MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE THREE AND
SIX MONTHS ENDED 30 JUNE 2014

Content

The following discussion should be read in conjunction with the unaudited consolidated interim condensed financial statements prepared in accordance with IFRS and the related notes, published simultaneously with this Management's Discussion and Analysis of financial condition and results of operations (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.

This report includes forward-looking statements – words such as "believes," "anticipates," "expects," "estimates," "intends," "plans," etc. – that reflect management's current estimates and beliefs, but are not guarantees of future results. Please see "Forward-looking statements" on page 22 for a discussion of some factors that could cause actual results to differ materially.

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 petrochemicals', mainly tires, production and marketing.

As of 30 June 2014 and 31 December 2013 OJSC 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 OJSC 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 Commission 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 majority of the Group's crude oil and gas production, refining capacity and other operations are located in Tatarstan, a republic of the Russian Federation, situated between the Volga River and the Ural Mountains, 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 30 June 2014	Three months ended 30 June 2013	Change, %	Six months ended 30 June 2014	Six months ended 30 June 2013	Change, %
Financial results						
Sales, net (RR million)	128,122	104,696	*22.4*	244,862	211,250	*15.9*
Profit attributable to Group shareholders (RR million)	27,174	14,935	*81,9*	51,565	31,909	*61.6*
EBITDA [(1)] (RR million)	41,336	26,010	*58.9*	79,270	54,988	*44.2*
Additions to property, plant and equipment (RR million)	12,261	14,776	*(17.0)*	21,923	27,209	*(19.4)*
Free Cash Flow (RR million)	15,398	15,842	*(2.8)*	46,798	32,227	*45.2*
Net debt [(4)] (RR million)	7,197	29,868	*(75.9)*	7,197	29,868	*(75.9)*
Basic and Diluted net profit per share of common stock (RR)						
Common	11.97	6.58	*81.9*	22.71	14.05	*61.6*
Preferred	11.94	6.55	*82.3*	22.68	14.02	*61.8*
Operational results						
Crude oil production by the Group (th. tonnes)	6,610	6,588	*0.3*	13,136	13,091	*0.3*
Crude oil production by the Group (th. barrels)	47,083	46,925	*0.3*	93,567	93,244	*0.3*
Crude oil daily production (th. barrels per day)	517.4	515.7	*0.3*	516.9	515.2	*0.3*
Gas production by the Group (million cubic meters)	230.4	233.5	*(1.3)*	459.9	463.4	*(0.8)*
Gas daily production (th. boe per day)	14.9	15.1	*(1.3)*	15.0	15.1	*(0.7)*
Refined products produced (th. tonnes)	2,273.4	1,798.3	*26.4*	4,484.9	3,711.8	*20.8*
Gas products produced (th. tonnes)	279.0	276.5	*0.9*	552.3	554.9	*(0.5)*
Refining throughput [(2)] (th. barrels per day)	186.0	148.0	*25.7*	184.7	153.5	*20.3*
Production of tires (million tires)	3.0	3.3	*(9.1)*	5.6	6.4	*(12.5)*
Number of petrol (gas) stations in Russia[(3) (4)]	528	508		528	508	
Number of petrol (gas) stations outside of Russia[(3) (4)]	122	122		122	122	

(1) *As defined on page 13*
(2) *Including reprocessed products*
(3) *Including leased stations*
(4) *At the end of the period*

Our net profit in the second quarter of 2014 of RR 27,174 million was higher by RR 12,239 million than in the corresponding period of 2013 mostly due to an increase in sales and other operating revenues.

Our net profit in the six months of 2014 was RR 51,565 million, which is RR 19,656 million, or 61.6%, more than in the corresponding period of 2013. Higher sales were the main factor behind an increase of our profit in the six months of 2014 compared to the corresponding period of 2013 (for more detailed presentation of various factors affecting the results of our operations as well as period-to-period comparison, please see page 6).

In the second quarter of 2014 the Group (including consolidated subsidiaries OAO Ilekneft, OOO Tatneft-Samara, OOO Tatneft-Severny) produced 6.6 million metric tonnes of crude oil which is 0.3% higher than in the second quarter of 2013. Our gas production in the second quarter of 2014 was 230.4 million cubic meters which is 1.3% lower than in the corresponding period of 2013.

In the six months of 2014 the Group produced 13.1 million metric tonnes of crude oil which is 0.3% higher than in the six months of 2013. Our gas production in the six months of 2014 was 459.9 million cubic meters which is 0.8% lower than in the corresponding period of 2013. Increase of refining throughput by 20.8% in the six months of 2014 compared to the corresponding period of 2013 was due to expansion of initial processing volumes at the TANECO refinery.

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, as well as production subsidiaries, geological, engineering and reservoir oil yield improvement subdivisions, pumping equipment repair centers, and other ancillary oilfield services' operations. Most oil and gas exploration and production activities are concentrated within the Company.

- **Refining and marketing** – consists of the Company's sales and marketing division (URNiN), a refining and petrochemical complex in Nizhnekamsk, Tatarstan, operated by OAO TANECO ("TANECO"), as well as the Company's construction projects management division; our gas production, transportation and refining division Tatneftegaspererabotka; OOO Tatneft-AZS Center, OOO Tatneft-AZS-Zapad, OOO Tatneft-AZS-Sibir and OOO Tatneft-AZS-Yug which manage the Tatneft branded gas stations network in Russia and carry out refined products wholesale sales; and certain other oil trading and ancillary companies.

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

Results of operations for the three and six months ended 30 June 2014 compared to the three and six months ended 30 June 2013

The following table sets forth the consolidated statement of profit or loss both in absolute values and respective change (where relevant) over the analyzed periods:

(RR million)	Three months ended 30 June 2014 (unaudited)	Three months ended 30 June 2013 (unaudited)	Change, %	Six months ended 30 June 2014 (unaudited)	Six months ended 30 June 2013 (unaudited)	Change, %
Sales and other operating revenues, net	**128,122**	**104,696**	***22.4***	**244,862**	**211,250**	***15.9***
Costs and other deductions						
Operating	(22,736)	(21,068)	*7.9*	(42,398)	(39,909)	*6.2*
Purchased oil and refined products	(15,495)	(12,731)	*21.7*	(26,279)	(25,051)	*4.9*
Exploration	(437)	(335)	*30.4*	(828)	(661)	*25.3*
Transportation	(5,402)	(6,928)	*(22.0)*	(11,645)	(15,446)	*(24.6)*
Selling, general and administrative	(10,815)	(10,804)	*0.1*	(20,064)	(20,569)	*(2.5)*
Depreciation, depletion and amortization	(5,289)	(4,169)	*26.9*	(10,232)	(9,215)	*11.0*
(Loss)/ gain on disposals of property, plant and equipment, investments and impairments	(640)	142	*n/a*	(857)	473	*n/a*
Taxes other than income taxes	(30,359)	(25,476)	*19.2*	(61,712)	(52,860)	*16.7*
Maintenance of social infrastructure and transfer of social assets	(902)	(1,486)	*(39.3)*	(1,809)	(2,239)	*(19.2)*
Total costs and other deductions	**(92,075)**	**(82,855)**	***11.1***	**(175,824)**	**(165,477)**	***6.3***
Foreign exchange gain/ (loss)	403	(948)	*n/a*	(803)	(1,152)	*(30.3)*
Interest income	1,813	840	*115.8*	3,173	1,572	*101.8*
Interest expense, net of amounts capitalized	(1,422)	(1,421)	*0.1*	(2,873)	(3,138)	*(8.4)*
Earnings/ (losses) from equity investments	203	(4)	*n/a*	40	223	*(82.1)*
Other income/ (expenses), net	197	(264)	*n/a*	(318)	429	*n/a*
Total other income/ (expenses)	**1,194**	**(1,797)**	***n/a***	**(781)**	**(2,066)**	***(62.2)***
Profit before income taxes	**37,241**	**20,044**	***85.8***	**68,257**	**43,707**	***56.2***
Current income tax expense	(4,841)	(3,665)	*32.1*	(12,342)	(9,969)	*23.8*
Deferred income tax (expense)/ benefit	(3,287)	(425)	*673.4*	(1,308)	176	*n/a*
Total income tax expense	**(8,128)**	**(4,090)**	***98.7***	**(13,650)**	**(9,793)**	***39.4***
Profit for the period	**29,113**	**15,954**	***82.5***	**54,607**	**33,914**	***61.0***
Less: Profit attributable to non-controlling interest	(1,939)	(1,019)	*90.3*	(3,042)	(2,005)	*51.7*
Profit attributable to Group shareholders	**27,174**	**14,935**	***81.9***	**51,565**	**31,909**	***61.6***

Sales and other operating revenues

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

(RR million)	Three months ended 30 June 2014	Three months ended 30 June 2013	Change, %	Six months ended 30 June 2014	Six months ended 30 June 2013	Change, %
Crude oil						
Sales	*89,867*	*89,363*	*0.6*	*174,221*	*177,656*	*(1.9)*
Less related export duties	*(27,341)*	*(35,718)*	*(23.5)*	*(56,077)*	*(70,853)*	*(20.9)*
	62,526	53,645	*16.6*	118,144	106,803	*10.6*
Refined products						
Sales	*62,622*	*46,629*	*34.3*	*126,792*	*99,550*	*27.4*
Less related export duties and excise taxes	*(11,634)*	*(9,637)*	*20.7*	*(27,037)*	*(22,429)*	*20.5*
	50,988	36,992	*37.8*	99,755	77,121	*29.3*
Petrochemicals	8,426	8,767	*(3.9)*	14,398	15,691	*(8.2)*
Corporate and other sales	6,182	5,292	*16.8*	12,565	11,635	*8.0*
Total Sales and other operating revenues, net	**128,122**	**104,696**	***22.4***	**244,862**	**211,250**	***15.9***

Increase in sales and other operating revenues in the second quarter of 2014 in comparison to the corresponding period of 2013 was due to increased sales of refined products.

Increase in sales and other operating revenues in the six months of 2014 in comparison to the corresponding period of 2013 was mostly due to increased sales of refined products as well as the effect of decreased export duties paid in the current period.

In the three and six months ended of 2014 export duties, paid by the Group, decreased by 17.1% and by 13.2% to RR 37,423 million and RR 80,598 million, respectively, compared to the corresponding periods of 2013 due to lower volumes of crude oil sold for export to non-CIS directions in the current period.

Our expenses on excise taxes in the three and six months ended of 2014 increased to RR 1,552 million and RR 2,516 million, respectively, compared to the RR 191 million and RR 454 million in the corresponding periods of 2013 due to higher volumes of refined products sold which are subject to excise tax as well as an increase of excise tax rates in the current period.

Export of crude oil and refined products from Russia

For crude oil export the Group is using transportation services of OAO AK Transneft ("Transneft"), the state-owned monopoly owner and operator of Russia's trunk crude oil pipelines.

Three months ended 30 June 2014

During the second quarter of 2014, the Group exported approximately 51% of all its crude oil sold compared to approximately 67% in the corresponding period of 2013.

In the second quarter of 2014 the Company delivered 43% (46% in the second quarter of 2013) of its own crude oil for export through Transneft's Druzhba pipeline (mainly to Poland, Hungary and Slovakia); 27% (14% in the second quarter of 2013) of crude oil was shipped through Russian Black Sea ports (mainly Novorossiysk) and 30% (40% in the second quarter of 2013) of crude oil exported through Russian Baltic Sea ports (mainly Primorsk).

In the second quarter of 2014 the Group exported 1,128 thousand tonnes of refined products (including 18 thousand tonnes of purchased refined products) in comparison to 1,105 thousand tonnes in the second quarter of 2013 (including 16 thousand tonnes of purchased refined products).

Six months ended 30 June 2014

During the six months of 2014, the Group exported approximately 52% of all its crude oil sold compared to approximately 68% in the corresponding period of 2013.

In the six months of 2014 the Company delivered 42% (43% in the six months of 2013) of its own crude oil for export through Transneft's Druzhba pipeline (mainly to Poland, Hungary and Slovakia); 37% (19% in the six months of 2013) of crude oil was shipped through Russian Black Sea ports (mainly Novorossiysk) and 21% (38% in the six months of 2013) of crude oil exported through Russian Baltic Sea ports (mainly Primorsk).

In the six months of 2014 the Group exported 2,616 thousand tonnes of refined products (including 30 thousand tonnes of purchased refined products) in comparison to 2,570 thousand tonnes in the corresponding period of 2013 (including 30 thousand tonnes of purchased refined products).

Sales breakdown

Sales revenues

(RR million)	Three months ended 30 June 2014	Three months ended 30 June 2013	Change, %	Six months ended 30 June 2014	Six months ended 30 June 2013	Change, %
Crude oil						
Non-CIS						
Export sales	59,294	72,865	*(18.6)*	119,331	146,376	*(18.5)*
Less related export duties	(27,341)	(35,718)	*(23.5)*	(56,077)	(70,853)	*(20.9)*
CIS sales[(1)]	2,915	1,881	*55.0*	4,957	3,261	*52.0*
Domestic sales	27,658	14,617	*89.2*	49,933	28,019	*78.2*
	62,526	**53,645**	***16.6***	**118,144**	**106,803**	***10.6***
Refined products						
Non-CIS export sales						
Export sales	25,552	22,239	*14.9*	63,077	55,519	*13.6*
Less related export duties	(9,988)	(9,433)	*5.9*	(24,259)	(21,939)	*10.6*
CIS sales						
CIS sales	2,486	1,475	*68.5*	3,830	2,502	*53.1*
Less related export duties	(94)	(13)	*623.1*	(262)	(36)	*627.8*
Domestic sales						
Domestic sales	34,584	22,915	*50.9*	59,885	41,529	*44.2*
Less related excise taxes	(1,552)	(191)	*712.6*	(2,516)	(454)	*454.2*
	50,988	**36,992**	***37.8***	**99,755**	**77,121**	***29.3***
Petrochemical products						
Tires sales	7,986	8,480	*(5.8)*	13,526	15,109	*(10.5)*
Other petrochemicals sales	440	287	*53.3*	872	582	*49.8*
	8,426	**8,767**	***(3.9)***	**14,398**	**15,691**	***(8.2)***
Other sales	**6,182**	**5,292**	***16.8***	**12,565**	**11,635**	***8.0***

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

Sales volumes

(thousand tonnes)	Three months ended 30 June 2014	Three months ended 30 June 2013	Change, %	Six months ended 30 June 2014	Six months ended 30 June 2013	Change, %
Crude oil						
Non-CIS export sales	2,202	3,181	*(30.8)*	4,462	6,233	*(28.4)*
CIS sales	211	166	*27.1*	362	281	*28.8*
Domestic sales	2,359	1,648	*43.1*	4,386	3,083	*42.3*
	4,772	**4,995**	***(4.5)***	**9,210**	**9,597**	***(4.0)***
Refined products						
Non-CIS export sales	1,019	1,047	*(2.7)*	2,444	2,476	*(1.3)*
CIS sales	109	58	*87.9*	172	94	*83.0*
Domestic sales	1,676	1,074	*56.1*	2,878	2,068	*39.2*
	2,804	**2,179**	***28.7***	**5,494**	**4,638**	***18.5***

Realized average sales prices

(th. RR per tonne)	Three months ended 30 June 2014	30 June 2013	Change, %	Six months ended 30 June 2014	30 June 2013	Change, %
Crude oil						
Non-CIS export sales	*26.93*	*22.91*	*17.5*	*26.74*	*23.48*	*13.9*
CIS sales	*13.82*	*11.33*	*22.0*	*13.69*	*11.60*	*18.0*
Domestic sales	*11.72*	*8.87*	*32.1*	*11.38*	*9.09*	*25.2*
Refined products						
Non-CIS export sales	*25.08*	*21.24*	*18.1*	*25.81*	*22.42*	*15.1*
CIS sales	*22.81*	*25.43*	*(10.3)*	*22.27*	*26.62*	*(16.3)*
Domestic sales	*20.63*	*21.34*	*(3.3)*	*20.81*	*20.08*	*3.6*

Sales of crude oil

In the second quarter of 2014 in comparison to the corresponding period of 2013 sales of crude oil increased by 0.6% to RR 89,867 million mainly due to relatively higher average prices of crude oil in the current period.

Increased volumes of own refining throughput resulting in decreased volumes of crude oil sales was the main reason of decreased sales of crude oil in the six months of 2014 in comparison to the corresponding period of 2013 by 1.9%.

Sales of refined products

In the second quarter of 2014 increase in sales of refined products by 34.3% to RR 62,622 million from RR 46,629 million in the corresponding period of 2013 was due to higher volumes of refined products sold on domestic market in the current period.

In the six months of 2014 increase in sales of refined products by 27.4% to RR 126,792 million from RR 99,550 million in the corresponding period of 2013 was due to increased volumes of refined products sold on domestic market and higher average prices of refined products sold on export in the current period.

	Three months ended				Change*, %		Six months ended				Change*, %	
	30 June 2014		30 June 2013				30 June 2014		30 June 2013			
Non-CIS export sales	**RR mln**	**mln tonnes**	**RR mln**	**mln tonnes**	**Sales**	**Volumes**	**RR mln**	**mln tonnes**	**RR mln**	**mln tonnes**	**Sales**	**Volumes**
Vacuum gasoil	1,191	0.04	6,915	0.30	*(82.8)*	*(86.7)*	7,712	0.29	18,861	0.80	*(59.1)*	*(63.8)*
Fuel oil	8,406	0.46	7,060	0.41	*19.1*	*12.2*	16,197	0.88	14,360	0.84	*12.8*	*4.8*
Naphtha	13,022	0.40	5,641	0.22	*130.8*	*81.8*	25,552	0.80	12,496	0.46	*104.5*	*73.9*
Gas products	762	0.03	1,749	0.07	*(56.4)*	*(57.1)*	1,513	0.06	3,645	0.14	*(58.5)*	*(57.1)*
Middle distillates	39	0.00	398	0.02	*(90.2)*	*n/a*	6,220	0.20	4,936	0.18	*26.0*	*11.1*
Diesel fuel	1,414	0.05	152	0.01	*830.3*	*400.0*	4,659	0.15	529	0.02	*780.7*	*650.0*
Other	718	0.03	324	0.02	*121.6*	*50.0*	1,224	0.06	692	0.04	*76.9*	*50.0*
Total	**25,552**	**1.01**	**22,239**	**1.05**	***14.9***	***(3.8)***	**63,077**	**2.44**	**55,519**	**2.48**	***13.6***	***(1.6)***

	Three months ended				Change*, %		Six months ended				Change*, %	
	30 June 2014		30 June 2013				30 June 2014		30 June 2013			
CIS export sales	**RR mln**	**mln tonnes**	**RR mln**	**mln tonnes**	**Sales**	**Volumes**	**RR mln**	**mln tonnes**	**RR mln**	**mln tonnes**	**Sales**	**Volumes**
Fuel oil	8	0.01	10	0.00	*(20.0)*	*n/a*	256	0.02	10	0.00	*2,460.0*	*n/a*
Vacuum gasoil	-	-	-	-	*n/a*	*n/a*	-	-	-	-	*n/a*	*n/a*
Gas products	283	0.01	233	0.01	*21.5*	*n/a*	559	0.03	545	0.02	*2.6*	*50.0*
Naphtha	1,422	0.08	-	-	*n/a*	*n/a*	1,496	0.08	-	-	*n/a*	*n/a*
Other	773	0.01	1,232	0.05	*(37.3)*	*(80.0)*	1,519	0.04	1,947	0.07	*(22.0)*	*(42.9)*
Total	**2,486**	**0.11**	**1,475**	**0.06**	***68.5***	***83.3***	**3,830**	**0.17**	**2,502**	**0.09**	***53.1***	***88.9***

Domestic sales	Three months ended				Change*, %		Six months ended				Change*, %	
	30 June 2014		30 June 2013				30 June 2014		30 June 2013			
	RR mln	mln tonnes	RR mln	mln tonnes	Sales	Volumes	RR mln	mln tonnes	RR mln	mln tonnes	Sales	Volumes
Middle distillates	13,204	0.64	9,862	0.47	*33.9*	*36.2*	24,230	1.15	17,369	0.88	*39.5*	*30.7*
Petrol fuel	7,720	0.24	6,666	0.22	*15.8*	*9.1*	13,554	0.43	12,075	0.40	*12.2*	*7.5*
Diesel fuel	8,569	0.34	4,323	0.15	*98.2*	*126.7*	12,971	0.50	7,405	0.26	*75.2*	*92.3*
Gas products	2,410	0.22	1,887	0.21	*27.7*	*4.8*	4,909	0.43	3,685	0.40	*33.2*	*7.5*
Other	2,681	0.24	177	0.02	*1,414.7*	*1,100.0*	4,221	0.37	995	0.13	*324.2*	*184.6*
Total	**34,584**	**1.68**	**22,915**	**1.07**	***50.9***	***57.0***	**59,885**	**2.88**	**41,529**	**2.07**	***44.2***	***39.1***

** The difference between percents presented here and in the sections is a result of rounding*

Sales of petrochemical products

Sales of petrochemical products decreased in the second quarter and in the six months of 2014 compared to the corresponding periods of 2013 by 3.9% and 8.2%, respectively. The Group's production of tires in the second quarter of 2014 and in the six months of 2014 decreased by 9.1% and 12.5% and amounted to 3.0 million and 5.6 million tires, respectively.

Other sales

Other sales primarily represent sales of materials and equipment, various oilfield services (such as drilling, well construction and repairs, and geophysical works) and sales of energy, water and steam by the Group entities to third parties.

In the second quarter of 2014 other sales increased by 16.8% to RR 6,182 million from RR 5,292 million in the corresponding period of 2013.

In the six months of 2014 other sales increased by 8% to RR 12,565 million from RR 11,635 million in the corresponding period of 2013.

Costs and other deductions

Operating expenses. Operating expenses include the following costs:

(RR million)	Three months ended 30 June 2014	Three months ended 30 June 2013	Six months ended 30 June 2014	Six months ended 30 June 2013
Crude oil extraction expenses	11,410	10,814	22,185	20,832
Refining expenses	2,108	903	3,863	1,996
Petrochemical production expenses	7,285	6,847	12,154	12,511
Other operating expenses	1,973	2,340	4,189	4,407
Operating expenses not attributed to the revenue in the current period(1)	(40)	164	7	163
Total operating expenses	**22,736**	**21,068**	**42,398**	**39,909**

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

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

The Company's crude oil production units' and subsidiaries' costs of purchased services and goods that are unrelated to their core activities and the change in crude oil and refined products inventory, have been excluded from extraction expenses and are included in other operating costs.

In the second quarter of 2014 lifting expenses averaged to RR 242.3 per barrel compared to RR 230.5 per barrel in the corresponding period of 2013.
In the six months of 2014 lifting expenses averaged to RR 237.1 per barrel compared to RR 223.4 per barrel in the corresponding period of 2013.

Expenses on injection costs and artificial stimulation of reservoirs were the primary reason for the increase in lifting expenses in the three and six months ended 30 June 2014 compared to the corresponding periods of 2013.

Refining expenses. Refining expenses mostly consist of expenses related to the production of refined products at our TANECO refinery and primarily include expenditures of raw materials and supplies, maintenance and repairs of productive equipment, labour and electricity costs, and other similar costs.

The refining expenses incurred at TANECO in the second quarter of 2014 were RR 939.1 per tonne of crude oil throughput (RR 951.5 per tonne of products output) compared to RR 568.2 per tonne of crude oil throughput (RR 572.2 per tonne of products output) in the corresponding period of 2013.

The refining expenses incurred at TANECO in the six months of 2014 were RR 871.1 per tonne of crude oil throughput (RR 880.6 per tonne of products output) compared to RR 585.0 per tonne of crude oil throughput (RR 589.2 per tonne of products output) in the corresponding period of 2013.

Petrochemical production expenses. Petrochemical production expenses primarily include the costs of raw materials, labour, maintenance and electricity consumed in the production of petrochemical products.

Cost of petrochemical products increased in the second quarter of 2014 by 6.4% to RR 7,285 million compared to the corresponding period of 2013 primarily due to higher volumes of raw materials consumed.

In the six months of 2014 cost of petrochemical products decreased by 2.9% to RR 12,154 million compared to the corresponding period of 2013 primarily due to decrease in volumes of petrochemicals produced as well as lower costs of raw materials.

Other operating expenses include costs of other services, goods and materials not related to the core production activities of the Group.

Compared to the prior periods, in the second quarter of 2014 and in the six months of 2014 other operating expenses decreased by 15.7% and 4.9% to RR 1,973 million and RR 4,189 million, respectively, due to decrease in sales volumes of other services, goods and materials.

Cost of purchased crude oil and refined products. A summary of purchased oil and refined products in the respective periods of 2014 and 2013 were as follows:

	Three months ended		Six months ended	
	30 June 2014	**30 June 2013**	**30 June 2014**	**30 June 2013**
Purchased crude oil (RR million)	7,535	4,303	12,368	8,991
Volume (thousand tonnes)	*504*	*188*	*750*	*382*
Average price (th. RR per tonne)	*14.95*	*22.89*	*16.50*	*23.54*
Purchased refined products (RR million)	7,960	8,428	13,911	16,060
Volume (thousand tonnes)	*270*	*324*	*498*	*627*
Average price (th. RR per tonne)	*29.48*	*26.01*	*27.93*	*25.61*
Total purchased oil and refined products	**15,495**	**12,731**	**26,279**	**25,051**

Exploration expenses. Exploration expenses consist primarily of exploratory drilling, geological and geophysical costs, and the costs of carrying and retaining undeveloped properties.

In the second quarter of 2014 and in the six months of 2014 exploration expenses increased to RR 437 million and RR 828 million, respectively, from RR 335 million and RR 661 million in the corresponding periods of 2013.

Transportation expenses. Transportation of the Group's crude oil and refined products, including purchased crude oil and refined products, are mostly carried out using the Transneft trunk pipeline system and the railway.

Decrease of transportation expense in the second quarter and six months of 2014 by 22.0% and by 24.6% to RR 5,402 million and RR 11,645 million, respectively, compared to the corresponding periods of 2013 were due to decreased volumes of crude oil sold for export in the current period as well as decrease in refined products' transportation expenses.

Selling, general and administrative expenses. Certain selling, general and administrative expenses by nature are 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.

In the second quarter of 2014 selling, general and administrative expenses were almost at the same level as in the corresponding period of 2013 and amounted to RR 10,815 million.

Decrease in selling, general and administrative expenses by RR 505 million to RR 20,064 million in the six months of 2014 compared to the corresponding period of 2013 was attributed, among other factors, to a decrease in bad debt provision and charitable expenses.

(Loss)/ gain on disposals of property, plant and equipment and impairment of investments. In the second quarter of 2013 we recorded a loss in the amount of RR 640 million from disposals of one of our subsidiaries, which resulted to the loss recorded in the three and six months ended 30 June 2014 compared to the corresponding periods of 2013.

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

	Three months ended		Six months ended	
(RR million)	**30 June 2014**	**30 June 2013**	**30 June 2014**	**30 June 2013**
Mineral extraction tax	28,778	23,952	58,598	49,811
Property tax	1,261	1,161	2,501	2,316
Penalties and interest	25	9	32	29
Other	295	354	581	704
Total taxes other than income taxes	**30,359**	**25,476**	**61,712**	**52,860**

Taxes other than income taxes increased in the three and six months ended 30 June 2014 in comparison to the corresponding periods of 2013 by 19.2% and 16.7%, respectively, due to higher mineral extraction tax mostly due to an increase in base tax rate and devaluation of Ruble against US Dollar. Other taxes include land tax and non-recoverable VAT.

Effective 1 January 2007, the tax rate formula for mineral extraction tax was modified to provide for fields whose depletion rate is 80% or above as determined under Russian reserves classification. Under these rules, the Group receives a benefit of 3.5% per field for each percent of depletion within the limits of 80% to 100%. As Romashkinskoye field, the Group's largest, along with certain other fields is more than 80% depleted, the Group received a benefit in the three and six months ended 30 June 2014 of RR 8.0 billion and RR 15.4 billion, respectively (in comparison to RR 5.6 billion and RR 11.6 billion, respectively, in the corresponding periods of 2013).

Since April 2007, a zero mineral extraction tax rate is applied to the production of highly viscous crude oil from the Group's Ashalchinskoye, Mordovo-Karmalskoye, and since 2010 and 2011 – also from some other fields, resulting in the three and six months ended 30 June 2014 of RR 0.9 billion and RR 1.7 billion, respectively (in comparison to RR 0.8 billion and RR 1.2 billion, respectively, in the corresponding periods of 2013).

Maintenance of social infrastructure and transfer of social assets. In the three and six months ended 30 June 2014 maintenance of social infrastructure expenses and transfer of social assets decreased to RR 902 million and RR 1,809 million, respectively, from RR 1,486 million and RR 2,239 million, respectively, in the three and six months ended 30 June 2013. These social infrastructure expenses relate primarily to housing, schools and cultural buildings in Tatarstan.

Foreign exchange gain/ (loss). In the three and six months ended 30 June 2014 the Group recorded a foreign exchange gain amounted to RR 403 million and a foreign exchange loss amounted to RR 803 million, respectively, compared to a foreign exchange losses of RR 948 million and RR 1,152 million in the three and six months ended 30 June 2013, respectively, which were due to volatility of Ruble to US Dollar exchange rate in the reporting periods, resulting to the corresponding revaluation of US Dollars denominated debt under the long-term credit facilities of the Group.

Interest income increased by 115.8% and 101.8% in the three and six months ended 30 June 2014 to RR 1,813 million and RR 3,173 million, respectively, compared to the corresponding periods of 2013 due to increase in interest income received from the certificates of deposit.
Interest expense, net of amounts capitalized, includes among other things an unwinding of the discount on the provision for the future costs of decommissioning of oil and gas assets.

In the second quarter of 2014 interest expense, net of amounts capitalized, was almost at the same level as in the corresponding period of 2013 and amounted to RR 1,422 million compared to RR 1,421 million in the second quarter of 2013.

In the six months ended 30 June 2014 interest expense, net of amounts capitalized, decreased by 8.4% to RR 2,873 million, compared to the corresponding period of 2013 due to the decrease in the current period's amounts outstanding of foreign currency denominated debt.

Earnings/ (losses) from equity investments. In the second quarter of 2014 the Group recorded a gain from equity investments amounted to RR 203 million compared to RR 4 million loss in the corresponding period of 2013.

In the six months of 2014 the Group recorded a gain from equity investments amounted to RR 40 million compared to RR 223 million gain in the corresponding period of 2013. The decrease in the gain from equity investments was mainly due to a lower gain earned from the Group's investment in Bank Zenit in comparison to the corresponding period of 2013.

Other income/ (expenses). Other income, net, in the second quarter of 2014 amounted to RR 197 million compared to RR 264 million of other expense, net, in the corresponding period of 2013.

In the six months of 2014 the Group recorded other expense, net, amounted to RR 318 million compared to RR 429 million of other income, net, in the corresponding period of 2013.

Income taxes

The Group's effective income tax rate in the six months of 2014 was on the level of the statutory tax rate of 20% in the Russian Federation.

EBITDA reconciliation

	Three months ended		Six months ended	
(RR million)	**30 June 2014**	**30 June 2013**	**30 June 2014**	**30 June 2013**
Sales and other operating revenues, net	128,122	104,696	244,862	211,250
Costs and other deductions	(92,075)	(82,855)	(175,824)	(165,477)
Depreciation, depletion and amortization	5,289	4,169	10,232	9,215
EBITDA	**41,336**	**26,010**	**79,270**	**54,988**

EBITDA is a non-IFRS financial measure, defined as earnings before interest, taxes, depreciation and amortization. The Company believes that EBITDA provides useful information to investors because it is an indicator of the strength and performance of our business operations, including our ability to finance capital expenditures, acquisitions and other investments and our ability to incur and service debt. While depreciation and amortization are considered operating costs under IFRS, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. Our EBITDA calculation is commonly used as a basis by some investors, analysts and credit rating agencies to evaluate and compare the periodic and future operating performance and value of companies within the oil and gas industry. EBITDA should not be considered in isolation as an alternative to net profit, operating income or any other measure of performance under IFRS. 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 million)	At 30 June 2014	At 31 December 2013
Current assets	181,178	151,998
Long-term assets	533,863	522,090
Total assets	**715,041**	**674,088**
Current liabilities	89,843	83,173
Long-term liabilities	86,604	86,934
Total liabilities	**176,447**	**170,107**
Shareholders' equity	**538,594**	**503,981**
Working capital	91,335	68,825

Working capital position

As of 30 June 2014 working capital of the Group amounted to RR 91,335 million compared to RR 68,825 million as of 31 December 2013. The increase in the working capital in the current period compared to previous period was attributable to an increase in current assets (mainly short-term investments).

Liquidity and Capital Resources

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

(RR million)	Six months ended 30 June 2014	Six months ended 30 June 2013
Net cash provided by operating activities	68,721	59,436
Net cash used in investment activities	(54,539)	(29,343)
Net cash used in financing activities	(25,156)	(15,535)
Net change in cash and cash equivalents	(10,974)	14,558

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 15.6% to RR 68,721 million in the six months of 2014 from RR 59,436 million in the corresponding period of 2013 which is explained primarily through higher profit attributable to Group shareholders earned in the six months of 2014.

Net cash used in investing activities

Net cash used in investing activities increased by 85.9% to RR 54,539 million in the six months of 2014 from RR 29,343 million in the corresponding period of 2013, which was primarily due to increase in cash used to purchase certificates of deposit.

Net cash used in financing activities

Cash flow used in financing activities was RR 25,156 million in the six months of 2014 in comparison to RR 15,535 million used in the corresponding period of 2013. It was in line with net debt repayments of RR 24,454 million in the six months of 2014 compared to net debt repayments of RR 14,804 million in the corresponding period of 2013.

Additions to property, plant and equipment

The following additions to property, plant and equipment (by segment, excluding non-cash additions) were made in the three and six months ended 30 June 2014 compared to the corresponding period of 2013:

(RR million)	Three months ended 30 June 2014	Three months ended 30 June 2013	Six months ended 30 June 2014	Six months ended 30 June 2013
Exploration and production	4,428	7,303	7,933	13,224
Refining and marketing	4,319	4,575	8,313	10,055
Petrochemicals	117	98	886	172
Corporate and other	3,397	2,800	4,791	3,758
Total additions to property, plant and equipment	**12,261**	**14,776**	**21,923**	**27,209**

Calculation of Free Cash Flow

(RR million)	Three months ended 30 June 2014	Three months ended 30 June 2013	Six months ended 30 June 2014	Six months ended 30 June 2013
Net cash provided by operating activities	27,659	30,618	68,721	59,436
Additions to property, plant and equipment	(12,261)	(14,776)	(21,923)	(27,209)
Free Cash Flow	**15,398**	**15,842**	**46,798**	**32,227**

Analysis of Debt

At 30 June 2014, long-term debt, net of current portion, amounted to RR 8,572 million as compared to RR 12,785 million at 31 December 2013.

The decrease in total debt outstanding balances in the current period was mainly attributed to scheduled repayments under a dual (3 and 5 year) tranches secured syndicated pre-export credit facility for up to US$ 1.5 billion arranged in October 2009 and a triple (3, 5 and 7 year) tranches secured credit facility for up to US$ 2 billion arranged in June 2010.

Under the US$ 1.5 billion facility the undiscounted amounts outstanding, including the current portion, as of 30 June of 2014 and 31 December 2013 were RR 1,157 million (US$ 34 million) and RR 2,478 million (US$ 76 million), respectively.

Under the US$ 2 billion facility the undiscounted amounts outstanding, including the current portion, as of 30 June of 2014 and 31 December 2013 were RR 11,553 million (US$ 344 million) and RR 15,789 million (US$ 482 million), respectively.

In June 2011, the Company entered into a US$ 550 million unsecured credit facility with a fixed rate of 3.50% per annum with bullet repayment in three years, arranged by BNP Paribas (Suisse) SA, The Bank of Tokyo Mitsubishi UFJ, LTD., Commerzbank Aktiengesellschaft, ING Bank N.V., Natixis, Open Joint Stock Company Nordea Bank, Sumitomo Mitsui Banking Corporation and WestLB AG, London Branch. The undiscounted amount outstanding under this credit facility as of 31 December 2013 was RR 18,001 million (US$ 550 million). The Group repaid the loan in full in June 2014.

In November 2011, TANECO entered into a US$ 75 million credit facility with equal semi-annual repayments during ten years. The loan was arranged by Nordea Bank AB (Publ), Société Générale and Sumitomo Mitsui Banking Corporation Europe Limited. The loan bears interest at LIBOR plus 1.1% per annum. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth and interest coverage ratios. The undiscounted amounts outstanding under this credit facility, including the current portion, as of 30 June of 2014 and 31 December 2013 were RR 1,892 million (US$ 56 million) and RR 1,964 million (US$ 60 million), respectively.

Also in November 2011, TANECO entered into a US$ 144.5 million credit facility with equal semi-annual repayments during ten years with the first repayment date on 15 May 2014. The loan was arranged by Société Générale, Sumitomo Mitsui Banking Corporation Europe Limited and the Bank of Tokyo-Mitsubishi UFJ, LTD. The loan bears interest at LIBOR plus 1.25% per annum. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and interest coverage ratios. The undiscounted amounts outstanding under this credit facility as of 30 June of 2014 and 31 December 2013, including the current portion, were RR 2,696 million (US$ 80 million) and RR 2,762 million (US$ 84 million), respectively.

In May 2013, TANECO entered into a EUR 55 million credit facility with equal semi-annual repayment during ten years. The loan was arranged by The Royal Bank of Scotland plc and Sumitomo Mitsui Banking Corporation Europe Limited. The loan bears interest at LIBOR plus 1.5% per annum. The loan agreement requires compliance with certain financial covenants including, but not limited to, minimum levels of consolidated tangible net worth, and interest coverage ratios. The undiscounted amount outstanding under this credit facility as of 30 June of 2014 and 31 December 2013, including the current portion, was RR 2,226 million (EUR 49 million) and RR 2,018 million (EUR 45 million), respectively.

Calculation of Net Debt

(RR million)	At 30 June 2014	At 31 December 2013
Short term debt	17,278	36,561
Long term debt, net of current portion	8,572	12,785
Total debt	**25,850**	**49,346**
Cash and cash equivalents	18,653	29,535
Net Debt	**7,197**	**19,811**

Contractual obligations, other contingencies and off balance sheet arrangements

Guarantees

The Group has no outstanding guarantees at 30 June 2014 and 31 December 2013.

Commitments and Contingent Liabilities

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 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 27 November 1998 ("Russia-Ukraine BIT") in connection with the forcible takeover of Ukrtatnafta and seizure of shares of the Group in Ukrtatnafta. In July 2014 the arbitral tribunal issued the award holding Ukraine liable for violation of the Russia-Ukraine BIT and required Ukraine to pay Tatneft US$ 112 million plus interest.

Libya

As a result of the political situation in Libya, in February 2011 the Group had to entirely suspend its operations there and evacuate all its personnel. From February 2013 the Group has started the process of resuming its activities in Libya, including the return of some of its personnel to a branch in Tripoli and recommencement of some exploration activities.

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.

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

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

Crude oil and refined products prices

The primary driver of our revenue is the selling price of crude oil and refined products. During the second quarter and the six months of 2014, Brent crude oil price fluctuated between $103 and $115 per barrel and averaged $109.6 per barrel and $108.9 per barrel, respectively (in comparison to average $102.4 per barrel and $107.5 per barrel, respectively, during the second quarter and the six months of 2013).

Substantially all the crude oil we sell is Urals blend. The table below shows for average crude oil and refined products prices for the respective periods in US Dollars and RUB. The prices nominated in US$ are translated into RUB at average US$/RUB exchange rate for the respective period.

	Average for the three months ended		Change,	Average for the six months ended		Change,
	30 June 2014	30 June 2013	%	30 June 2014	30 June 2013	%
World market [1]	(in US Dollars per barrel, except for figures in percent)					
Brent crude	109.6	102.4	*7.0*	108.9	107.5	*1.3*
Urals crude *(CIF Mediterranean)*	108.0	102.3	*5.6*	107.4	106.7	*0.7*
Urals crude *(CIF Rotterdam)*	107.3	101.9	*5.3*	106.8	106.2	*0.6*
	(in US Dollars per tonne, except for figures in percent)					
Gasoil 0.1 1/2 *(CIF NWE/Basis ARA + FOB Rotterdam)*	909.1	868.7	*4.7*	911.7	913.3	*(0.2)*
Fuel oil 3.5% 1/2 *(CIF NWE/Basis ARA+ FOB Rotterdam)*	576.0	577.9	*(0.3)*	572.6	594.4	*(3.7)*
Fuel oil 3.5% *(FOB Med (Italy))*	575.2	574.1	*0.2*	573.4	591.0	*(3.0)*
Naphtha Phy 1/2 *(CIF NEW/Basis ARA+ FOB Rotterdam)*	936.6	828.8	*13.0*	924.6	885.9	*4.4*
Naphtha *(FOB Med)*	916.1	804.2	*13.9*	900.7	858.5	*4.9*
Naphtha *(FOB Med+CIF Med)*	922.4	813.0	*13.5*	907.9	868.1	*4.6*
HS VGO(2) 1/2 *(CIF NWE/Basis ARA+ FOB Rotterdam)*	773.9	727.8	*6.3*	777.9	764.9	*1.7*
Diesel fuel 10 ppm *(CIF NWE/Basis ARA+ FOB Rotterdam)*	924.6	894.0	*3.4*	926.5	936.4	*(1.1)*
	(in th. RR per tonne, except for figures in percent)					
Brent crude	27.32	23.06	*18.5*	27.13	23.75	*14.2*
Urals crude *(CIF Mediterranean)*	26.92	23.03	*16.9*	26.76	23.58	*13.5*
Urals crude *(CIF Rotterdam)*	26.75	22.94	*16.6*	26.61	23.47	*13.4*
	(in th. RR per tonne, except for figures in percent)					
Gasoil 0.1 1/2 *(CIF NWE/Basis ARA + FOB Rotterdam)*	31.82	27.46	*15.9*	31.89	28.33	*12.6*
Fuel oil 3.5% 1/2 *(CIF NWE/Basis ARA+ FOB Rotterdam)*	20.16	18.27	*10.3*	20.03	18.44	*8.6*
Fuel oil 3.5% *(FOB Med (Italy))*	20.13	18.15	*10.9*	20.06	18.33	*9.4*
Naphtha Phy 1/2 *(CIF NEW/Basis ARA+ FOB Rotterdam)*	32.78	26.20	*25.1*	32.34	27.48	*17.7*
Naphtha *(FOB Med)*	32.06	25.42	*26.1*	31.51	26.63	*18.3*
Naphtha *(FOB Med+CIF Med)*	32.28	25.70	*25.6*	31.76	26.93	*17.9*
HS VGO(2) 1/2 *(CIF NWE/Basis ARA+ FOB Rotterdam)*	27.09	23.01	*17.7*	27.21	23.73	*14.7*
Diesel fuel 10 ppm *(CIF NWE/Basis ARA+ FOB Rotterdam)*	32.36	28.26	*14.5*	32.41	29.05	*11.6*
Russian market [1]	(in th. RR per tonne (incl.excise tax and VAT), except for figures in percent)					
Crude oil	14.42	11.69	*23.4*	14.16	12.19	*16.2*
Diesel (summer)	31.61	28.72	*10.1*	30.98	28.78	*7.6*
Diesel (winter)	31.47	30.22	*4.1*	32.08	31.17	*2.9*
Fuel oil	10.13	8.01	*26.5*	9.39	7.73	*21.5*

Source: Platts (world market), Kortes (Russian market)

[1] The Company sells crude oil for export and in the domestic market on various delivery terms. Therefore, our average realized sales prices differ from average reported prices

There is no independent nor uniform market price for crude oil in Russia primarily because a significant portion of crude oil destined for sale in Russia is produced by vertically integrated Russian oil companies and is refined by the same vertically integrated companies. Crude oil that is not exported from Russia, refined by the producer or sold on previously agreed terms, offered for sale in the domestic market at prices determined on a transaction-by-transaction basis. However, there may be significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions.

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 in the inflatory economy this will generally cause costs to increase relative to revenues. The Group has not historically used financial instruments to hedge against foreign currency exchange rate fluctuations.

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

	Three months ended		Six months ended	
	30 June 2014	30 June 2013	30 June 2014	30 June 2013
Ruble inflation, %	2.5	1.6	4.8	3.5
Period-end exchange rate (Ruble to US$)	33.63	32.71	33.63	32.71
Average exchange rate (Ruble to US$)	35.00	31.61	34.98	31.02

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

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

Taxation

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

	Three months ended		Change,	Six months ended		Change,	Taxable
Tax	30 June 2014	30 June 2013	%	30 June 2014	30 June 2013	%	base
Income tax – maximum rate	20%	20%	-	20%	20%	-	Taxable income
Value Added Tax (VAT)	18%	18%	-	18%	18%	-	Sales from goods/services
Property tax – maximum rate	2.2%	2.2%	-	2.2%	2.2%	-	Taxable property
	(in RR per tonne, except for figures in percent)						
Mineral extraction tax, average rates[1]	6,136	4,955	*23.8*	6,109	5,108	*19.6*	Tonne produced (crude oil)
	(in US $ per tonne, except for figures in percent)						
Crude oil export duty, average rates	382.7	379.7	*0.8*	386.6	393.1	*(1.7)*	Tonne exported
Refined products export duty average rates:							
Gasoline, straight-run gasoline	344.4	341.8	*0.8*	347.9	353.8	*(1.7)*	
Diesel fuel	248.7	250.6	*(0.8)*	251.9	259.5	*(2.9)*	
Light and middle distillates, gasoils, fuel oil *(mazut)*	252.6	250.6	*0.8*	255.2	259.5	*(1.7)*	Tonne exported

(1) *Without taking into account differentiated taxation*

Starting from 1 May 2011 the Russian Government ("the Government") introduced a special export duty on gasoline equivalent to 90% of the export duty on crude oil. Starting from 1 June 2011 the Government introduced a special export duty on straight-run gasoline equivalent to 90% of the export duty on crude oil. The Group's results of operation are not materially affected by these special export duties.

The rates of mineral extraction tax and export duties for crude oil and refined products are linked to international crude oil prices and are changed in line with them. Below are presented tax rates calculation approach.

Mineral extraction tax (MET) rate. The base tax rate for the production of oil in the six months of 2014 is set at RR 493 per tonne (an increase from RUR 470 base tax rate applied in the corresponding period of 2013) and is adjusted depending on the international market price of Urals blend and the Ruble exchange rate. The tax rate is zero when the average Urals blend international market price for a tax period is less than or equal to $15.00 per barrel. Each $1.00 per barrel increase in the international Urals blend price over the threshold ($15.00 per barrel) results in an increase of the tax rate by $1.89 per tonne extracted.

The MET rate is applied with a discount based on the level of depletion of the related oil fields as determined under Russian reserves classification guidelines. Such formula benefits producers with oil fields having a depletion level 80% and above as determined by the Russian reserves classification. The Group receives a benefit of 3.5% per field for each percent of depletion within the limits of 80% to 100%. As Romashkinskoye field, the Group's largest, along with certain other fields, is more than 80% depleted, the Group received a benefit related to crude oil production from these fields in the three and six months ended 30 June 2014 of RR 8.0 billion and RR 15.4 billion, respectively (in comparison to RR 5.6 billion and RR 11.6 billion, respectively, in the corresponding periods of 2013).

Also a zero MET rate applies to the production of highly viscous crude oil (defined as crude oil of more than 200 Megapascal second in reservoir conditions). Since April 2007, the Group's production of highly viscous crude oil from the Ashalchinskoye and Mordovo-Karmalskoye fields, and since 2010 and 2011 - also from some other fields is subject to a zero MET rate, resulting in a tax benefit in the three and six months ended 30 June 2014 attributed to that production of RR 0.9 billion and RR 1.7 billion, respectively (in comparison to RR 0.8 billion and RR 1.2 billion, respectively, in the corresponding periods of 2013).

At the end of November 2011 new amendments to the Tax Code of the Russian Federation were signed into law, which provide for a possibility to decrease the mineral extraction tax payable on production of crude oil until 2016 from certain fields located entirely or partially in Tatarstan.

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

Quoted Urals price (P), US$ per tonne	Maximum Export Duty Rate
0 – 109.50	0%
109.50 – 146.00	35.0% * (P - 109.50)
146.00 – 182.50	US$ 12.78 + 45.0% * (P - 146.00)
>182.50	US$ 29.20 + 60.0% * (P - 182.50) (from 1 October 2011 till 31 December 2013) US$ 29.20 + 59.0% * (P - 182.50) (from 1 January 2014 till 31 December 2014)

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

Effective from 1 October 2011 the Government sets the export duty for crude oil at a marginal rate of 60% of the Urals crude oil price during the monitoring period. Starting from January 2014 the marginal export duty rate decreased to 59%.

In accordance with the amendments to the Russian Federation law on customs tariffs, with effect from 1 April 2013 the Government established formulas for calculation of the export customs duties on crude oil based on international oil prices (reflecting the levels described above and providing for special formulas with respect to extra-viscous oil and oil with special physical and chemical characteristics). With effect from 1 April 2013 specific crude oil export customs duties are calculated and published by the Russian Ministry of Economic Development in accordance with the established formulas.

Refined products export duties. Export customs duty on refined products is set every month by the Government simultaneously with the export customs duty on crude oil and is denominated in US$ per tonne. The rate of the export customs duty on refined products is linked to the crude oil export duty rate. At the moment, the rate of the export customs duty is the same for all types of refined products with the exception of gasoline, straight-run gasoline and diesel fuel and is calculated by multiplying the current crude oil export duty rate by a coefficient according to the table below.

	From 1 January 2014 till 31 December 2014	Prior to 1 January 2014
Diesel fuel	0.650	0.660
Jet fuel	0.660	0.660
Fuel oil	0.660	0.660
Oil lubricants	0.660	0.660
Gasoline	0.900	0.900
Straight-run gasoline	0.900	0.900

With effect from 1 April 2013 specific rates are calculated and published by the Russian Ministry of Economic Development.

Starting from January 1, 2014 calculation of the export duty rate for diesel fuel applies lower factor 0.65 instead of 0.66.

Crude oil and refined products exported to the member countries of the Custom Union – Belarus and Kazakhstan are not subject to export duties.

Excise tax on refined products. According to the legislation introduced in December 2010 the excise tax rates on the refined products were increased and linked to the environmental characteristics of the products. The responsibility to pay excise taxes on refined products in Russia is imposed on refined product producers (except for straight-run gasoline). The excise tax is paid per metric tonne produced and sold domestically. The table below shows average excise tax rates on refined products for indicated periods.

	Three months ended		Six months ended	
(RR per tonne)	**30 June 2014**	**30 June 2013**	**30 June 2014**	**30 June 2013**
Gasoline:				
High octane gasoline below Euro-3,4,5	11,110	10,100	11,110	10,100
High octane gasoline Euro-3	10,725	9,750	10,725	9,750
High octane gasoline Euro-4	9,916	8,560	9,916	8,560
High octane gasoline Euro-5	6,450	5,143	6,450	5,143
Straight-run gasoline	11,252	10,229	11,252	10,229
Diesel fuel:				
Diesel below Euro- 3,4,5	6,446	5,860	6,446	5,860
Diesel Euro-3	6,446	5,860	6,446	5,860
Diesel Euro-4	5,427	4,934	5,427	4,934
Diesel Euro-5	4,767	4,334	4,767	4,334
Motor oils	8,260	7,509	8,260	7,509
Heating oil	6,446	-	6,446	-

Excise tax rates on refined products increased in the three and six months ended 30 June 2014 by 10% on average in comparison to the corresponding period of 2013.

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

Value added tax (VAT). The Group is subject to value added tax (or VAT) of 18% on most sales. The Group's results of operations exclude the impact of VAT.

Income tax. The total income tax rate of 20% includes federal part of 2.0%, and the regional part, which varies between 13.5% and 18.0%.

Transportation of crude oil and refined products

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

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

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

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

Transneft collects on prepayment terms a Ruble tariff on domestic shipments and an additional US Dollar tariff on exports.

Transportation of refined products in Russia is mostly performed by railway transport. The Russian railway infrastructure is owned and operated by OAO Russian Railways.

Transneft and OAO Russian Railways are state-owned companies. As the activities of the above mentioned companies fall under the scope of natural monopolies, the fundamentals of their tariff policies are defined by the state authorities to ensure the balance of interests of the state and all participants in the transportation process. Transportation tariffs of natural monopolies are set by the Federal Service for Tariffs of the Russian Federation ("FST") and are dependent on transport destination, delivery volume, distance of transportation, and several other factors. Tariffs are revised by the FST at least annually.

Critical accounting policies

The preparation of consolidated financial statements in conformity with IFRS 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 2 of our consolidated financial statements.

Forward-looking statements

Certain statements in this document 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.

This list of important factors is not exhaustive; when relying on forward-looking statements to make decisions with respect to our shares, American Depositary Shares (ADSs) or other securities, 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.