 2002       | 2001      |
| Investments in equity affiliates and joint ventures:                     |   |                   |                      |  |            |           |
| ZAO Tatex  | 50  | 1,744             | 1,775                | 32                                       | 108        | 150       |
| ZAO Financial-Leasing Company ("FLK")                                    | -   | -                 | 512                  | -  | 18         | -         |
| Other  |   | 13                | 246                  | -  | 12         | (88)      |
| <b>Total investments in equity affiliates and joint ventures/ income</b> |   | <b>1,757</b>      | <b>2,533</b>         | <b>32</b>                                | <b>138</b> | <b>62</b> |
| Long-term investments, at cost:  |   |                   |                      |  |            |           |
| ZAO Ukratatnafta   | 9   | 504               | 504                  |  |            |           |
| OAo AK Bars Bank   | 18  | 609               | 609                  |  |            |           |
| Other  |   | 917               | 557                  |  |            |           |
| <b>Total long-term investments, at cost</b>                              |   | <b>2,030</b>      | <b>1,670</b>         |  |            |           |
| <b>Total long-term investments</b>                                       |   | <b>3,787</b>      | <b>4,203</b>         |  |            |           |

Summary financial information pertaining to these investments has not been presented as the investments are not material to the Group's interim consolidated financial statements.

**Note 7: Inventories**

Inventories are as follows:

|   | At June 30,<br>2003 | At December 31,<br>2002 |
|---|---------------------|-------------------------|
| Materials and supplies                    | 7,054               | 6,407                   |
| Crude oil                                 | 2,100               | 1,861                   |
| Refined oil products                      | 1,631               | 799                     |
| Petrochemical supplies and finished goods | 621                 | 895                     |
| <b>Total inventories, net</b>             | <b>11,411</b>       | <b>9,962</b>            |

The accompanying notes are an integral part of these consolidated financial statements.

**OA O TATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 8: Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets are as follows:

|  | At June 30,<br>2003 | At December 31,<br>2002 |
|--|---------------------|-------------------------|
| Notes receivable                                       | 6,941               | 5,422                   |
| Prepaid VAT  | 5,665               | 5,908                   |
| Advances   | 3,223               | 2,065                   |
| Prepaid profit tax                                     | 1,332               | 1,561                   |
| Current deferred tax asset                             | 705                 | 113                     |
| Interest receivable                                    | 453                 | 170                     |
| Prepaid export duties                                  | 25                  | 1,011                   |
| Prepaid transportation expenses                        | -                   | 252                     |
| Other  | 2,338               | 2,661                   |
| <b>Total prepaid expenses and other current assets</b> | <b>20,682</b>       | <b>19,163</b>           |

**Note 9: Loans Receivable and Advances**

|  | At June 30,<br>2003 | At December 31,<br>2002 |
|--|---------------------|-------------------------|
| Banking loans and advances to customers, net           | 14,228              | 11,352                  |
| Other Rouble denominated loans receivable              | 1,452               | 1,893                   |
| <b>Total loans receivable and advances</b>             | <b>15,680</b>       | <b>13,245</b>           |
| Less: current portion of loans receivable and advances | (11,730)            | (10,494)                |
| <b>Total long-term loans receivable and advances</b>   | <b>3,950</b>        | <b>2,751</b>            |

**Banking loans and advances to customers.** Banking loans and advances to customers are presented net of allowance for losses of RR 1,128 million and RR 1,011 million as at June 30, 2003 and December 31, 2002, respectively.

At June 30, 2003 and December 31, 2002 the weighted average interest rate on banking loans and advances was 18% on balances denominated in Russian Roubles and 14% on balances denominated in foreign currency, respectively. The fair value of banking loans and advances approximate the carrying values as interest rates typically adjust on a three months basis and the majority is short-term in nature.

**Other Rouble denominated loans receivable.** Other Rouble denominated loans receivable at June 30, 2003 include non interest-bearing loans to third parties in the amount of RR 1,452 million, of which RR 612 million are current loans receivable and RR 840 million are long-term. At December 31, 2002 other Rouble denominated loans receivable include non interest-bearing loans to third parties in the amount of RR 1,893 million, of which RR 651 million are current loans receivable and RR 1,242 million are long-term.

**Note 10: Property, Plant and Equipment**

Effective January 1, 2003, the Group adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." This new accounting standard applies to legal obligations associated with the retirement of tangible long-lived assets. SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying amount of the related long-lived asset. Subsequently, the liability is accreted for the passage of time and the related asset is depreciated over its estimated useful life. The adoption of SFAS No. 143 affected the accounting and reporting of the assets, liabilities and expenses related to these obligations. As of January 1, 2003, the Group recorded a cumulative-effect adjustment resulting in an after-tax increase to net income of RR 4,815 million in relation to this change in accounting principle. The effect of adoption also included an increase of net property, plant and equipment of RR 10,119 million, and the establishment of an additional asset retirement obligation of RR 5,304 million, net of tax.

The accompanying notes are an integral part of these consolidated financial statements.

**OAo TATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 10: Property, Plant and Equipment (continue)**

Included in operating expenses in the first six months 2003 was RR 341 million of expenses related to the accretion of the asset retirement obligation. As of June 30, 2003 the total assets retirement obligation was RR 5,643 million, of which RR 731 million was included in other current liabilities.

Property, plant and equipment are as follows:

|                             | <b>Cost</b>    | <b>Accumulated depreciation,<br/>depletion and amortization</b> | <b>Net book value</b> |
|-----------------------------|----------------|---|-----------------------|
| Oil and gas properties      | 250,232        | 131,578   | 118,654               |
| Buildings and constructions | 27,109         | 8,362   | 18,747                |
| Machinery and equipment     | 39,824         | 28,695  | 11,129                |
| Assets under construction   | 15,724         | -   | 15,724                |
| <b>June 30, 2003</b>        | <b>332,889</b> | <b>168,635</b>  | <b>164,254</b>        |
| Oil and gas properties      | 235,223        | 127,569   | 107,654               |
| Buildings and constructions | 27,559         | 7,806   | 19,753                |
| Machinery and equipment     | 38,872         | 27,415  | 11,457                |
| Assets under construction   | 15,183         | -   | 15,183                |
| <b>December 31, 2002</b>    | <b>316,837</b> | <b>162,790</b>  | <b>154,047</b>        |

The Group's oil and gas fields are located on the territory of Tatarstan. The Group obtains licenses from the local authorities to explore and produce oil and gas from these fields. These licenses expire between 2013 and 2015, and may be extended at the initiative of the Group. Management intends to extend licenses for properties which are expected to produce hydrocarbons subsequent to the expiration of their respective licenses.

The Group's cash flow from operations is dependent on the level of oil prices, which are historically volatile and are also significantly impacted by the proportion of production that it can sell on the export market. Historically, the Group has supplemented its cash flow from operations with additional borrowings and may continue to do so. Should oil prices decline for a prolonged period and should the Group not have access to additional capital, the Group would need to reduce its capital expenditures, which could limit its ability to maintain or increase production and in turn meet its debt service requirements and pay dividends.

In 1999, the Group entered into an agreement with Nizhnekamskneftekhim, and OAO Tataro-American Investment Fund (TAIF), related parties under the significant influence of a common shareholder, to form a joint venture company, OAO Nizhnekamsk Refinery. This joint venture is expected to expand, upgrade, and operate the existing refinery in Nizhnekamsk. The Group's total investment in the refinery amounted to approximately US \$218 million as of June 30, 2003. The ultimate level of the Group's interest in the refinery is still under negotiation.

**Social assets.** During periods ended June 30, 2003, 2002 and 2001 the Group transferred social assets with a net book value of RR 878 million, RR 217 million and RR 560 million, respectively, to local authorities for no consideration. All the amounts transferred in periods ended June 30, 2003, 2002 and 2001 relate to assets that were constructed or procured by the Group subsequent to privatization. At June 30, 2003, and December 31, 2002, the Group held social assets with a net book value of RR 5,320 million and RR 5,833 million all of which were constructed after the privatization date. The Group incurred social infrastructure expenses of RR 126 million, RR 43 million and RR 195 million for the periods ended June 30, 2003, 2002, and 2001, respectively, for maintenance that mainly relates to housing, schools and cultural buildings.

**Impairment of fixed assets.** In 2001, based on a reassessment of its future development plans and cash flows of a telecommunications subsidiary, the Group has written off its investment resulting in a charge to operations of RR 394 million.

The accompanying notes are an integral part of these consolidated financial statements.



**OA0 TATNEFT**

**Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 11: Debt**

|  | At June 30,<br>2003 | At December 31,<br>2002 |
|--|---------------------|-------------------------|
| <b>Short-term debt</b>                   |                     |                         |
| <b>Foreign currency denominated debt</b> |                     |                         |
| Current portion of long-term debt        | 5,73                | 6,11                    |
| Other foreign currency denominated debt  | 7,45                | 5,56                    |
| <b>Rouble denominated debt</b>           |                     |                         |
|  | 5,47                | 4,94                    |
| <b>Total short-term debt</b>             | <b>18,66</b>        | <b>16,61</b>            |
| <b>Long-term debt</b>                    |                     |                         |
| <b>Foreign currency denominated debt</b> |                     |                         |
| BNP Paribas                              | 10,32               | 11,74                   |
| Credit Swiss First Boston                | 5,01                | 5,72                    |
| Zenit's Eurobonds                        | 3,28                | -                       |
| Commerzbank AG                           | 843                 | 2,20                    |
| Other foreign currency denominated debt  | 137                 | 491                     |
| <b>Rouble denominated debt</b>           |                     |                         |
|  | 608                 | 572                     |
| Less: current portion                    | (5,73)              | (6,11)                  |
| <b>Total long-term debt</b>              | <b>14,48</b>        | <b>14,62</b>            |

**Short-term foreign currency denominated debt.** As of June 30, 2003 other short-term foreign currency denominated debt includes loans from Winter Bank, BNP Paribas, Donau bank, Credit Swiss Zurich, Whill Trading, Colima Associates and interbank loans.

In July 2001 the Group entered into a RR 1,042 million (US \$30 million) loan agreement with Winter Bank. The loan bears an interest rate of 6 month LIBOR plus 4.5% per annum. The loan must be repaid in full every six months and may be renewed immediately for an additional six months during the three year term of the commitment. The loan matures in November 2004. The amount of loan outstanding as of June 30, 2003 was RR 910 million.

In April 2003 the Group entered into a RR 1,877 million (US \$60 million) loan agreement with BNP Paribas. The loan bears interest at 1 month LIBOR plus 3.25 % per annum and is collateralized by crude oil export contracts of 45 thousand tonnes per month. The amount of loan outstanding as of June 30, 2003 was RR 1,593 million (US \$52.5 million). The loan matures in January 2004.

In December 2002 the Group entered into a RR 636 million (US \$20 million) loan agreement with Donau bank. The loan bears interest at 2.3 % per annum and is collateralized by deposit with Bank Zenit. Matures in December 2003. The amount of loan outstanding as of June 30, 2003 was RR 607 million.

In 2002 the Group entered into a RR 636 million (US \$20 million) one month revolving overdraft facility with Credit Swiss Zurich. The monthly revolving loan bears interest from 3.150% to 3.750% per annum and is collateralized by crude oil sales. The amount of loan outstanding as of June 30, 2003 was RR 418 million (US \$14 million).

In March 2003 the Group entered into a RR 630 million (US \$20 million) one month revolving overdraft facility with Credit Swiss Zurich. The monthly revolving loan bears interest from 2.85% to 3.1% per annum and is collateralized by crude oil sales. The amount of loan outstanding as of June 30, 2003 was RR 38 million (US \$1 million).

In 2003 the Group entered into a RR 927 million (US \$29 million) loan agreement with Whill Trading. The loan bears interest at 12 % per annum, matures in first half of 2004 and is unsecured. The amount of loan outstanding as of June 30, 2003 was RR 889 million.

In 2003 the Group entered into a RR 83 million (US \$2.7 million) loan agreements with Colima Associates. The loans bear interest at 2% per annum and are unsecured. The amount of loan outstanding as of June 30, 2003 was RR 82 million.

The accompanying notes are an integral part of these consolidated financial statements.

**OA O TATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)****(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)****Note 11: Debt (continued)**

Interbank loans from foreign banks of RR 2,919 million and RR 2,522 million as at June 30, 2003 and December 31, 2002 had effective average interest rate of 7% and 4% per annum, respectively.

**Short-term Rouble denominated debt.** Rouble denominated short-term debt primarily comprises of loans with Russian banks. Short-term Rouble denominated loans of RR 5,474 million and RR 4,941 million bear contractual interest rates from 10% to 25% and 10% to 25% per annum for the periods ended June 30, 2003 and December 31, 2002, respectively. The loans are collateralized by the assets of the Group.

**Long-term foreign currency denominated debt.** In November 2001, the Group entered into a loan agreement with BNP Paribas for US \$100 million. The loan bears interest at LIBOR plus 3.5% per annum, is collateralized by crude oil export contracts of 50 thousand tonnes per month and matures in February 2004. The amount of loan outstanding as of June 30, 2003 was RR 1,391 million. In October 2002, the Group entered into another loan agreement with BNP Paribas for US \$300 million. The amount outstanding under this loan as of June 30, 2003 was RR 8,936 million. The loan bears interest from LIBOR plus 3.75% to LIBOR plus 4.25%, per annum, is collateralized by crude oil export contracts of 120 thousand tonnes per month, and matures in October 2007. The loan agreements require compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and maximum debt and interest coverage ratios.

In March 2002 the Group entered into a US \$200 million loan agreement with Credit Suisse First Boston. The amount of loan outstanding as of June 30, 2003 was RR 5,017 million (US \$166 million). The loan bears interest at LIBOR plus 3.78% per annum, is collateralized by the crude oil export contracts of 200 thousand tonnes per month and matures in March 2007.

In October 2001 the Group entered into a US \$125 million loan agreement with Commerzbank AG. The amount outstanding under this loan as of June 30, 2003 was RR 843 million. The loan bears interest at LIBOR plus 3.75% per annum, is collateralized by the Group's oil export contracts of 80 thousand tonnes per month and matures in October 2003.

**Eurobonds.** Eurobonds issued represent internationally traded long-term Notes issued by the Group on June 12, 2003 with the face value of \$125,000 and interest rate of 9.25% payable semi-annually in arrears on June 12 and December 12. The issue matures on June 12, 2006. The entire amount of Eurobonds outstanding at June 30, 2003 and was RR 3,288 million. The Group performs dealing operations with its eurobonds.

**Other long-term foreign currency denominated debt.** During the period ended December 31, 2002 the Group entered into a RR 278 million (US \$9 million) loan agreement with West Deutsche Landesbank Vostok. The amount outstanding under this loan as of June 30, 2003 was RR 137 million. The loan bears interest at LIBOR plus 4.5% per annum and is collateralized by crude oil export contracts of approximately 7.5 thousand tonnes per month. The loan matures in February 2004.

**Long-term Rouble denominated debt.** Long-term Rouble denominated debt includes debentures and other loans bearing interest rates from 12% to 19%. Debentures outstanding as of June 30, 2003 amounted to RR 279 million. Other loans include loans with other counter parties. The loans mature between 2003 to 2015.

The fair value of the Group's long-term debt is similar to its book value. Fair value assessment is subject to considerable uncertainty.

Aggregate maturities of long-term debt outstanding at June 30, 2003 is as follows:

|                               |               |
|-------------------------------|---------------|
| June 30, 2004- June 30, 2005  | 4,525         |
| June 30, 2005- June 30, 2006  | 6,607         |
| June 30, 2006- and thereafter | 3,356         |
| <b>Total long-term debt</b>   | <b>14,488</b> |

The accompanying notes are an integral part of these consolidated financial statements.

**OAOTATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 12: Notes payable and banking customer deposits**

Notes payable are as follows:

|                                | At June 30,<br>2003 | At December 31,<br>2002 |
|--------------------------------|---------------------|-------------------------|
| Bank notes payable             | 2,810               | 1,707                   |
| Other notes payable            | 3,770               | 2,641                   |
| Less: current portion          | (5,530)             | (3,482)                 |
| <b>Notes payable long-term</b> | <b>1,050</b>        | <b>866</b>              |

Bank notes payable as of June 30, 2003 include short-term and long-term notes payable of Zenit Bank in the amounts of RR 2,607 million and RR 20 million, respectively, and short-term notes payable of Devon Credit Bank in the amount of RR 183 million. Bank notes payable for the year ended December 31, 2002 include short-term and long-term notes payable of Zenit Bank in the amounts of RR 1,640 million and RR 13 million, respectively, and short-term notes payable of Devon Credit Bank in the amount of RR 54 million.

Other notes payable as of June 30, 2003 include short-term and long-term trade promissory notes payable to third parties and bear contractual interest rates ranging from 2% to 19%, respectively.

Banking customer deposits are as follows:

|  | At June 30,<br>2003 | At December 31,<br>2002 |
|--|---------------------|-------------------------|
| Interest bearing deposits                  | 8,450               | 9,011                   |
| Non interest deposits                      | 7,230               | 4,133                   |
| Less: current portion                      | (15,320)            | (11,992)                |
| <b>Banking customer deposits long-term</b> | <b>355</b>          | <b>1,152</b>            |

Contractual interest rates were 11% and 12% for Russian Rouble interest deposits, and 7% and 6% for foreign currency interest deposits for the periods ended June 30, 2003 and December 31, 2002, respectively. The carrying values of notes payable and banking customer deposits approximate their fair values.

**Note 13: Other Accounts Payable and Accrued Liabilities**

Other accounts payable and accrued liabilities are as follows:

|   | At June 30,<br>2003 | At December 31,<br>2002 |
|---|---------------------|-------------------------|
| Salaries and wages payable                                  | 1,320               | 1,600                   |
| Insurance provision   | 934                 | 788                     |
| Current portion of asset retirement obligations             | 731                 | -                       |
| Advances received   | 556                 | 552                     |
| Interest payable  | 538                 | 474                     |
| Advances for purchase of securities                         | 175                 | 691                     |
| Deferred revenues   | 114                 | 132                     |
| Other accrued liabilities                                   | 3,460               | 1,328                   |
| <b>Total other accounts payable and accrued liabilities</b> | <b>7,830</b>        | <b>5,571</b>            |

The accompanying notes are an integral part of these consolidated financial statements.

**OA O TATNEFT**
**Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 14: Taxes**

Deferred income taxes reflect the impact of temporary differences between the amount of assets and liabilities recognized for financial reporting purposes and such amounts recognized for statutory tax purposes. Deferred tax assets (liabilities) are comprised of the following at June 30, 2003 and December 31, 2002:

|                                   | At June 30,<br>2003 | At December 31,<br>2002 |
|-----------------------------------|---------------------|-------------------------|
| Inventories                       | 36                  | -                       |
| Accounts receivable               | 567                 | 68                      |
| Long-term investments             | 146                 | 32                      |
| Other accounts payable            | 82                  | 39                      |
| <b>Deferred tax assets</b>        | <b>831</b>          | <b>139</b>              |
| Property, plant and equipment     | (21,31)             | (19,201)                |
| Inventories                       | -                   | (222)                   |
| Long-term investments             | (402)               | (491)                   |
| Other liabilities                 | (69)                | (55)                    |
| <b>Deferred tax liabilities</b>   | <b>(21,78)</b>      | <b>(19,969)</b>         |
| <b>Net deferred tax liability</b> | <b>(20,95)</b>      | <b>(19,830)</b>         |

At June 30, 2003 and December 31, 2002, deferred taxes were classified in the consolidated balance sheet as follows:

|   | At June 30,<br>2003 | At December 31,<br>2002 |
|---|---------------------|-------------------------|
| Prepaid expenses and other current assets | 705                 | 113                     |
| Current deferred tax liability            | -                   | -                       |
| Non-current deferred tax liability        | (21,663)            | (19,943)                |
| <b>Net deferred tax liability</b>         | <b>(20,958)</b>     | <b>(19,830)</b>         |

Presented below is a reconciliation between the provision for income taxes and taxes determined by applying the statutory tax rate to income before income taxes:

|   | Six months<br>ended<br>June 30,<br>2003 | Six months<br>ended<br>June 30,<br>2002 | Six months<br>ended<br>June 30,<br>2001 |
|---|---|---|---|
| Income before income taxes and minority interest      | 5,031                                   | 7,271                                   | 17,911                                  |
| Theoretical income tax expense at statutory rate      | 1,201                                   | 1,741                                   | 6,271                                   |
| Increase (reduction) due to:                          |   |   |   |
| Inflationary effects                                  | -                                       | 1,341                                   | 2,111                                   |
| Non-deductible expenses                               | 561                                     | 334                                     | 2,231                                   |
| Tax credits   | (182)                                   | (724)                                   | (1,961)                                 |
| Non-taxable income                                    | (134)                                   | (91)                                    | (32)                                    |
| Statutory devaluation / (revaluation) of Fixed Assets | 890                                     | (2,801)                                 | -                                       |
| Statutory fall in Tax value of Fixed Assets           | 1,271                                   | -                                       | -                                       |
| Effect of increase (reduction) in income tax rate     | -                                       | -                                       | (9,261)                                 |
| Other   | (168)                                   | 149                                     | -                                       |
| <b>Provision (benefit) for income taxes</b>           | <b>3,441</b>                            | <b>(43)</b>                             | <b>(646)</b>                            |

The accompanying notes are an integral part of these consolidated financial statements.

**OA O TATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 14: Taxes (continued)**

Tax credits reduce taxable income in the period incurred and are granted by the governments of the Russian Federation and the Republic of Tatarstan.

In August 2001, changes in the Russian Tax Code were enacted, which introduced a new income tax rate of 24%, effective January 1, 2002 compared to 35% in 2001. The net deferred tax benefit recognized as a result of remeasuring the deferred tax liability for tax rate changes on an enactment date basis, amounted to RR 9,264 for the period ended June 30, 2001.

No provision has been made for additional income taxes of RR 2,258 million on undistributed earnings of a foreign subsidiary. These earnings have been and will continue to be reinvested. These earnings could become subject to additional tax of approximately RR 339 million if they were remitted as dividends.

The Company is subject to a number of taxes other than income taxes, which are detailed as follows:

|  | <b>Six months ended<br/>June 30,<br/>2003</b> | <b>Six months ended<br/>June 30,<br/>2002</b> | <b>Six months ended<br/>June 30,<br/>2001</b> |
|--|---|---|---|
| Unified production tax                     | 9,5   | 7,350   | -   |
| Export tariffs                             | 8,8   | 5,291   | 7,893   |
| Excise taxes                               | 1,3   | -   | 791   |
| Property tax                               | 661   | 670   | 409   |
| Mineral restoration tax and royalty        | -   | -   | 5,921   |
| Other                                      | 406   | 603   | 965   |
| <b>Total taxes other than income taxes</b> | <b>20,7</b>                                   | <b>13,914</b>                                 | <b>15,979</b>                                 |

Effective January 1, 2002, the unified production tax was introduced and replaced the mineral restoration tax, royalty tax and excise tax on crude oil production. The base for the unified production tax is set at RR 340 per metric tonne of crude oil produced, and is adjusted depending on the market price of Urals blend and the US \$/ RR exchange rate. The tax becomes zero if Urals blend price falls to or below US \$8.00 per barrel.

**Note 15: Share Capital and Additional Capital**

**Authorized share capital.** At June 30, 2003 the authorized share capital consists of 2,178,690,700 voting common shares and 147,508,500 non-voting preferred shares; both classes of shares have a nominal value of RR 1.00 per share.

**Golden share.** One share of the Company, held by the Government of Tatarstan, carries the right to veto certain decisions taken at shareholders' and Board of Directors' meetings. Decisions subject to veto include: increases and decreases in share capital, amendments to the Company's charter, liquidation or reorganization of the Company or any of its subsidiaries or branches, investment in other legal entities and disposal or encumbrance of the Company's property. The term of the "Golden Share" was extended indefinitely in 1998 by a decree of the President of Tatarstan and may be utilized by the Government of Tatarstan if it owns less than 25% of the Company.

The accompanying notes are an integral part of these consolidated financial statements.

**Note 15: Share Capital and Additional Capital (continued)**

**Restricted common and preferred shares.** Under the privatization laws of Tatarstan, initially certain common shares were made subject to restrictions on transfer. These include shares sold to employees for a discount from nominal value and common shares sold to any individual for privatization vouchers. The preferred shares of the Company were also subject to restrictions on transfer. The preferred shares were originally allocated pursuant to applicable privatization laws to employees, former employees, and pensioners who had worked for the Group for a specified period of time. Afterwards by decree of the President of Tatarstan, all restrictions on common and preferred shares have been removed.

**Rights attributable to preferred shares.** Unless a different amount is approved at the annual shareholders meeting, preferred shares earn dividends equal to their nominal value. The amount of a dividend for a preferred share may not be less than the amount of a dividend for a common share.

Preferred shareholders may vote at meetings only on the following decisions:

- the amendment of the dividends payable per preferred share;
- the issuance of additional shares with rights greater than the current rights of preferred shareholders; and
- the liquidation or reorganization of the Company.

The decisions listed above can be made only if approved by 75% of preferred shareholders.

Holders of preferred shares acquire the same voting rights as holders of common shares in the event that dividends are either not declared, or declared but not paid. On liquidation, the shareholders are entitled to receive a distribution of net assets.

**Amounts available for distribution to shareholders.** Amounts available for distribution to shareholders are based on the Company's non-consolidated statutory accounts prepared in accordance with RAR, which differ from US GAAP. The statutory accounts are the basis for profit distribution and other appropriations. Russian legislation identifies the basis of distribution as the current period net profit calculated in accordance with RAR. However, this legislation and other statutory laws and regulations dealing with distribution rights are open to legal interpretation. For the periods ended June 30, 2003 and December 31, 2002, the Company had a statutory current profit of RR 5,404 million and RR 6,309 million, respectively, as reported in the published statutory accounts of the Company.

At the annual general meeting of shareholders on June 27, 2003, final dividends of RR 0.10 per common share and RR 1.00 per preferred share, expressed in nominal Russian Roubles, were approved for 2002 for all shareholders. At June 30, 2003 the Company has not paid of its accrued dividends for 2002.

No interim dividends for 2003 were declared.

**Net income per share.** Under the two-class method of computing net income per share, net income is computed for common and preferred shares according to dividends declared and participation rights in undistributed earnings. Under this method, net income is reduced by the amount of dividends declared in the current period for each class of shares, and the remaining income is allocated to common and preferred shares to the extent that each class may share in income if all income for the period had been distributed.

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Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

Note 15: Share Capital and Additional Capital (continued)

|  | Six months<br>ended<br>June 30,<br>2003 | Six months<br>ended<br>June 30,<br>2002 | Six months<br>ended<br>June 30,<br>2001 |
|--|---|---|---|
| Income before cumulative effect of change in accounting principle              | 1,520                                   | 7,(                                     | 17,77                                   |
| Common share dividends   | (216)                                   | (237)                                   | (282)                                   |
| Preferred share dividends  | (148)                                   | (161)                                   | (36)                                    |
| <b>Income available to common and preferred shareholders, net of dividends</b> | <b>1,156</b>                            | <b>6,(</b>                              | <b>17,45</b>                            |

**Basic:**

Weighted average number of shares outstanding (millions of shares):

|   |             |             |             |
|---|-------------|-------------|-------------|
| Common  | 1,984       | 2,(         | 2,09        |
| Preferred   | 148         | 148         | 148         |
| Combined weighted average number of common and preferred shares outstanding | 2,132       | 2,1         | 2,23        |
| <b>Basic net income per common share (RR)</b>                               | <b>0.65</b> | <b>3.18</b> | <b>7.94</b> |
| <b>Basic net income per preferred share (RR)</b>                            | <b>1.54</b> | <b>4.15</b> | <b>8.04</b> |

**Diluted:**

Weighted average number of shares outstanding (millions of shares):

|   |             |             |             |
|---|-------------|-------------|-------------|
| Common  | 1,993       | 2,(         | 2,09(       |
| Preferred   | 148         | 148         | 148         |
| Combined weighted average number of common and preferred shares outstanding | 2,141       | 2,(         | 2,238       |
| <b>Diluted net income per common share (RR)</b>                             | <b>0.65</b> | <b>3.14</b> | <b>7.94</b> |
| <b>Diluted net income per preferred share (RR)</b>                          | <b>1.54</b> | <b>4.11</b> | <b>8.04</b> |

The difference in the weighted average number of common shares outstanding between basic and diluted is due to the outstanding stock option discussed in Note 16.

**Note 16: Stock-Based Compensation**

On March 30, 2002, the Board of Directors approved a stock based compensation plan which provides for the issuance of options to purchase 9,300,000 common shares of OAO Tatneft. In September 2002, options to purchase 9,300,000 common shares with an exercise price of RR 9.5 were granted to senior management and directors of the Group. All options vest in 270 days from the grant date and expire in 365 days after the grant date. The market price of the Group's ordinary stock as of the date of grant was RR 22.62 per share. Stock options were sold at RR 1 for each option giving the option holders the right to purchase 9,300,000 shares at RR 9.5 for each share. The full price of the stock option issue in the amount of RR 9.3 million was paid by the option holders on grant date. The full exercise price in the amount of RR 88.4 million is due when stock options are exercised. As the exercise price of the options was lower than the market price at the date of grant, compensation expense of RR 120 million was recognized in the consolidated statement of operations for the year ended December 31, 2002, in accordance with the provisions of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and as the Company expects to redeem the stock options after vesting, a corresponding liability has been recorded in accrued liabilities in the consolidated balance sheet as of December 31, 2002.

The accompanying notes are an integral part of these consolidated financial statements.

**OAOTATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)****(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)****Note 16: Stock-Based Compensation (continued)**

No additional options to purchase common shares of the Company have been granted to senior management of the Group during six months ended June 30, 2003.

The following table summarizes the stock option activity for the periods presented:

|   | Number of shares<br>underlying options | Weighted average<br>price |
|---|--|---------------------------|
| <b>Options outstanding at January 1, 2003</b> |  |                           |
| Granted                                       |  |                           |
| Redeemed                                      |  |                           |
| <b>Options outstanding at June 30, 2003</b>   |  |                           |

In accordance with SFAS No. 123, *Accounting for Stock-Based Compensation*, pro forma information regarding net income and earnings per share is required to be presented as if the Group had accounted for its Stock Compensation Plan under the fair value method of that statement.

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, this option pricing model requires the input of highly subjective assumptions, including the expected stock price volatility, therefore the actual fair value of the Group's options may be different.

If compensation expense for the Group had been determined using the fair-value method prescribed by SFAS No. 123, the Group's net income and earnings per share would not substantially differ from what was recorded.

**Note 17: Segment Information**

The Group's business activities are conducted predominantly through four major business segments: Exploration and Production, Refining and Marketing, Petrochemicals and Banking.

The segments were determined based on the way management recognizes the segments within the Group for making operating decisions and how they are evident from the Group structure.

Exploration and production segment activities consist of oil extraction by production divisions. Intersegment sales in exploration and production constitute transfers of crude oil and gas from production divisions to the refining and marketing divisions and subsidiaries. The intersegment sales are measured at the estimated market prices of those transactions and are eliminated on consolidation.

"Other" exploration and production sales include revenues from ancillary services provided by the specialized subdivisions and subsidiaries of the Group, such as sales of oilfield equipment and drilling services provided to other companies in Tatarstan. Business activities, which do not constitute reportable business segments, are also included in "Other" exploration and production sales.

Refining and marketing comprises purchases and sales of crude oil and refined products from the Group's own production divisions and third parties, own refining activities and retailing operations. As in prior years, the Company sold significant volumes of oil to intermediaries, which refine oil in domestic refineries, and purchased refined products processed from its oil.

Sales of petrochemical products include sales of petrochemical raw materials and refined products, which are used in production of tires. Sales of tires are disclosed by geographic segment for the reporting periods. "Other" petrochemical sales represent revenues from the sales of auxiliary services and materials not included above.

Earnings of the banking segment include earnings of Devon Credit Bank and Zenit Bank.

The accompanying notes are an integral part of these consolidated financial statements.



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**Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 17: Segment Information (continued)**

**Segment sales and other operating revenues.** Reportable operating segment sales and other operating revenues are stated in the following table:

|   | Six months<br>ended<br>June 30,<br>2003 | Six months<br>ended<br>June 30,<br>2002 | Six months<br>ended<br>June 30,<br>2001 |
|---|---|---|---|
| <b>Exploration and production</b>                       |   |   |   |
| Intersegment sales                                      | 39,37                                   | 36,58                                   | 48,09                                   |
| Other sales   | 3,85                                    | 3,97                                    | 8,77                                    |
| <b>Total exploration and production</b>                 | <b>43,22</b>                            | <b>40,56</b>                            | <b>56,86</b>                            |
| <b>Refining and marketing</b>                           |   |   |   |
| Crude oil   | 6,70                                    | 3,30                                    | 18,33                                   |
| Refined products  | 11,11                                   | 10,24                                   | 8,64                                    |
| Domestic sales  | 17,82                                   | 13,54                                   | 26,97                                   |
| Crude oil   | 3,80                                    | 5,49                                    | 638                                     |
| Refined products  | 36                                      | 5                                       | 14                                      |
| CIS sales <sup>(1)</sup>                                | 3,84                                    | 5,50                                    | 652                                     |
| Crude oil   | 30,36                                   | 29,31                                   | 30,30                                   |
| Refined products  | 9,71                                    | 9,80                                    | 11,86                                   |
| Non – CIS sales <sup>(2)</sup>                          | 40,08                                   | 39,11                                   | 42,17                                   |
| <b>Total refining and marketing</b>                     | <b>61,74</b>                            | <b>58,16</b>                            | <b>69,79</b>                            |
| <b>Petrochemicals</b>                                   |   |   |   |
| Intersegment sales                                      | 113                                     | 36                                      | 15                                      |
| Tires - domestic sales                                  | 3,47                                    | 3,12                                    | 352                                     |
| Tires - CIS sales                                       | 762                                     | 299                                     | -                                       |
| Tires - non-CIS sales                                   | 326                                     | 256                                     | -                                       |
| Petrochemical and refined products                      | 482                                     | 655                                     | 484                                     |
| Other   | 74                                      | 187                                     | 56                                      |
| <b>Total petrochemicals</b>                             | <b>5,23</b>                             | <b>4,55</b>                             | <b>907</b>                              |
| <b>Total segment sales and other operating revenues</b> | <b>110,19</b>                           | <b>103,28</b>                           | <b>127,56</b>                           |
| Elimination of intersegment sales                       | (39,48)                                 | (36,61)                                 | (48,11)                                 |
| <b>Total sales and other operating revenues</b>         | <b>70,71</b>                            | <b>66,66</b>                            | <b>79,45</b>                            |

<sup>(1)</sup> - CIS is an abbreviation for Commonwealth of Independent States (excluding the Russian Federation).

<sup>(2)</sup> - Non-CIS sales of crude oil and refined products are mainly made to European markets.

The accompanying notes are an integral part of these consolidated financial statements.

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**Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 17: Segment Information (continued)**

**Segment earnings and assets.** The Group evaluates the performance of its operating segments on a before-tax basis, without considering the impacts of non-banking net interest expense, monetary effects and the earnings of minority interest shareholders. Segment earnings are as follows:

|   | <b>Six months<br/>ended<br/>June 30,<br/>2003</b> | <b>Six months<br/>ended<br/>June 30,<br/>2002</b> | <b>Six months<br/>ended<br/>June 30,<br/>2001</b> |
|---|---|---|---|
| <b>Segment earnings (loss)</b>                          |   |   |   |
| Exploration and production                              | 3,72  | 4,548   | 16,057  |
| Refining and marketing                                  | 1,72  | 3,303   | 2,075   |
| Petrochemicals  | 1   | (98)  | 751   |
| Banking   | 233   | 208   | 41  |
| <b>Total segment earnings</b>                           | <b>5,71</b>                                       | <b>7,961</b>                                      | <b>18,928</b>                                     |
| Exchange loss   | 271   | (579)   | (607)   |
| Monetary gain   | -   | 693   | 722   |
| Other interest expense, net                             | (947)   | (804)   | (1,130)   |
| <b>Income before income taxes and minority interest</b> | <b>5,02</b>                                       | <b>7,271</b>                                      | <b>17,913</b>                                     |

Segment assets are as follows:

|                            | <b>At June 30,<br/>2003</b> | <b>At December 31,<br/>2002</b> |
|----------------------------|-----------------------------|---------------------------------|
| <b>Assets</b>              |                             |                                 |
| Exploration and production | 174,1                       | 163,13                          |
| Refining and marketing     | 42,6                        | 37,62                           |
| Petrochemicals             | 9,4                         | 9,59                            |
| Banking                    | 24,6                        | 17,65                           |
| <b>Total assets</b>        | <b>250,8</b>                | <b>228,00</b>                   |

The accompanying notes are an integral part of these consolidated financial statements.

**OA TATNEFT**
**Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 17: Segment Information (continued)**

Segment depreciation, depletion and amortization and additions to property, plant and equipment are as follows:

|   | Six months<br>ended<br>June 30,<br>2003 | Six months<br>ended<br>June 30,<br>2002 | Six months<br>ended<br>June 30,<br>2001 |
|---|---|---|---|
| <b>Depreciation, depletion and amortization</b>                   |   |   |   |
| Exploration and production  | 3,01                                    | 3,07                                    | 3,04                                    |
| Refining and marketing  | 210                                     | 157                                     | 167                                     |
| Petrochemicals  | 518                                     | 356                                     | 50                                      |
| Banking   | 14                                      | 7                                       | 3                                       |
| <b>Total segment depreciation, depletion<br/>and amortization</b> | <b>3,75</b>                             | <b>3,55</b>                             | <b>3,26</b>                             |
| <b>Additions to property, plant and equipment</b>                 |   |   |   |
| Exploration and production  | 3,39                                    | 6,78                                    | 8,67                                    |
| Refining and marketing  | 951                                     | 1,37                                    | 1,95                                    |
| Petrochemicals  | 554                                     | 410                                     | 46                                      |
| Banking   | 132                                     | 9                                       | 9                                       |
| <b>Total additions to property, plant<br/>and equipment</b>       | <b>5,03</b>                             | <b>8,57</b>                             | <b>10,72</b>                            |

**Note 18: Related Party Transactions**

Transactions are entered into in the normal course of business with significant shareholders, directors and companies with which the Group has significant shareholders in common. These transactions include sales of crude oil and refined products, purchases of electricity and banking transactions.

The amounts of transactions for each period and the outstanding balances at each period end with related parties are as follows:

|   | Six months<br>ended<br>June 30,<br>2003 | Six months<br>ended<br>June 30,<br>2002 | Six months<br>ended<br>June 30,<br>2001 |
|---|---|---|---|
| <b>Revenues/(expenses)</b>                              |   |   |   |
| Sales of crude oil                                      | 8,603                                   | 7,417                                   | 4,882                                   |
| Volumes of crude oil sales (thousand tonnes)            | 1,596                                   | 2,133                                   | 1,482                                   |
| Sales of refined products                               | 5,652                                   | 3,579                                   | 2,510                                   |
| Volumes of refined product sales (thousand tonnes)      | 1,732                                   | 1,149                                   | 925                                     |
| Sales of petrochemical products                         | 341                                     | 343                                     | 3,612                                   |
| Other sales   | 309                                     | 260                                     | 98                                      |
| Purchases of crude oil                                  | (525)                                   | (692)                                   | (1,582)                                 |
| Volumes of crude oil purchases (thousand tonnes)        | 176                                     | 95                                      | 426                                     |
| Purchases of refined products                           | -                                       | (6)                                     | (580)                                   |
| Volumes of refined products purchases (thousand tonnes) | -                                       | 1                                       | 558                                     |
| Purchases of petrochemical products                     | (1,010)                                 | (833)                                   | (1,260)                                 |
| Purchases of electricity                                | (1,325)                                 | (1,556)                                 | (1,100)                                 |
| Other purchases   | (423)                                   | (181)                                   | (787)                                   |
| Accrued interest receivable                             | 10                                      | 35                                      | 17                                      |
| Bank commission receivable                              | 3                                       | 18                                      | 28                                      |

The accompanying notes are an integral part of these consolidated financial statements.

**OA O TATNEFT****Supplemental Information on Oil and Gas Exploration and Production Activities (Unaudited)**

(Expressed in millions of constant Russian Roubles of June 30, 2003 purchasing power, except as indicated)

**Note 18: Related Party Transactions (continued)**

|   | At June 30,<br>2003 | At December 31,<br>2002 |
|---|---------------------|-------------------------|
| <b>Assets/(liabilities)</b>             |                     |                         |
| Trade accounts receivable               | 3,2                 | 1,380                   |
| Notes receivable                        | 291                 | 1,880                   |
| Banking loans and advances to customers | 284                 | 326                     |
| Banking customer deposits               | (240)               | (585)                   |
| Loans payable                           | (677)               | (112)                   |
| Trade accounts payable                  | (275)               | (66)                    |
| <b>Other</b>                            |                     |                         |
| Loan guarantee obligations              | (162)               | (211)                   |

**Note 19: Financial Instruments**

**Fair values.** The carrying amounts of short-term financial instruments, other than short-term debt and the related loans receivable, approximates fair value because of the relatively short period of time between the origination of these instruments and their expected realization.

Information concerning the fair value of long-term investments is disclosed in Note 6.

Information concerning the fair value of loans receivable and advances is disclosed in Note 9.

Information concerning the fair value of short-term and long-term debt is disclosed in Note 11.

Information concerning the fair value of notes payable and banking customer deposits is disclosed in Note 12.

**Credit risk.** A significant portion of the Company's accounts receivable are from domestic and export trading companies. Although collection of these receivables could be influenced by economic factors affecting these entities, management believes there is no significant risk of loss to the Group beyond provisions already recorded. The Group's banks take on exposures to credit risk which is the risk that a counterparty will be unable to pay amounts in full when due. The banks structure the levels of credit risk they undertake by placing limits on the amount of risk accepted in relation to one borrower, or groups of borrowers, and to geographical and industry segments. Such risks are monitored on a revolving basis and subject to an annual or more frequent review. Limits on the level of credit risk by product, borrower and industry sector are reviewed regularly.

The accompanying notes are an integral part of these consolidated financial statements.

**Note 20: Commitments and Contingent Liabilities**

**Operating environment.** While there have been improvements in the economic situation in the Russian Federation in recent years, the country continues to display some characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible in most countries outside of the Russian Federation, restrictive currency controls, and relatively high inflation.

The prospects for future economic stability in the Russian Federation are largely dependent upon the effectiveness of economic measures undertaken by the government, together with legal, regulatory, and political developments.

**Taxation.** Russian tax legislation is subject to varying interpretations and constant changes. Further, the interpretations of tax legislation by tax authorities as applied to the transactions and activities of the Group may not coincide with that of management. Also interpretations on the application of the tax legislation may vary between regional and Federal tax authorities. As a result, transactions may be challenged by tax authorities and the Group may be assessed for additional taxes, penalties and interest. Consolidated tax returns are not required under existing Russian tax legislation and tax audits are performed on an individual entity basis only. Tax periods remain open to review by the tax authorities for three years.

**Environmental liabilities.** The Group, through its predecessor entities, has operated in Tatarstan for many years without developed environmental laws, regulations and Group policies. Environmental regulations and their enforcement are currently being considered in the Russian Federation and the Group is monitoring its potential obligations related thereto. The outcome of environmental liabilities under proposed or any future environmental legislation cannot reasonably be estimated at present, but could be material. Under existing legislation, however, management believes that there are no probable liabilities that are in addition to amounts already accrued in the interim consolidated financial statements, which would have a material adverse effect on the operating results or financial position of the Group.

**Legal contingencies.** The Group is the named defendant in a number of lawsuits as well as the named party in numerous other proceedings arising in the ordinary course of business. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, management believes that any resulting liabilities will not have a materially adverse effect on the operating results or the financial position of the Group.

On December 6, 2002 the Group filed a lawsuit in the Arbitration court of Tatarstan against the Tax Ministry of Tatarstan claiming a refund for mineral use tax (royalty tax) paid in the amount of RR 2,251 million. On January 17, 2003 the Arbitration court ruled in favor of the Group and permitted the Group to apply this amount against future tax payments. The Tax Ministry of Tatarstan appealed this decision to the Federal Arbitration court of Povolzhsky district which, on April 6, 2003, upheld the decision of the Arbitration court of Tatarstan. These decisions could be reversed by higher courts and thus the Group has not yet recorded any benefit attributable to this refund in its interim consolidated financial statements.

**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 are incurred.

**Transportation of crude oil.** The Group benefits from the blending of its crude oil in the Transneft pipeline system since the Group's crude oil production is generally of a lower quality than that produced by other regions of the Russian Federation which supply the same pipeline system. There is currently no equalization scheme for differences in crude oil quality within the Transneft pipeline system and the implementation of any such scheme is not determinable at present. However, if this practice were to change, the Group's business could be materially and adversely affected.

**Banking commitments and contingent liabilities.** Credit related commitments comprise Zenit Bank loan commitments and guarantees of RR 5,511 million and RR 4,773 million at June 30, 2003 and December 31, 2002, respectively. The contractual amount of these commitments represents the value at risk if the bank's clients default and all existing collateral becomes worthless.

Zenit Bank fiduciary assets and trust arrangements at nominal value amounted to RR 6,637 million and RR 4,418 million at June 30, 2003 and December 31, 2002, respectively, and recorded off balance sheet as they are not assets of Zenit Bank. There is no insurance coverage maintained.

The accompanying notes are an integral part of these consolidated financial statements.