Management's Discussion and Analysis

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

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

Background

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

As of December 31, 2007 OAO Svyazinvestneftekhim, a company wholly owned by the government of Tatarstan, together with its subsidiary, held 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 and "major" and "interested party" transactions as defined under Russian law. The Golden Share currently has an indefinite term. The Tatarstan government, including through OAO Svyazinvestneftekhim, also controls or exercises significant influence over a number of the Company's suppliers and contractors, such as the electricity producer OAO Tatenergo and the petrochemicals company OAO Nizhnekamskneftekhim.

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

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

As of December 31, 2007, the Group's total proved reserves (SPE/WPC) of crude oil and condensate were 862 million tons (6,140 million barrels).

Key financial and operational results

	Year ended December 31, 2007	Change	Year ended December 31, 2006
Sales (millions of RR)	356,276	11.9%	318,284
Net income (millions of RR)	43,279	45.4%	29,773
EBITDA (*) (millions of RR)	70,269	36.4%	51,508
Basic and Diluted net income per share of common stock (RR)			
Common	19.50	42.9%	13.65
Preferred	19.27	41.9%	13.58
Crude oil production by the Group (thousand of tons)	25,933	0.8%	25,741
Gas production by the Group (millions of cubic meters)	738.5	0.0%	738.5
Refined gas products produced (thousand of tons)	1,154	1.6%	1,135
Crude and condensate proved reserves (millions of bbl)	6,140	3.9%	5,911

(*) *As defined on page 16*

During 2007 our net income was RR 43,279 million, which is RR 13,506 million, or 45.4%, more than in 2006.

The improvement of our performance resulted from overall favorable market price conditions and production volumes in 2007. These improvements were partially offset by increasing operating expenses, taxes other than income taxes and transportation tariffs. These factors, as well as other drivers impacting the results of our operations are considered in detail below.

Segment information

Our operations are currently divided into the following main segments:

- **Exploration and production** – which consists of oil extraction production divisions of the Company, 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** – which consists of our participation in OJSC TANECO, previously named as ZAO Nizhnekamsk Oil Refinery, a project company established to build and operate a refining and petrochemical complex with a throughput capacity of seven million tones of crude oil per year in Nizhnekamsk, Tatarstan; our gas production, transportation and refining division Tatneftegaspererabotka, OOO Tatneft-AZS-Center and OOO Tatneft-AZS-Zapad, management companies for Tatneft-branded gas station 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 and OAO Nizhnekamskiy mekhanicheskiy zavod. 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. Due to the relative maturity of the Company's main producing fields, approximately 44.7% (11.5 million tones) of all crude oil produced by the Company in Tatarstan was extracted using various enhanced recovery techniques. In 2007 the Company put into operation 349 new production wells. Average crude oil flow rates in 2007 for the Company's wells in Tatarstan were 4.3 tones per day compared to 4.1 tones per day in 2006.

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

E&P activities outside of Tatarstan

The Group continues to expand its operations outside of Tatarstan. In 2007 the Group obtained one new E&P license in the Nenets Autonomous Region of Russia, one new license in Ulyanovsk region and one new license in Orenburg region.

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

Highly viscous oil (natural bitumen) production

During 2007 the Company continued to carry out a pilot project of highly viscous oil (natural bitumen) production from the Ashalchinskoye field in Tatarstan using parallel steam injection and producing wells. Highly viscous oil production from the pilot wells yielding up to 25 tons per day. The Company continues to assess economic parameters and development of E&P activities relating to highly viscous oil production in Tatarstan.

Tatneft believes that untapped resources of natural bitumen in Tatarstan have significant potential and should be considered for commercial production in the current economic and technological environment. 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 2007 the Group continued work relating to the permitting and construction by OJSC TANECO ("TANECO"), formerly known as ZAO Nizhnekamsk Refinery, of a new refining and petrochemicals complex in Nizhnekamsk, Tatarstan. The new facility's projected throughput capacity is seven million tones of crude oil per year. In 2007 TANECO finalized the process of selecting licensors for various units of the facility, entered into an agreement with Fluor Corporation for project management consulting services as well as engineering, procurement and construction management services for selected scopes of work focused on the utilities and infrastructure relating to the facility. Up to December 2007 most of the expenditures relating to the refinery construction were financed by the Company in form of loans made to TANECO. From December 2007 these expenditures are financed through a US$ 2 billion senior secured credit facility for TANECO arranged by ABN AMRO, BNP Paribas (Suisse) SA, Citibank International PLC, Bayerische Hypo-und Vereinsbank AG, Sumitomo Mitsui Finance Dublin and WestLB AG. An investment agreement relating to RR 16.5 billion external infrastructure financing from the Russian Federation Investment Fund for the facility was signed in 2007.

Petrochemicals

In 2007 the core entity of the Group's petrochemicals segment – OAO Nizhnekamskshina produced 12,415 thousand tires. A new advanced rubber mix production line was launched in 2007 with monthly capacity of 1,200 tons, which allows Nizhnekamskshina to produce modern high performance tires. The Group continued to invest into modernization and upgrading of Nizhnekamskshina's facilities to strengthen its market competitiveness.

Changes in the Group Structure

Ukrtatnafta

In December 2007, the Company acquired equity interests in AmRUZ Trading AG ("AmRUZ") and Seagroup International Inc. ("Seagroup"). These entities primary activities are ownership interests in Closed Joint Stock Company Ukrtatnafta ("Ukrtatnafta"), the owner of the Kremenchug refinery, which constitute 8.34% and 9.96% of the outstanding common shares in Ukrtatnafta, respectively. The Company acquired 49.6% of AmRUZ for US $23.9 million and 100% of Seagroup for US$ 57.1 million. The AmRUZ purchase agreement also contains an option allowing the Company to acquire an additional 49.1% in AmRUZ for US $23.7 million. As the exercise of the option is subject to certain contingencies, the acquisition of AmRUZ has been accounted for under the equity method. These acquisitions increased the Group's direct and indirect ownership in Ukrtatnafta.

On October 23, 2006, the Group entered into a five-year agreement with the Tatarstan government for the fiduciary management of 28.78% ordinary shares of Ukrtatnafta held by the Tatarstan government. Under this agreement, the Group is entitled to exercise principle shareholder rights vested into these shares but may not manage them without prior approval of the Tatarstan government. The Group's investment of 18.6% in Ukrtatnafta (represented by those shares owned by the Company and its subsidiary Seagroup directly) is accounted for under cost method in these consolidated financial statements as Management believes the Group does not currently have the ability to exercise significant influence over Ukrtatnafta, given the current corporate conflict and the Company's lack of effective influence through Ukrtatnafta's Board of directors.

Banking

In May 2006, the Group increased its shareholding in Bank Zenit from 25.95% to 39.73% as a result of acquiring 2,935.3 million newly issued shares of the bank at their par value for RR 2,935.3 million. In March 2007, the Group disposed of 1,138 million of Bank Zenit shares for RR 1,787 million, decreasing the Company's ownership in Bank Zenit to 28.35%.

Also, in June 2007 Bank Zenit carried out a private placement of 1,545 million newly issued ordinary shares to a private investor unrelated to the Group, resulting in the dilution of the Group's ownership in Bank Zenit to 24.56%.

In June 2006 the Company increased its shareholding in Bank AK Bars from 29.46% up to 32.19% as a result of acquiring newly issued shares at their par value for RR 3,825 million. In August 2007, the Company disposed of its entire interest in Bank AK Bars for RR 6.8 billion to parties unrelated to the Group.

Other

During 2007, the Group sold a number of oil field service assets to unrelated entities for RR 1,826 million.

Resource base

As determined by the Group's independent petroleum engineering consultants, Miller and Lents, Ltd., the following information presents the balances of our crude oil and condensate reserves as of December 31, 2007 and 2006 under the Society of Petroleum Engineers and the World Petroleum Congress definitions.

Net crude and condensate reserves (in mmbbl)	**At December 31, 2007**	**Changes in 2007**		**At December 31, 2006**
		Production	**Revision**	
Total proved reserves	6,140	(184)	413	5,911
Total probable reserves	2,141			1,994
Total possible reserves	610			453

Most evaluated properties are located in the Volga-Ural Oil Basin and include approximately 120 developed and producing oil fields, containing approximately 28,800 active completions. In addition, in 2007, estimated reserves for 21 bitumen oil fields were recorded.

The process of estimating reserves is inherently judgmental. Proved crude and condensate reserves are estimated quantities, which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions (i.e., prices and costs as of the date that the estimate is made). Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon judgments about future conditions. Actual prices and costs are subject to change due, in significant part, to factors beyond the Group’s control. These factors include world oil prices, energy costs and increases or decreases of oil field service costs. Due to inherent uncertainties and the limited nature of reservoir data, estimates of underground reserves are subject to changes over time as additional information becomes available.

The determination of estimated proved reserves is a significant element in arriving at the results of operations of exploration and production activities. The Company uses independent reservoir engineers to estimate all of our oil and gas reserves. The estimates of proved reserves impact well capitalization, undeveloped lease impairments and the depreciation rates of proved properties, wells and equipment. Reduction in reserve estimates may result in the need for impairments of proved properties and related assets.

Operational highlights

	Year ended December 31, 2007	**Year ended December 31, 2006**
Crude oil production (millions of metric tons)	25.9	25.7
Crude oil production (millions of barrels)	184.7	183.4
Refining and tolling of crude oil throughput (millions of metric tons)	0.5	0.6
Refining and tolling of crude oil throughput (millions of barrels)	3.9	3.9
Gas production by the Group (million of cubic meters)	738.5	738.5
Refining of gas products throughput (million of cubic meters)	658.8	646.2

Crude oil and gas production

Crude oil production of the Group (including production of consolidated subsidiaries OAO Ilekneft, ZAO Abdulinskneftegaz, ZAO Tatneft-Samara, ZAO Tatneft-Severny and ZAO Kalmtatneft) increased by 0.8% to 25.9 million metric tons in 2007. Increase of crude oil production is mainly the result of implementing modern secondary and tertiary methods and new technologies on the Company’s fields in Tatarstan. Our gas production remained stable and amounted to 738.5 million cubic meters in 2007.

Export of crude oil from Russia

The Group continues to utilize Transneft, the state-owned monopoly owner and operator of Russia's trunk crude oil and export pipelines, upon export of its crude oil. During 2007, the Group exported from Russia approximately 68.6% of its crude oil production compared with approximately 63.2% in 2006. The increase of crude oil exported from Russia is attributable to the general growth of world prices resulting in favorable export netback prices.

Certain Macroeconomic Factors Affecting the Group's Results of Operations

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

Crude oil and refined product prices

The Group's operations are significantly affected by changes in crude oil and refined product prices, both in export markets and in Russia. These prices are affected by external factors over which the Group has no control, such as global economic conditions, demand and supply fluctuations, inventory levels, weather and competing fuel prices. Export and domestic prices for crude oil and refined products have been highly volatile, depending, *inter alia*, on the balance between supply and demand and on OPEC production levels.

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

The table below represents average crude oil prices worldwide and in Russia for 2007 and 2006.

World market	**Year ended December 31, 2007, US $/ bbl**	**Change**	**Year ended December 31, 2006, US $/ bbl**
Brent crude	72.5	11.3%	65.1
Urals crude (*CIF Mediterranean*)*	69.5	13.3%	61.3
Urals crude (*CIF Rotterdam*)*	69.3	13.2%	61.2

Source: Platts
* The company sells crude oil on foreign markets on various delivery terms. Therefore, our average sale price differs from average reported market prices.

Russian market	**Year ended December 31, 2007, RR per ton***	**Change**	**Year ended December 31, 2006, RR per ton***
Crude oil	6,288	8.7%	5,784

Source: Kortes
*(excluding VAT)

Transportation of crude oil and refined products

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. The Russian government is expected to retain control over Transneft for the foreseeable future. Although pipeline capacity in Russia has increased in recent years, this capacity has not kept up with increases in production experienced by Russian oil and gas companies and therefore the capacity of the pipeline network still acts as a constraint on exports and indirectly on oil production in Russia. Currently, there are government-sponsored and private programs to increase pipeline capacity.

Transportation of 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. 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 is authorized to periodically review and set the tariff rates applicable for each segment of the pipeline.

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 are 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.

Prior to March 2004, the Russian Federal Energy Commission periodically reviewed and set the tariff rates for each segment of the Transneft and Transnefteproduct pipelines. In March 2004, the Federal Energy Commission was reorganized into the Federal Tariffs Service.

According to the Federal Statistics Service of the Russian Federation, during the year ended December 31, 2007 transportation tariffs increased as follows: transportation of crude oil by pipeline – 9.9%, transportation of refined products by pipeline – 17.2%, transportation by railway – 7.7%. These amounts differ from actual changes in tariffs for transportation of crude oil and refined products by the Group for the period considered due to the specifics in the routes and geography of our supplies from the Russian transportation averages.

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. In particular, operating margins are generally adversely affected by an appreciation of the Ruble against the US Dollar, because this will generally cause costs to increase relative to revenues. The Group has not historically used financial instruments to hedge against foreign currency exchange rate fluctuations.

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

	Year ended December 31, 2007	Year ended December 31, 2006
Ruble inflation	11.9%	9.0%
US $ period-end exchange rate	24.55	26.33
Average US $ exchange rate	25.57	27.17
Nominal appreciation of the Ruble	6.8%	8.5%
Real Ruble appreciation	20.0%	19.1%

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

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

Taxation

The Group is subject to numerous taxes that have had 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;
- export duties;
- excise taxes on refined products;
- value added taxes;
- property taxes;
- land tax;
- vehicle tax;
- other local taxes and levies; and
- tax penalties and interest.

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

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

Tax	**Year ended December 31, 2007**	**Year ended December 31, 2006**	**Taxable base**
Income tax – maximum rate	24%	24%	Taxable income
VAT	18%	18%	Added value
Unified production tax, average rates[(1)]	RR 2,470	RR 2,264	Metric ton produced (crude oil)
Refined products excise tax:			
High octane gasoline	RR 3,629	RR 3,629	
Low octane gasoline	RR 2,657	RR 2,657	
Diesel fuel	RR 1,080	RR 1,080	Metric ton produced and sold domestically [(2)]
Motor oils	RR 2,951	RR 2,951	
Straight run gasoline.	RR 2,657	RR 2,657	
Crude oil export duty, average rates	US $206.5	US $196.9	Metric ton exported
Refined products export duty average rates:			
Light refined products (gasoline products) and mid refined products (diesel fuel)	US $151.5	US $145.0	Metric ton exported
Fuel oil (mazut)	US $81.6	US $78.1	
Property tax – maximum rate	2.2%	2.2%	Taxable property

[(1)] *Without taking into account differentiated taxation*

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

During 2007, the tax rates specific to the oil industry rose substantially compared to the previous year. Unified production tax increased by 9.1%, average crude oil export duties by 4.9%, an average refined products export duties by 4.5%.

The increase in unified production tax rates is a result of increase in the average Urals blend price by 14% partly offset by a decrease in average exchange rate of US Dollar against Ruble by 5.9% for the year ended December 31, 2007 as compared to year ended December 31, 2006. Excise taxes on refined products remained at the same level as in the respective period of 2006.

Unified production tax rate. Effective from January 1, 2005, the base rate for the unified production tax was set at RR 419 per ton of crude oil produced and adjusted monthly depending on the market price of Urals blend and the Ruble exchange rate. The tax becomes zero if the Urals blend price falls to or below US $9.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($9.00 per barrel) results in an increase of the tax rate by $1.61 per tonne extracted (or $0.226 per barrel extracted using a conversion factor of 7.123). This method of determining the unified production tax was applied until December 31, 2006.

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

Under the New Natural Resources Production Tax Law, the Company receives a benefit of 3.5% per field for each percent of depletion in excess of the 80% threshold. As Romashkinskoye field, the Company's largest, along with certain other fields, is more than 80% depleted, the Company received a benefit in the current period of approximately RR 5.07 billion. The output from Romashkinskoye field comprises 94.6% of the Group fields' total potential oil production that might be subject to the tax relief terms. Currently the direct method of accounting for produced oil, which implies segregated accounting for crude oil produced from the 80% or more depleted fields that is required to apply the benefit of differentiated taxation, is being introduced at four other fields, operated by the NGDU Prikamneft, with overall annual oil production of about 1 million tons. The implementation of this new method will result in additional tax benefits in 2008.

Also one of the key provisions of the New Natural Resources Production Tax Law is zero unified production tax rate for high viscous crude oil (defined as crude oil of more than 200 Megapascal second under reservoir conditions) where the direct (segregated) method of accounting for produced oil is used. Since April 2007, the Company's production of highly viscous crude oil from the Ashalchinskoye and Mordovo-Karmalskoye fields was subject to a zero unified production tax rate, resulting in tax benefit attributed to that production of approximately RR 20 million.

Crude oil export duties. Maximum rates of export duties for crude oil depend on a lagged average of Urals blend prices. The rates are zero when the lagged Urals blend price is at or below US $109.5 per metric ton. They then increase by US $0.35 per ton for each US $1.00 increase in the lagged Urals blend price when the lagged Urals blend price is between US $109.5 and US $146.0 per ton, by US $0.45 per ton for each US $1.00 increase in the lagged Urals blend price when the lagged Urals blend price is between US $146.0 and US $182.5 per ton, and by US $0.65 per ton for each US $1.00 increase in the lagged Urals blend price when the lagged Urals blend price is above US $182.5 per ton.

Export duty rates are set by the Russian Government with regard to the average Urals blend price on international crude oil markets (Mediterranean and Rotterdam) during the latest monitoring period and are effective from the first date of the second calendar month following the monitoring period. Each monitoring period consists of two calendar months starting from November 1, 2001.

Thus, the calculation method for the crude oil export duty rate results in a two-month lag between movements in crude prices and revision of export duty rate.

In 2006 crude oil and refined products exported to CIS countries, other than Ukraine, were not subject to export duties. On January 1, 2007, customs regulations between Russia and Belorussia were changed. Crude oil exported from Russia to Belorussia is now subject to export duties. The latest amendments made by customs authorities set a multiplier of 0.293 to be applied from February 1, 2007 to the regular export duty rate set by the Russian Government for calculation of export duty on crude oil exports from Russia to Belorussia.

Excise tax on refined products. In accordance with Russian legislation effective from January 1, 2005 the excise tax rates are set at RR 2,657 per metric ton for gasoline with octane numbers not exceeding “80” (low octane gasoline), RR 3,629 per metric ton for gasoline with octane numbers exceeding “80” (high octane gasoline), RR 1,080 per metric ton for diesel fuel and RR 2,951 per metric ton for motor oils. Effective from January 1, 2006 excise tax for straight run gasoline was introduced. The rate was set at RR 2,657 per metric ton. Accrued excise tax for straight run gasoline could be subsequently recovered if used for petrochemical production.

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

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

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

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

RR millions	Year ended December 31, 2007	Year ended December 31, 2006	Change
Sales and other operating revenues	**356,276**	**318,284**	**11.9%**
Costs and other deductions			
Operating	59,623	57,099	4.4%
Purchased oil and refined products	43,297	33,882	27.8%
Exploration	1,577	1,555	1.4%
Transportation	8,431	6,650	26.8%
Selling, general and administrative	22,349	20,510	9.0%
Depreciation, depletion and amortization	10,379	10,673	(2.8%)
Loss on disposals of property, plant and equipment and investments and impairments	5,253	3,438	52.8%
Taxes other than income taxes	146,299	144,976	0.9%
Maintenance of social infrastructure and transfer of social assets	2,340	328	-
Total costs and other deductions	**299,548**	**279,111**	**7.3%**
Earnings from equity investments	5,789	621	-
Foreign exchange loss	(2,623)	(1,829)	43.4%
Interest income	2,779	2,036	36.5%
Interest expense, net of amounts capitalized	(60)	(247)	(75.7%)
Other income (expense), net	(4)	2,870	-
Total other income	**5,881**	**3,451**	**70.4%**
Income before income taxes and minority interest	**62,609**	**42,624**	**46.9%**
Current income tax expense	(18,895)	(13,088)	44.4%
Deferred income tax benefit	641	982	(34.7%)
Total income tax expense	**(18,254)**	**(12,106)**	**50.8%**
Minority interest	(1,076)	(745)	44.4%
Net income	**43,279**	**29,773**	**45.4%**

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

Sales and other operating revenues

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

RR millions	Year ended December 31, 2007	Year ended December 31, 2006
Crude oil	270,960	237,869
Refined products	43,226	43,468
Petrochemicals	23,180	20,747
Other sales	18,910	16,200
Total sales and other operating revenues	**356,276**	**318,284**

Sales and other operating revenues increased in 2007 by 12% to RR 356,276 million from RR 318,284 million in 2006. The increase is mainly attributable to an increase in crude oil prices as well as increased volumes of crude oil sales and petrochemicals sales.

Sales of crude oil

Sales of crude oil increased by 14% to RR 270,960 million in 2007 from RR 237,869 million in 2006. The table below provides an analysis of the changes in sales of crude oil:

	Year ended December 31, 2007	Change	Year ended December 31, 2006
Domestic sales of crude oil			
Revenues (RR millions)	54,954	4.6%	52,551
Volume (thousand tons)	*8,957*	*(3.0%)*	*9,235*
Realized price (RR per ton)	*6,135*	*7.8%*	*5,690*
CIS export sales of crude oil [(1)]			
Revenues (RR millions)	57,893	(9.0%)	63,605
Volume (thousand tons)	*5,401*	*(6.4%)*	*5,767*
Realized price (RR per ton)	*10,719*	*(2.8%)*	*11,028*
Non-CIS export sales of crude oil			
Revenues (RR millions)	158,113	29.9%	121,713
Volume (thousand tons)	*12,394*	*18.0%*	*10,507*
Realized price (RR per ton)	*12,757*	*10.1%*	*11,584*

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

Sales of refined products

Sales of refined products decreased by 1% to RR 43,226 million in 2007 from RR 43,468 million in 2006. The table below provides an analysis of the changes in sales of refined products:

	Year ended December 31, 2007	Change	Year ended December 31, 2006
Domestic sales of refined products			
Revenues (RR millions)	37,013	13.2%	32,687
Volume (thousand tons)	*2,939*	*(1.9%)*	*2,997*
Realized price (RR per ton)	*12,594*	*15.5%*	*10,908*
CIS export sales of refined products			
Revenues (RR millions)	2,669	(58.9%)	6,487
Volume (thousand tons)	*150*	*(61.7%)*	*392*
Realized price (RR per ton)	*17,793*	*7.5%*	*16,552*
Non-CIS export sales of refined products			
Revenues (RR millions)	3,544	(17.5%)	4,294
Volume (thousand tons)	*329*	*8.2%*	*304*
Realized price (RR per ton)	*10,772*	*(23.7%)*	*14,123*

Sales of petrochemical products

The table below provides an analysis of petrochemical product sales.

RR millions	Year ended December 31, 2007	Change	Year ended December 31, 2006
Tires sales	22,516	*12.9%*	19,943
Other petrochemicals sales	664	*(17.4%)*	804
Total sales of petrochemical products	**23,180**		**20,747**

The increase in tire sales was primarily attributable to the combined effect of increased prices and higher volume of tires sold. The Group increased production of tires by 2% to 12.4 million tires in 2007.

Other sales

Other sales increased by 17% to RR 18,910 million in 2007 from RR 16,200 million in 2006. Other sales primarily represent sales of materials and equipment and various field services provided by the Company's production subsidiaries to third parties (such as drilling, lifting, construction, repairs, and geophysical works). In 2007 other sales was mainly attributable to increased sales of drilling services, as well as materials and equipment sales.

Costs and other deductions

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

RR millions	Year ended December 31, 2007	Year ended December 31, 2006
Crude oil extraction expenses	22,168	19,195
Petrochemical production expenses	18,287	17,513
Other operating expenses	19,168	20,391
Total operating expenses	**59,623**	**57,099**

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 goods and services (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 120.0 per barrel in 2007 compared to RR 104.7 per barrel in 2006. The increase of 15% is primarily a result of increases in electricity tariffs, wages and other service costs.

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 production increased by 4% to RR 18,287 million primarily due to increases in the cost of raw materials, electricity tariffs and other services costs, as well as increase in production and sales of tires by 2% and 13%, respectively.

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 received not related to the core oil and gas production activities of the Group.

Other operating expenses decreased to RR 19,168 million, or by 6%, compared to 2006. The decrease is primarily due to decrease in other non-core activities including selling of other goods and services.

Cost of purchased crude oil and refined products. A summary of purchased oil and refined products for 2007 and 2006 is as follows:

RR millions	**Year ended December 31, 2007**	**Year ended December 31, 2006**
Purchased refined products (RR millions)	29,938	29,557
Volume (thousand tons)	*2,403*	*2,402*
Average price per ton (RR)	*12,460*	*12,303*
Purchased crude oil (RR millions)	13,359	4,325
Volume (thousand tons)	*1,334*	*739*
Average price per ton (RR)	*10,014*	*5,851*
Total purchased oil and refined products	**43,297**	**33,882**

Purchases of refined products increased by 1% to RR 29,938 million in 2007 from RR 29,557 million in 2006.

Purchases of crude oil increased by 209% to RR 13,359 million in the 2007 from RR 4,325 million in the 2006 due to increase in volumes of purchased crude oil for trading as well as increase in average purchase price per ton.

Exploration expenses. Exploration expenses consist primarily of exploratory drilling, geological and geophysical costs, and the costs of carrying and retaining undeveloped properties. Exploration expenses increased by 1% to RR 1,577 million in 2007 from RR 1,555 million in 2006.

Transportation expenses. Transportation expenses relate to the delivery of our own crude oil production as well as purchased crude and refined products, which are primarily incurred using Transneft pipeline for deliveries of crude oil to our customers. Transportation costs increased by 27% to RR 8,431 million in 2007 from RR 6,650 million in 2006 due to increase in transportation tariffs and overall increase in sales volumes.

Selling, general and administrative expenses. Certain selling, general and administrative expenses are by nature fixed costs, which are not directly attributable to production, such as payroll, general business costs, insurance, advertising, share based compensation, legal fees, consulting and audit services, charity and other expenses, including bad debt provisions. Selling, general and administrative expenses increased by 9% to RR 22,349 million in 2007 from RR 20,510 million in 2006.

Loss on disposals of property, plant and equipment and impairment of investments. Loss on disposals of property, plant and equipment and impairment of investments in 2007 amounted to RR 5,253 million compared to RR 3,438 million in 2006.

The following impairments were recorded in the Company's US GAAP consolidated financial statements in 2007: impairment of a number of oil field service assets which were sold to two newly formed entities unrelated to the Group (RR 4 455 million), impairment on disposal of Bank Ak Bars (RR 694 million) (see Change in the Group structure above), and the cost of transferring the Group's 10.8 millions treasury shares to the National Non-governmental Pension Fund (RR 1,289 million), through which a substantial portion of the Group's pension and post employment benefit programs are administered.

Impairments relating to the sale of Bank Ak Bars and oil field service assets mentioned in the paragraph above are due to sales price for disposal transactions approximated their asset carrying values under Russian statutory accounting, which is lower than their related US GAAP carrying values; with respect to oil field service assets this is primarily due to prior years indexation for the effect of hyperinflation recorded according to US GAAP resulting in recognition of a gain on these assets, which was effectively off-set upon their disposal.

Other gains include gains on the disposal of a number of non-core assets.

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

	Year ended December 31, 2007	**Year ended December 31, 2006**
Unified production tax	58,049	56,843
Export duties	85,327	85,358
Excise taxes	300	602
Property tax	1,398	1,322
Penalties and interest	205	102
Other	1,020	749
Total taxes other than income taxes	**146,299**	**144,976**

Taxes other than income taxes increased by 1% to RR 146,299 million in 2007 from RR 144,976 million in 2006. The increase was primarily a result of an increase in unified production tax, which is linked to crude oil market prices partly offset by introduction of differentiated rates of unified production taxes. Unified production tax increased by 2% to RR 58,049 million from RR 56,843 million. Excise tax decreased to RR 300 million from RR 602 million, which is the result of the decrease in purchases of taxable refined products (mainly diesel fuel). Other taxes include land tax and non-recoverable VAT.

Effective January 1, 2007, the base tax rate formula for unified production tax was modified to provide a benefit for fields whose depletion rate is 80% or above as determined under Russian resource classification. Under the new rules of unified production tax, 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 current period of approximately RR 5.07 billion.

Since April 2007, the Company applied a zero unified production tax rate to production of highly viscous crude oil from Ashalchinskoye and Mordovo-Karmalskoye fields, resulting in a 2007 tax benefit of approximately RR 20 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 increased to RR 2,330 million in 2007 from RR 288 million in 2006.

Transfer of social assets constructed after privatization decreased to RR 10 million in 2007 from RR 40 million in 2006. The social assets comprise mainly dormitories, hotels, gyms and other facilities.

Other income and expenses

Earnings from equity investments increased to RR 5,789 million in 2007 from RR 621 million in 2006 due to an increase in our share of the IPCG Fund's operating gains (RR 4,545 million) compared to our share in the IPCG Fund's losses (RR 986 million) in 2006, as well as higher income received from the Company's equity affiliate ZAO Tatex (RR 303 million).

The foreign exchange loss amounted to RR 2,623 million in 2007 compared with a loss of RR 1,829 million in 2006 due to appreciation of the Russian Ruble against the US Dollar.

Interest income increased to RR 2,779 million in 2007 from RR 2,036 million in 2006 due to an increase in loans issued. Interest expense decreased to RR 60 million in 2007 from RR 247 million in 2006, which is the result of an increase in capitalized interest related to the construction of TANECO.

Other expense, net in 2007 amounted to RR 4 million compared with RR 2,870 million of other income, net in 2006. The change is primarily due to realized and unrealized losses recorded on our trading investments.

Income taxes

The effective income tax rate in 2007 was 29.2%, which is higher than statutory tax rate for the Russian Federation (24%). This difference is attributable to non deductible or partially deductible expenses incurred during the year.

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

RR millions	Year ended December 31, 2007	Year ended December 31, 2006
Net income	43,279	29,773
Add back:		
Minority interest	1,076	745
Income tax expense	18,254	12,106
Depreciation, depletion and amortization	10,379	10,673
Interest expense	60	247
Interest income	(2,779)	(2,036)
EBITDA	**70,269**	**51,508**

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 December 31, 2007	At December 31, 2006
Current assets	126,595	101,868
Long-term assets	243,624	217,556
Total assets	**370,219**	**319,424**
Current liabilities	38,428	32,747
Long-term liabilities	63,233	51,800
Total liabilities	**101,661**	**84,547**
Shareholders' equity	**264,059**	**231,703**
Working capital	88,167	69,121
Current ratio	3.29	3.11

Working capital position

As of December 31, 2007 working capital of the Group amounted to RR 88,167 million compared to RR 69,121 million as of December 31, 2006. The increase in the working capital is primarily attributable to an increase in cash and cash equivalents and accounts receivable.

Liquidity and Capital Resources

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

RR millions	Year ended December 31, 2007	Year ended December 31, 2006
Net cash provided by operating activities	48,033	32,943
Net cash used for investment activities	(39,624)	(36,078)
Net cash used for financing activities	(2,268)	(8,180)
Increase (decrease) in cash and cash equivalents	6,141	(11,315)

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 46% to RR 48,033 million in 2007 from RR 32,943 million in 2006 which is explained primarily through higher net income earned in 2007.

Net cash used for investing activities

Net cash used for investing activities increased by 10% to RR 39,624 million in 2007 from RR 36,078 million in 2006, which is primarily due to an increase in spending for purchases of property, plant and equipment partly offset by increased proceeds from disposal of investments (see Changes in the Group structure).

Net cash provided by financing activities

Cash flow used for financing decreased by 72% to RR 2,268 million in 2007 from RR 8,180 million in 2006. The decrease is primarily due to net debt proceeds of RR 9,283 million in 2007 compared with net debt repayments of RR 4,263 million in 2006 partly offset by an increase in dividends paid to shareholders.

Additions to property, plant and equipment

The following additions to property, plant and equipment (by segment) were made in 2007, compared to the same period of 2006:

RR millions	Year ended December 31, 2007	Year ended December 31, 2006
Exploration and production	19,445[(1)]	12,032
Refining and marketing	10,754[(2)]	3,101
Petrochemicals	2,061[(3)]	621
Corporate and other	2,175	6,249
Total additions to property, plant and equipment	**34,435**	**22,003**

[(1)] *Includes RR 4,174 million acquisition of new E&P licenses*
[(2)] *Includes RR 10,234 million expenditure related to the refinery construction by TANECO*
[(3)] *Includes RR 1,086 million expenditure related to the new metal cord tires production line*

Analysis of Debt

At December 31, 2007, long-term debt, including the current portion of long-term debt, amounted to RR 9,326 million as compared to RR 1,696 million at December 31, 2006. The related increase is due to a new US$ 2.0 billion senior secured credit facility for TANECO arranged by ABN AMRO, BNP Paribas (Suisse) SA, Citibank International PLC, Bayerische Hypo-und Vereinsbank AG, Sumitomo Mitsui Finance Dublin and WestLB AG, to be used in the construction of TANECO’s refinery and petrochemical complex.

The aggregate maturities of total long-term debt, including current portion as of December 31, 2007 and 2006 are as follows:

RR millions	At December 31, 2007	At December 31, 2006
2007		1,391
2008	144	157
2009	545	93
2010	8,591	25
2011 and thereafter	46	30
Total long-term debt	**9,326**	**1,696**

Contractual obligations, other contingencies and off balance sheet arrangements

Social commitments

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

Guarantees

The Group has no outstanding guarantees at December 31, 2007 and 2006.

Litigation and claims

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

Ukrtatnafta

In December 2007 the Company acquired a substantial interest in AmRUZ and a controlling interest in Seagroup, whose principle activities are investments in Ukrtatnafta. Historically, and in particular during the course of 2007, there have been a number of attempts by Ukraine to challenge AmRUZ and Seagroup's acquisition of shares in Ukrtatnafta, and in particular, by the State Property Fund and NJSC Naftogaz of Ukraine ("Naftogaz"). Naftogaz is 100% owned by the Ukrainian Government and also owner of record of 43% Ukrtatnafta's common shares.

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

In October 2007 the existing management of Ukrtatnafta, as appointed by its shareholders, was forcibly removed based on an alleged court order. Subsequently installed new management at Ukrtatnafta immediately took certain actions effectively assisting MFEU in taking control over the shares in Ukrtatnafta owned by Seagroup and AmRUZ. In addition, Ukrtatnafta subsequently refused to settle its payables to ChMPKP Avto, a Ukrainian intermediary that previously purchased crude from the Group for deliveries to Ukrtatnafta. As of December 31, 2007 receivables of RR 10.7 billion are due from ChMPKP Avto. Following this forced change of control of Ukrtatnafta, the Company (originally the key crude supplier to the Kremenchug refinery) suspended its deliveries to Ukrtatnafta and initiated legal proceedings against the Ukrainian side in international arbitration.

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

Also, the Group continues to defend its interests as of a shareholder in Ukrtatnafta in respective court hearings in Ukraine and has initiated court proceedings to recover the unpaid receivable.

Quantitative and qualitative disclosures about market risks

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

Interest rate risk

We are exposed to interest rate risk on our indebtedness that bears interest at floating rates and to a lesser extent, on our indebtedness that bears interest at fixed rates. At December 31, 2007 we had approximately RR 13,608 million in loans outstanding, of which approximately RR 1,576 million bore interest at fixed rates and approximately RR 12,032 million bore interest at floating rates determined by reference to the LIBOR for US dollar deposits (for details please refer to Note 13 “Debt” of the audited consolidated financial statements).

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

Foreign currency risk

Our principal exchange rate risk involves changes in the value of the ruble relative to the US dollar. At December 31, 2007, approximately RR 12,496 million of our indebtedness was denominated in US dollars (out of approximately RR 13,608 million of our total indebtedness at that date). Depreciation in the value of the ruble relative to the US dollar will increase the cost in rubles of our foreign currency denominated costs and expenses and of our debt service obligations for foreign currency denominated indebtedness. A depreciation of the ruble relative to the US dollar will also result in foreign exchange losses as the ruble value of our foreign currency denominated indebtedness is increased. We believe that the risks associated with our foreign currency exposure are mitigated by the fact that a significant portion of our revenues are US dollar denominated and thus more closely match our foreign currency costs and debt service obligations. Furthermore, accounts receivable of RR 34,464 million at December 31, 2007 were also US dollar based and serve to mitigate our exposure to foreign currency fluctuations. As of December 31, 2007, the ruble had appreciated against the US dollar by approximately 6.8% since December 31, 2006. We recognized a net foreign currency translation loss of RR 2,623 million in 2007.

Commodity instruments

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

Critical accounting policies

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

Forward-looking statements

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

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

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

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

These factors include:

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

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