# Management's Discussion and Analysis

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

*For financial reporting purposes, Tatneft converts metric tonnes of crude oil to barrels using a conversion factor of 7.123. This factor represents a blend of varying conversion factors specific to each of Tatneft's fields. Because the proportion of actual production by field varies from period to period, total reserves and production volumes for the Group in barrels converted from tonnes using the blended rate may differ from total reserves and production calculated on a field by field basis. Translations of cubic meters to cubic feet were made at the rate of 35.31 cubic feet per cubic meter. Translations of barrels of crude oil into barrels of oil equivalent ("BOE") were made at the rate of 1 barrel per BOE and of cubic feet into BOE at the rate of 6 thousand cubic feet per BOE.*

## Background

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

As of March 31, 2009 OAO Svyazinvestneftekhim, a company wholly owned by the government of Tatarstan, together with its subsidiary, hold approximately 36% of the Company's voting stock. These shares were contributed to Svyazinvestneftekhim by the Ministry of Land and Property Relations of Tatarstan in 2003. Tatarstan also holds a "Golden Share", a special governmental right, in the Company. The exercise of its powers under the Golden Share enables the Tatarstan government to appoint one representative to the Board of Directors and one representative to the Revision Committee of the Company as well as to veto certain major decisions, including those relating to changes in the share capital, amendments to the Charter, liquidation or reorganization of the Company and "major" and "interested party" transactions as defined under Russian law. The Golden Share currently has an indefinite term. The Tatarstan government, including through OAO Svyazinvestneftekhim, also controls or exercises significant influence over a number of the Company's suppliers and contractors, such as the electricity producer OAO Tatenergo and the petrochemicals company OAO Nizhnekamskneftekhim.

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

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

## Key financial and operational results

| | Three months ended March 31, 2009 | Change | Three months ended March 31, 2008 |
|---|---|---|---|
| Sales (millions of RR) | 73,540 | (32.56)% | 109,052 |
| Net income (millions of RR) | 7,929 | 25.16% | 6,335 |
| EBITDA [(*)] (millions of RR) | 15,063 | 34.91% | 11,165 |
| Basic and Diluted net income per share of common stock (RR) | | | |
| Common…………… | 3.56 | 25.11% | 2.85 |
| Preferred…………… | 3.56 | 25.11% | 2.85 |
| Crude oil production by the Group (thousand of tonnes) | 6,425 | (2.2)% | 6,571 |
| Crude oil production by the Group (thousand of barrels) | 45,766 | (2.2)% | 46,808 |
| Gas production by the Group (millions of cubic meters) | 195.6 | (3.7)% | 203.2 |
| Refined gas products produced (thousand of tonnes) | 261.6 | (2.5)% | 268.3 |

[(*)] *As defined on page 15*

During the first quarter of 2009 our net income was RR 7,929 million, which is RR 1,594 million, or 25.16%, more than in the corresponding period of 2008.

In the first quarter of 2008 we recognised a provision on accounts receivable related to crude oil sales to Ukraine, which decreased our net income in that reporting period. Crude oil prices, which are the key driver in our financial performance, in the first quarter of 2009 were twice lower than in the corresponding period of 2008. However, stabilization of crude oil prices (compared to a significant drop in the fourth quarter of 2008), devaluation of the Ruble against the US Dollar (most of the Group's revenues are denominated in US Dollars), decrease of certain costs compared to the fourth quarter of 2008 and decrease of tax burden on the industry, in the first quarter of 2009, all had a positive effect on the Group's financial performance and results.

## Segment information

Our operations are currently divided into the following main segments:

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

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

• **Petrochemicals -** our petrochemicals segment has been consolidated under a management company, Tatneft-Neftekhim, which manages OAO Nizhnekamskshina, one of the largest tire manufacturers in Russia, and the companies technologically integrated with it, including OAO Nizhnekamsk Industrial Carbon Plant, ZAO

Yarpolymermash-Tatneft, OAO Nizhnekamskiy Mekhanicheskiy Zavod and OOO Nizhnekamskiy Shinny Zavod CMK. OOO Tatneft-Neftekhimsnab and OOO Trading House Kama are responsible for procuring supplies and marketing products produced by the companies within this segment, respectively.

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

## Executive overview

### Recent developments and outlook

*E&P activities in Tatarstan*

One of the Company's primary strategic goals is to maintain current levels of crude oil production from its licensed fields in Tatarstan. In the first quarter of 2009 the Company decreased production by 2.3% from its fields in Tatarstan compared to the corresponding period of 2008. Due to the relative maturity of the Company's main producing fields significant portion of all crude oil produced by the Company in Tatarstan was extracted using various enhanced recovery techniques. In the first quarter of 2009 the Company put 83 new wells into operation in Tatarstan.

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

*E&P activities outside of Tatarstan*

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

*Highly viscous oil (natural bitumen) production*

During the first quarter of 2009 the Company continued a pilot project to produce highly viscous oil (natural bitumen) from the Ashalchinskoye and Mordovo-Karmalskoye fields in Tatarstan using parallel steam injection and producing wells. The Company continues to assess the economic parameters and expansion of the activities relating to highly viscous oil production in Tatarstan.

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

*Crude oil refining and marketing*

During the first quarter of 2009 the Group continued the development and construction by OAO TANECO ("TANECO"), formerly known as ZAO Nizhnekamsk Refinery, of a new refining and petrochemicals complex in Nizhnekamsk, Tatarstan. Expenditures related to the construction in the first quarter of 2009 were primarily financed from a US$ 2 billion senior secured credit facility arranged by ABN AMRO (now RBS), BNP Paribas (Suisse) SA, Citibank International PLC, Bayerische Hypo-und Vereinsbank AG, Sumitomo Mitsui Finance Dublin and WestLB AG in 2008.

*Petrochemicals*

In the first quarter of 2009 the core entity of the Group's petrochemicals segment – OAO Nizhnekamskshina produced 1.5 million tires in comparison to 2.9 million tires in the first quarter of 2008. The decrease was associated with the decline in, and in certain circumstances a temporary halt on, production of vehicles by major clients of Nizhnekamskshina, which was a reaction to the current economic crisis.

A new advanced rubber mix production line was launched in 2007 with monthly capacity of 1,200 tonnes, which allows Nizhnekamskshina to produce modern high performance tires. The Group continued to invest in the modernization and upgrading of Nizhnekamskshina's production facilities to strengthen its market competitiveness, including the construction of a new plant to produce modern radial tires for trucks and other heavy load vehicles.

## Operational highlights

### Crude oil and gas production

Tatneft undertakes exploration and production activities in Tatarstan and outside of Tatarstan in Russia: in Ulyanovsk, Samara and Orenburg regions, in the Kalmyk Republic, Nenets Autonomous District and the Chuvash Republic. Outside of Russia, we have exploration activities in Libya and Syria. The table below summarizes the results of our exploration and production activities:

| | Three months ended March 31, 2009 | Three months ended March 31, 2008 |
|---|---|---|
| Crude oil daily production (thousand bbl per day) | 508.5 | 520.1 |
| Gas daily production (thousand boe per day) | 12.8 | 13.3 |
| Crude oil extraction expenses (RR per bbl) | 163.9 | 126.2 |
| | (RR millions) | |
| Sales of crude oil | 54,306 | 87,695 |
| Crude oil extraction expenses | 7,500 | 5,905 |
| Exploration expenses | 293 | 3,053 |
| Unified production tax | 9,796 | 19,349 |

Crude oil production of the Group (including production of consolidated subsidiaries OAO Ilekneft, ZAO Tatneft-Samara, ZAO Tatneft-Severny and ZAO Kalmtatneft) decreased by 2.2% to 6.4 million metric tonnes in the first quarter of 2009 compared to the first quarter of 2008. Our gas production decreased by 3.7% to 195.6 million cubic meters in the first quarter of 2009 from 203.2 million cubic meters in the corresponding period of 2008.

### Refining and marketing

| | Three months ended March 31, 2009 | Three months ended March 31, 2008 |
|---|---|---|
| Refining of crude oil throughput (thousand bbl per day) | 11.33 | 10.99 |
| Refining of gas products throughput (thousand boe per day) | 10.53 | 10.49 |
| Number of petrol (gas) stations in Russia* | 466 | 421 |
| Number of petrol (gas) stations outside of Russia* | 138 | 141 |

** including stations rented from third parties*

### Export of crude oil from Russia

The Group is using transportation services of Transneft, the state-owned monopoly owner and operator of Russia's trunk crude oil and export pipelines, upon export of its crude oil. During the first quarter of 2009, the Group exported from Russia approximately 62% of all its crude oil sold compared with approximately 65% in the corresponding period of 2008.

In the first quarter of 2009 the Company delivered 38% of crude oil for export through Transneft's Druzhba pipeline (mainly to Poland, Czech Republic and Germany); 46% of crude oil was shipped through Black Sea ports (mainly Novorossiysk); 3% of crude oil exported through Baltic Sea port Primorsk and 13% of crude oil was shipped through Ukrainian ports (mainly Yuzhnyi).

## Certain Macroeconomic and Other Factors Affecting the Group's Results of Operations

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

### Crude oil prices

The main driver of our revenue is our selling prices of crude oil and refined products. During the first quarter of 2009 the average Brent crude oil price was $44.4 per barrel in comparison to $96.9 per barrel during the first quarter of 2008.

Stablization and increase of crude oil prices in the first quarter of 2009 in comparison to the fourth quarter of 2008 is considered by some market participants as a sign of economic recovery after the world economic downturn in the second half of 2008, which sent the crude oil price to the lowest level since July 2004.

There is no independent or uniform market price for crude oil in Russia primarily because a significant portion of crude oil destined for sale in Russia is produced by vertically integrated Russian oil companies and is refined by the same vertically integrated companies. Crude oil that is not exported from Russia, refined by the producer or sold on previously agreed terms, is offered for sale in the domestic market at prices determined on a transaction-by-transaction basis without direct reference or correlation to world market prices.

Substantially all the crude oil we sell on export and domestic markets is Urals blend. The table below shows average and the end of the period crude oil prices worldwide and in Russia for the first three months of 2009 and 2008, respectively.

| *World market* | **Average for the three months ended March 31** | | **Change** | **At March 31** | | **Change** |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | | **2009** | **2008** | |
| | (in US dollars per barrel, except for figures in percent) | | | | | |
| Brent crude | 44.4 | 96.9 | *(54.2)%* | 46.5 | 102.7 | *(54.7)%* |
| Urals crude (*CIF Mediterranean*)* | 43.7 | 93.2 | *(53.1)%* | 46.0 | 99.7 | *(53.9)%* |
| Urals crude (*CIF Rotterdam*)* | 43.6 | 93.5 | *(53.4)%* | 45.1 | 99.8 | *(54.8)%* |

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

| *Russian market* | **Average for the three months ended March 31** | | **Change** | **At March 31** | | **Change** |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | | **2009** | **2008** | |
| | (in RR per tonne, except for figures in percent) | | | | | |
| Crude oil* | 3,988 | 6,961 | *(42.7)%* | 5,911 | 7,394 | *(20.1)%* |

*Source: Kortes*
* Excluding VAT

### Transportation of crude oil and refined products

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

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

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

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

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

## Inflation and foreign currency exchange rate fluctuations

A significant part of the Group's revenues are derived from export sales of crude oil and refined products which are denominated in US dollars. The Group's operating costs are primarily denominated in Rubles. Accordingly, the relative movements of Ruble inflation and Ruble/US dollar exchange rates can significantly affect the results of operations of the Group. For instance, operating margins are generally adversely affected by an appreciation of the Ruble against the US dollar, because this will generally cause costs to increase relative to revenues. The Group has not historically used financial instruments to hedge against foreign currency exchange rate fluctuations.

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

| | **Three months ended March 31, 2009** | **Three months ended March 31, 2008** |
|---|---|---|
| Ruble inflation | 5.4% | 4.8% |
| Period-end exchange rate (Ruble to US $) | 34.01 | 23.52 |
| Average exchange rate (Ruble to US $) | 33.92 | 24.26 |
| Nominal (devaluation) appreciation of the Ruble | (15.8)% | 4.2% |
| Real Ruble (devaluation) appreciation | (8.9)% | 9.4% |

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

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

## Taxation

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

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

- unified natural resources production tax (or unified production tax);
- export duties;
- excise taxes on refined products;
- value added taxes;
- property taxes;
- land tax;

- vehicle tax;
- other local taxes and levies; and
- tax penalties and interest.

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

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

| | **Three months ended March 31, 2009** | **Three months ended March 31, 2008** | **Change** | **Taxable base** |
|---|---|---|---|---|
| Income tax – maximum rate | 20% | 24% | *(16.7)%* | Taxable income |
| VAT | 18% | 18% | - | Added value |
| Property tax – maximum rate | 2.2% | 2.2% | - | Taxable property |
| | (in RR per metric tonne, except for figures in percent) | | | |
| Unified production tax, average rates[1] | 1,544 | 3,306 | *(53.3)%* | Metric tonne produced (crude oil) |
| *Refined products excise tax:* | | | | |
| High octane gasoline | 3,629 | 3,629 | - | |
| Low octane gasoline | 2,657 | 2,657 | - | |
| Diesel fuel | 1,080 | 1,080 | - | |
| Motor oils | 2,951 | 2,951 | - | Metric tonne produced and sold domestically [2] |
| Straight run gasoline | 3,900 | 2,657 | *46.8%* | |
| | (in US $ per metric tonne, except for figures in percent) | | | |
| Crude oil export duty, average rates | 111.8 | 314.3 | *(64.4)%* | Metric tonne exported |
| *Refined products export duty average rates:* | | | | |
| Light refined products (gasoline products) and mid refined products (diesel fuel) | 87.6 | 224.1 | *(60.9)%* | Metric tonne exported |
| Fuel oil (*mazut*) | 47.2 | 120.7 | *(60.9)%* | |

(1) *Without taking into account differentiated taxation*
(2) *Excise taxes are paid on refined products produced and sold domestically. Excise taxes are paid by the companies that sell refined products to the end customers, while producers and intermediary re-sellers accrue excise tax and subsequently recover it subject to certain conditions set by the legislation.*

Due to decline in international crude oil prices the tax rates specific to the oil industry decreased substantially during the first quarter of 2009 compared to the corresponding period of previous year. Unified production tax decreased by 53%, average crude oil export duties by 64%, and average refined products export duties by 61%.

The decrease in unified production tax rates in the first quarter of 2009 was a result of decrease in the average Urals blend price by 53% as well as changes in the tax calculation (see "Unified production tax rate" below). Excise taxes on refined products remained at the same level as in the first quarter of 2008, except for excise tax for straight run gasoline which increased by 47% in the first quarter of 2009.

**Unified production tax rate.** Effective from January 1, 2007, the rate of the unified production tax is differentiated. The base tax rate for the production of oil was set at RR 419 per metric tonne and was adjusted depending on the international market price of Urals blend and the ruble exchange rate (before 2009, the tax rate was zero when the average Urals blend international market price for a tax period was less than or equal to $9.00 per barrel). This tax rate is applied with a discount based on the levels of the international oil prices and the levels of depletion of the related oil fields as determined under Russian reserves classification guidelines. Such formula benefits producers with oil fields having a depletion level 80% and above as determined by the Russian reserves classification. The Company receives a benefit of 3.5% per field for each percent of depletion in excess of the 80% threshold. As Romashkinskoye field, the Company's largest, along with certain other fields, is more than 80% depleted, the Company received a benefit from these fields in the first quarter of 2009 of RR 1.2 billion.

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

Also a zero unified production tax rate applies to the production of highly viscous crude oil (defined as crude oil of more than 200 Megapascal second in reservoir conditions) where the direct (segregated) method of accounting for produced oil is used. Since April 2007, the Company's production of highly viscous crude oil (bitumen) from the Ashalchinskoye and Mordovo-Karmalskoye fields was subject to a zero unified production tax rate, resulting in tax benefit during the first three months of 2009 attributed to that production of RR 7 million.

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

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

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

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

The export duty rate on crude oil decreased by 64% in the first quarter of 2009 to US$ 111.8 per tonne (US$ 15.3 per barrel) from US$ 314.3 per tonne (US$ 43.1 per barrel) in the corresponding period of 2008. The decrease in these comparative periods was associated with the decrease of Urals prices by 53% to US$ 43.7 per barrel in the first quarter of 2009 compared to US$ 93.2 per barrel in the corresponding period of 2008.

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

**Property tax.** The maximum property tax rate in Russia is 2.2%. Exact tax rates are set by the local authorities.

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

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

## Three months ended March 31, 2009 compared to the three months ended March 31, 2008

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

| RR millions | Three months ended March 31, 2009 (unaudited) | Three months ended March 31, 2008 (unaudited) | Change |
|---|---|---|---|
| **Sales and other operating revenues** | **73,540** | **109,052** | **(32.6)%** |
| **Costs and other deductions** | | | |
| Operating | 15,380 | 13,383 | 14.9% |
| Purchased oil and refined products | 7,801 | 15,053 | (48.2)% |
| Exploration | 293 | 3,053 | (90.4)% |
| Transportation | 3,302 | 2,781 | 18.7% |
| Selling, general and administrative | 5,349 | 10,576 | (49.4)% |
| Depreciation, depletion and amortization | 3,820 | 2,518 | 51.7% |
| (Gain)/loss on disposals of property, plant and equipment and investments and impairments | (1,710) | 790 | (316.5)% |
| Taxes other than income taxes | 25,638 | 50,000 | (48.7)% |
| Maintenance of social infrastructure and transfer of social assets | 342 | 451 | (24.2)% |
| **Total costs and other deductions** | **60,215** | **98,605** | **(38.9)%** |
| Earnings from equity investments | 744 | 266 | 179.7% |
| Foreign exchange loss | (3,206) | (1,691) | 89.6% |
| Interest income | 958 | 831 | 15.3% |
| Interest expense, net of amounts capitalized | (136) | (63) | 115.9% |
| Other income/(expense), net | 380 | (375) | (201.3)% |
| **Total other expense** | **(1,260)** | **(1,032)** | **22.1%** |
| **Income before income taxes and minority interest** | **12,065** | **9,415** | **28.1%** |
| Current income tax expense | (6,320) | (3,486) | 81.3% |
| Deferred income tax benefit | 2,526 | 747 | 238.2% |
| **Total income tax expense** | **(3,794)** | **(2,739)** | **38.5%** |
| Minority interest | (342) | (341) | 0.3% |
| **Net income** | **7,929** | **6,335** | **25.2%** |

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

**Sales and other operating revenues**

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

| RR millions | Three months ended March 31, 2009 | Three months ended March 31, 2008 |
|---|---|---|
| Crude oil | 54,306 | 87,695 |
| Refined products | 10,655 | 11,850 |
| Petrochemicals | 3,420 | 4,773 |
| Corporate and other sales | 5,159 | 4,734 |
| **Total sales and other operating revenues** | **73,540** | **109,052** |

Sales and other operating revenues decreased in the first quarter of 2009 by 32.6% to RR 73,540 million from RR 109,052 million in the corresponding period of 2008. The decrease is mainly attributed to an overall decrease in crude oil and refined product prices.

***Sales of crude oil***

Sales of crude oil decreased by 38.1% to RR 54,306 in the first quarter of 2009 from RR 87,695 million in the corresponding period of 2008. The table below provides an analysis of the changes in sales of crude oil:

| | Three months ended March 31, 2009 | Change | Three months ended March 31, 2008 |
|---|---|---|---|
| **Domestic sales of crude oil** | | | |
| Revenues (RR millions) | 11,284 | *(36.4)%* | 17,744 |
| Volume (thousand tonnes) | *2,592* | *6.9%* | *2,425* |
| Realized price (RR per tonne) | *4,353.4* | *(40.5)%* | *7,317* |
| **CIS export sales of crude oil** [(1)] | | | |
| Revenues (RR millions) | 4,080 | *27.4%* | 3,203 |
| Volume (thousand tonnes) | *475* | *58.3%* | *300* |
| Realized price (RR per tonne) | *8,589.5* | *(19.5)%* | *10,677* |
| **Non-CIS export sales of crude oil** | | | |
| Revenues (RR millions) | 38,942 | *(41.7)%* | 66,748 |
| Volume (thousand tonnes) | *3,776* | *(9.2)%* | *4,158* |
| Realized price (RR per tonne) | *10,313* | *(35.8)%* | *16,053* |

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

***Sales of refined products***

Sales of refined products decreased by 10.1% to RR 10,655 million in the first quarter of 2009 from RR 11,850 million in the corresponding period of 2008. The table below provides an analysis of the changes in sales of refined products:

| | Three months ended March 31, 2009 | Change | Three months ended March 31, 2008 |
|---|---|---|---|
| **Domestic sales of refined products** | | | |
| Revenues (RR millions) | 9,580 | *(3.3)%* | 9,902 |
| Volume (thousand tonnes) | *828* | *22.3%* | *677* |
| Realized price (RR per tonne) | *11,570* | *(20.9)%* | *14,626* |
| **CIS export sales of refined products** | | | |
| Revenues (RR millions) | 176 | *(1.1)%* | 178 |
| Volume (thousand tonnes) | *35* | *288.9%* | *9* |
| Realized price (RR per tonne) | *5,028.6* | *(74.6)%* | *19,778* |
| **Non-CIS export sales of refined products** | | | |
| Revenues (RR millions) | 899 | *(49.2)%* | 1,770 |
| Volume (thousand tonnes) | *76* | *(33.9)%* | *115* |
| Realized price (RR per tonne) | *11,828.9* | *(23.1)%* | *15,391* |

***Sales of petrochemical products***

The table below provides an analysis of petrochemical products sales.

| **RR millions** | Three months ended March 31, 2009 | Change | Three months ended March 31, 2008 |
|---|---|---|---|
| Tiers sales | 3,277 | *(28.9)%* | 4,606 |
| Other petrochemicals sales | 143 | *(14.4)%* | 167 |
| **Total sales of petrochemical products** | **3,420** | ***(28.3)%*** | **4,773** |

The decrease in sales of petrochemical products was primarily due to the lower volumes sold. The Group's production of tires in the first quarter of 2009 decreased by 49% compared to the corresponding period of 2008 and amounted to 1.5 million tires.

***Other sales***

Other sales increased by 9% to RR 5,159 million in the first quarter of 2009 from RR 4,734 million in the corresponding period of 2008. Other sales primarily represent sales of materials and equipment and various oilfield services provided by the Company's production subsidiaries to third parties (such as drilling, lifting, construction, repairs, and geophysical works).

**Costs and other deductions**

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

| **RR millions** | Three months ended March 31, 2009 | Three months ended March 31, 2008 |
|---|---|---|
| Crude oil extraction expenses | 7,500 | 5,905 |
| Petrochemical production expenses | 3,241 | 3,715 |
| Other operating expenses | 3,689 | 3,853 |
| Change in operating expenses in inventory of crude oil produced by the Group* | 950 | (90) |
| **Total operating expenses** | **15,380** | **13,383** |

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

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

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

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

Lifting expenses averaged to RR 163.9 per barrel in the first quarter of 2009 compared to RR 126.2 per barrel in the corresponding period of 2008. The increase of 30% is primarily a result of increases in equipment service costs, repair expenses and electricity tariffs.

***Petrochemical production expenses.*** Petrochemical production expenses primarily include the costs of raw materials, labour, maintenance and electricity consumed in the production of petrochemical products. Cost of petrochemical products decreased by 12.8% to RR 3,241 million in the first quarter of 2009 compared to the corresponding period of 2008 primarily due to decrease in volumes of petrochemicals produced.

***Other operating expenses*** include accretion of the asset retirement obligation, change in crude oil and refined products inventory, and the costs of other services, goods and materials not related to the core oil and gas production activities of the Group. Other operating expenses decreased to RR 3,689 million, or by 4.3%, compared to the first quarter of 2008 primarily due to decrease of costs of other services.

**Cost of purchased crude oil and refined products.** A summary of purchased oil and refined products for the corresponding periods of 2009 and 2008, respectively, is as follows:

| **RR millions** | **Three months ended March 31, 2009** | **Three months ended March 31, 2008** |
|---|---|---|
| Purchased crude oil (RR millions) | 576 | 6,984 |
| Volume (thousand tonnes) | *50* | *569* |
| Average price per tonne (RR) | *11,579* | *12,272* |
| | | |
| Purchased refined products (RR millions) | 7,225 | 8,069 |
| Volume (thousand tonnes) | *722* | *572* |
| Average price per tonne (RR) | *10,013* | *14,113* |
| **Total purchased oil and refined products** | **7,801** | **15,053** |

Purchases of crude oil in the first quarter of 2009 decreased by 92% to RR 576 million from RR 6,984 million in the corresponding period of 2008 due to decrease in volumes of purchased crude oil for trading by 91%.

Purchases of refined products decreased by 10% to RR 7,225 million in the first quarter of 2009 from RR 8,069 million in the corresponding period of 2008 due to decrease in average purchase price per tonne by 29% partly offset by increase in volumes of purchased refined products for trading by 26%.

**Exploration expenses.** Exploration expenses consist primarily of exploratory drilling, geological and geophysical costs, and the costs of carrying and retaining undeveloped properties. Exploration expenses decreased to RR 293 million in the first quarter of 2009 from RR 3,053 million in the corresponding period of 2008. Exploration expenses in the first three months of 2008 included accumulated prior years' exploration expenditures in the amount of RR 2,679 mln of first-time consolidated E&P companies under provisions of FIN 46R.

**Transportation expenses**. Transportation expenses relate to the delivery of crude oil produced as well as purchased crude oil and refined products, which are mostly carried out using Transneft pipeline for deliveries of crude oil to our customers. Transportation costs increased by 18.7% to RR 3,302 million in the first quarter of 2009 from RR 2,781 million in the corresponding period of 2008 due to an increase in transportation tariffs.

**Selling, general and administrative expenses.** Certain selling, general and administrative expenses are by nature fixed costs, which are not directly related to production, such as payroll, general business costs, insurance, advertising, share based compensation, legal fees, consulting and audit services, charity and other expenses, including bad debt provisions. Selling, general and administrative expenses decreased by RR 5,227 million to RR 5,349 million in the first quarter of 2009 compared to the corresponding period of 2008, primarily as a result of decrease in our bad debt provision on accounts receivables. In the first quarter of 2008 the Group posted a bad debt provision on accounts receivables related to sales of crude oil to Ukraine in the amount of RR 5,531 million.

**Loss on disposals of property, plant and equipment and impairment of investments**. In the first quarter of 2009 we recorded gain on disposals of property, plant and equipment and impairment of investments amounted to RR 1,710 million compared to RR 790 million losses in the corresponding period of 2008. This gain was recognized as a result of consolidation of a service company in the Group's financial statements under provisions of FIN 46R.

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

| | Three months ended March 31, 2009 | Three months ended March 31, 2008 |
|---|---|---|
| Export duties | 15,034 | 30,013 |
| Unified production tax | 9,796 | 19,349 |
| Property tax | 492 | 362 |
| Excise taxes | 104 | 88 |
| Penalties and interest | 1 | 6 |
| Other | 211 | 182 |
| **Total taxes other than income taxes** | **25,638** | **50,000** |

Taxes other than income taxes decreased by 48.7% to RR 25,638 million in the first quarter of 2009 from RR 50,000 million in the corresponding period of 2008. The decrease was primarily a result of a decrease in export duty and unified production tax rates, which are linked to crude oil market prices. In the first quarter of 2009 compared to the corresponding period of 2008, our export duties decreased by 49.9%. The Group's unified production tax decreased by 49.4%. Our expenses on excise tax increased to RR 104 million from RR 88 million in the first quarter of 2008, due to the increase in domestic sales of taxable refined products (mainly diesel fuel and gasoline). Other taxes include land tax and non-recoverable VAT.

Effective January 1, 2007, the base tax rate formula for unified production tax was modified to provide a benefit for fields whose depletion rate is 80% or above as determined under Russian reserves classification. Under these new rules, the Company receives a benefit of 3.5% per field for each percent of depletion in excess of the 80% threshold. As Romashkinskoye field, the Company's largest, along with certain other fields are more than 80% depleted, the Company received a benefit in the first quarter of 2009 of RR 1.2 billion.

Since April 2007, the Company applied a zero unified production tax rate to production of highly viscous crude oil (bitumen) from Ashalchinskoye and Mordovo-Karmalskoye fields, resulting in the three months of 2009 tax benefit of RR 7 million.

**Maintenance of social infrastructure and transfer of social assets.** Social infrastructure expenses relate primarily to housing, schools and cultural buildings in Tatarstan. Maintenance of social infrastructure expenses and transfer of social assets decreased to RR 342 million in the first quarter of 2009 from RR 451 million in the corresponding period of 2008.

**Other income and expenses**

The Group recorded gain from equity investments amounted to RR 744 million in the first quarter of 2009 compared to a RR 266 million gain in the corresponding period of 2008. This gain was mainly due to an increase of the IPCG Fund gains, RR 436 million of which was attributed to the Group.

Our foreign exchange loss increased to RR 3,206 million in the first quarter of 2009 from RR 1,691 million in the corresponding period of 2008. The increase was mainly due to foreign exchange loss in the amount of RR 6,913 million on US dollars denominated debt incurred under the secured credit facility for the construction of TANECO's refinery and petrochemical complex partly offset by foreign exchange gain on dollar denominated sales of crude oil.

Interest income increased by 15.3% to RR 958 million in the first quarter of 2009 compared to the corresponding period of 2008 due to more interest received on our long-term promissory notes. Interest expense increased from RR 63 million to RR 136 million in the first quarter of 2009 in comparison to the corresponding period of 2008, which is a result of further drawdowns under the US$ 2 billion secured credit facility for the construction of TANECO's refinery and petrochemical complex (average debt increased by more than 100% in the first quarter of 2009 compared with the corresponding period of 2008).

Other income, net in the first quarter of 2009 amounted to RR 380 million compared with RR 375 million of other expense, net in the corresponding period of 2008. The change is primarily due to realized gain recorded on our trading investments.

**Income taxes**

The effective income tax rate in the first three months of 2009 was 31.4%, compared to the statutory tax rate of 20% in the Russian Federation. This difference is due to non deductible or partially deductible expenses incurred during the reporting period.

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

| **RR millions** | **Three months ended March 31, 2009** | **Three months ended March 31, 2008** |
|---|---:|---:|
| Net income | 7,929 | 6,335 |
| Add back: | | |
| Minority interest | 342 | 341 |
| Income tax expense | 3,794 | 2,739 |
| Depreciation, depletion and amortization | 3,820 | 2,518 |
| Interest expense | 136 | 63 |
| Interest and dividend income | (958) | (831) |
| **EBITDA** | **15,063** | **11,165** |

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

## Financial Condition Summary Information

The following table shows certain key financial indicators:

| RR millions | At March 31, 2009 | At December 31, 2008 |
|---|---|---|
| Current assets | 128,520 | 116,620 |
| Long-term assets | 295,431 | 276,360 |
| **Total assets** | **423,951** | **392,980** |
| | | |
| Current liabilities | 35,387 | 32,043 |
| Long-term liabilities | 114,922 | 96,078 |
| **Total liabilities** | **150,309** | **128,121** |
| | | |
| **Shareholders' equity** | **267,966** | **260,276** |
| | | |
| Working capital | 93,133 | 84,577 |
| Current ratio | 3.63 | 3.64 |

**Working capital position**

As of March 31, 2009 working capital of the Group amounted to RR 93,133 million compared to RR 84,577 million as of December 31, 2008. The increase in the working capital is primarily attributable to an increase in cash and cash equivalents as well as increase in accounts receivable.

## Liquidity and Capital Resources

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

| RR millions | Three months ended March 31, 2009 | Three months ended March 31, 2008 |
|---|---|---|
| Net cash provided by operating activities | 14,278 | 13,629 |
| Net cash used for investment activities | (20,592) | (10,978) |
| Net cash provided by/(used for) financing activities | 12,781 | (370) |
| Increase in cash and cash equivalents | 6,467 | 2,281 |

**Net cash provided by operating activities**

Our primary source of cash flow is funds generated from our operations. Net cash provided by operating activities increased by 4.8% to RR 14,278 million in the first quarter of 2009 from RR 13,629 million in the corresponding period of 2008 which is explained primarily through higher net income received in the first quarter of 2009.

**Net cash used for investing activities**

Net cash used for investing activities increased by 87.6% to RR 20,592 million in the first quarter of 2009 from RR 10,978 million in the corresponding period of 2008, which is primarily due to an increase in expenditures, related to the construction of TANECO’s refinery and petrochemical complex.

## Net cash provided by/ (used for) financing activities

Cash flow provided by financing activities amounted to RR 12,781 million in the first quarter of 2009 compared to RR 370 million used for financing activities in the corresponding period of 2008. This is primarily due to net debt proceeds of RR 11,335 million in the first quarter of 2009 compared with net debt repayments of RR 220 million in the corresponding period of 2008.

## Additions to property, plant and equipment

The following additions to property, plant and equipment (by segment) were made in the first quarter of 2009, compared to the corresponding period of 2008:

| RR millions | Three months ended March 31, 2009 | Three months ended March 31, 2008 |
|---|---|---|
| Exploration and production | 2,806 | 4,651 |
| Refining and marketing | 14,591 [(1)] | 2,956 |
| Petrochemicals | 944 | 472 |
| Corporate and other | 803 | 226 |
| **Total additions to property, plant and equipment** | **19,144** | **8,305** |

[(1)] *Includes RR 14,442 million expenditure related to the refinery construction by TANECO*

## Analysis of Debt

At March 31, 2009, long-term debt, including the current portion of long-term debt, amounted to RR 61,281 million as compared to RR 44,889 million at December 31, 2008. The related increase is due to an increase in the long-term foreign currency denominated debt through further drawdowns under the US$ 2 billion secured credit facility for the construction of TANECO's refinery and petrochemical complex.

The aggregate maturities of total long-term debt, including current portion as of March 31, 2009 are as follows:

| RR millions | At March 31, 2009 |
|---|---|
| March 2009 - March 2010 | 477 |
| March 2010 - March 2011 | 60,665 |
| March 2011- March 2012 | 77 |
| March 2012- March 2013 | - |
| March 2013 and thereafter | 62 |
| **Total long-term debt** | **61,281** |