

## **Management's Discussion and Analysis**

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

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

## **Background**

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

As of March 31, 2012 and December 31, 2011 ОАО Svyazinvestneftekhim, a company wholly owned by the government of Tatarstan, together with its subsidiary, hold approximately 36% of the Company's voting stock. These shares were contributed to Svyazinvestneftekhim by the Ministry of Land and Property Relations of Tatarstan in 2003. Tatarstan also holds a "Golden Share", a special governmental right, in the Company. The exercise of its powers under the Golden Share enables the Tatarstan government to appoint one representative to the Board of Directors and one representative to the Revision Committee of the Company as well as to veto certain major decisions, including those relating to changes in the share capital, amendments to the Charter, liquidation or reorganization of the Company and "major" and "interested party" transactions as defined under Russian law. The Golden Share currently has an indefinite term.

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

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

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**Key financial and operational results**

	<b>Three months ended March 31, 2012</b>	<b>Change,%</b>	<b>Three months ended March 31, 2011</b>
Sales (millions of RR)	151,030	14.7	131,726
Net income attributable to Group shareholders (millions of RR)	28,061	14.6	24,476
EBITDA <sup>(1)</sup> (millions of RR)	41,237	17.9	34,990
Basic and Diluted net income per share of common stock (RR)			
Common.....	12.36	14.6	10.79
Preferred.....	12.36	14.6	10.79
Crude oil production by the Group (thousands of tonnes)	6,524	1.1	6,455
Crude oil production by the Group (thousands of barrels)	46,472	1.1	45,982
Refined products produced (thousands of tonnes)	1,448.4	2,280.5	60.8
Gas production by the Group (millions of cubic meters)	233.5	2.7	227.4

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

Our net income in the first quarter of 2012 was RR 28,061 million, which is RR 3,585 million, or 14.65%, more than in the corresponding period of 2011. Our net income grew mostly due to higher crude oil market prices.

**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 subsidiaries, well repair 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 ОАО ТАНЕКО, as well as the Company’s combined hydrocracker facility construction division (“ТАНЕКО refinery”); our gas production, transportation and refining division Tatneftegaspererabotka; ООО Tatneft-AZS Center, ООО Tatneft-AZS-Zapad, ООО Tatneft-AZS-Sibir and ООО 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 ОАО Nizhnekamskshina, one of the largest tire manufacturers in Russia, and the companies technologically integrated with it, including ОАО Nizhnekamsk Industrial Carbon Plant, ЗАО Yarpolymermash-Tatneft, ОАО Nizhnekamskiy Mekhanicheskiy Zavod, ООО Nizhnekamskiy Zavod Gruzovoykh Shin and ООО Nizhnekamskiy Zavod Shin CMK. ООО Tatneft-Neftekhimsnab and ООО Trading House Kama are responsible for procuring supplies and marketing products produced by the companies within this segment, respectively.

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

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**Operational highlights**

**Crude oil and gas production**

Tatneft carries out exploration and production activities in Tatarstan and other parts of Russia: Samara, Orenburg and Ulyanovsk regions, in the Kalmyk Republic, and Nenets Autonomous District. The table below summarizes key results of our exploration and production activities (daily volumes represent year average):

	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Crude oil daily production (thousands bbl per day)	510.7	510.9
Gas daily production (thousands boe per day)	15.1	14.9
Crude oil extraction expenses (RR per bbl)	185.2	172.0
	(RR millions)	
Sales of crude oil	101,896	107,127
Crude oil extraction expenses	8,606	7,911
Exploration expenses	369	184
Mineral extraction tax	26,598	19,991

Crude oil production of the Group (including production of consolidated subsidiaries OAO Ilekneft, OOO Tatneft-Samara, OOO Tatneft-Severnoy) increased by 1.1% to 6.5 million metric tonnes in the first quarter of 2012 compared to the corresponding period of 2011. Our gas production increased by 2.7% to 233.5 million cubic meters in the first quarter of 2012 from 227.4 million cubic meters in the corresponding period of 2011.

**Refining and marketing**

	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Refining throughput (thousands bbl per day)	122.88	11.99
Refined products produced (thousands of tonnes)	1,448.4	60.8
Gas products produced (thousands of tonnes)	288.5	275.0
Number of petrol (gas) stations in Russia <sup>(1)</sup>	511	497
Number of petrol (gas) stations outside of Russia <sup>(1)</sup>	130	128

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

Increase of refining throughput in the first quarter of 2012 compared to the corresponding period of 2011 was due to the start of production at TANECO refinery.

**Export of crude oil and refined products from Russia**

For the 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, upon export of its crude oil. During the first quarter of 2012, the Group exported from Russia approximately 65% of all its crude oil sold compared to approximately 70% in the corresponding period of 2011.

In the first quarter of 2012 the Company delivered 44% (58% in the first quarter of 2011) of its own crude oil for export through Transneft’s Druzhba pipeline (mainly to Poland, Hungary and Slovakia); 42% (36% in the first quarter of 2011) of crude oil was shipped through Russian Black Sea ports (mainly Novorossiysk) and 14% (6% in the first quarter of 2011) of crude oil exported through Baltic Sea port Primorsk.

In the first quarter of 2012 the Group exported from Russia 1,114 thousand tonnes of refined products (including 4 thousand tonnes of purchased refined products) in comparison to 64 thousand tonnes in the corresponding period of 2011 (including 2 thousand tonnes of purchased refined products).

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

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

**Crude oil prices**

The primary driver of our revenue is the selling price of crude oil and refined products. In the first quarter of 2012 growth of crude oil prices in comparison to the corresponding period of the corresponding period of 2011 was caused mainly by speculative factors as market reaction to the political instability in the Middle East and Northern Africa. During the first quarter of 2012, Brent crude oil price fluctuated between \$108 and \$128 per barrel and averaged \$118.5 per barrel.

Substantially all the crude oil we sell is Urals blend. The table below shows average and the end of the period crude oil prices for the first quarter of 2012 and 2011, respectively.

	Average for the		Change, %	At March 31		Change, %
	three months ended			2012	2011	
	2012	2011				
(in US Dollars per barrel, except for figures in percent)						
<b>World market <sup>(1)</sup></b>						
Brent crude	118.5	105.0	12.9	123.5	116.9	5.6
Urals crude (CIF Mediterranean)	116.9	102.2	14.4	120.5	113.4	6.3
Urals crude (CIF Rotterdam)	116.8	102.1	14.4	119.5	112.8	6.0
<b>Russian market <sup>(1)</sup></b>	(in RR per tonne (incl. excise tax and VAT), except for figures in percent)					
Crude oil	12,982	10,631	22.1	13,963	11,275	23.8

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

<sup>(1)</sup> The Company sells crude oil for export and domestic market on various delivery terms. Therefore, our average realized sales prices differ from average reported prices.

There is no independent or uniform market price for crude oil in Russia primarily because a significant portion of crude oil destined for sale in Russia is produced by vertically integrated Russian oil companies and is refined by the same vertically integrated companies. Crude oil that is not exported from Russia, refined by the producer or sold on previously agreed terms, offered for sale in the domestic market at prices determined on a transaction-by-transaction basis. However, there may be significant price differences between regions for similar quality crude oil as a result of the competition and economic conditions in those regions.

**Transportation of crude oil and refined products**

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

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

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

A significant portion of crude oil 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.

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

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

#### **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, 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.

	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Ruble inflation, %	1.5	3.8
Period-end exchange rate (Ruble to US\$)	29.33	28.43
Average exchange rate (Ruble to US\$)	30.26	29.27
Nominal appreciation of the Ruble, %	8.9	6.7
Real Ruble appreciation, %	11.4	11.3

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

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

#### **Taxation**

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

<b>Tax</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>	<b>Change, %</b>	<b>Taxable base</b>
Income tax – maximum rate	20%	20%	-	Taxable income
Value Added Tax (VAT)	18%	18%	-	Price of goods/services sold
Property tax – maximum rate	2.2%	2.2%	-	Taxable property
	(in RR per metric tonne, except for figures in percent)			
Mineral extraction tax, average rates <sup>(1)</sup>	5,284	4,090	29.2	Metric tonne produced (crude oil)
	(in US \$ per metric tonne, except for figures in percent)			
Crude oil export duty, average rates	400.8	343.0	16.8	Metric tonne exported
<i>Refined products export duty average rates:</i>				
Gasoline	360.7	234.3	53.9	
Straight-run gasoline	360.7	234.3	53.9	
Light and middle distillates, gasoils	264.5	234.3	12.9	Metric tonne exported
Fuel oil	264.5	151.4	74.7	

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

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

Due to increase in international crude oil prices the tax rates specific to the oil industry increased substantially during the first quarter of 2012 compared to the corresponding period of 2011. Mineral extraction tax rate increased by 29%, average crude oil export duty rate by 17% and average refined products export duty rate by 46% (the latter also increasing due to unification of duties paid upon export of majority of refined products effective from October 2011).

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 from 2012 is set at RR 446 per metric tonne (an increase from RUR 419 base tax rate applied in 2011) 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 \$1.71 per tonne extracted.

The base rate for 2013 is currently set at 470 Rubles per metric 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 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 related to crude oil production from these fields in the first quarter of 2012 of RR 5.4 billion (RR 3.8 billion in the corresponding period of 2011).

Effective from January 1, 2009, the list of regions where, depending on the period and volume of production, a zero crude oil production tax rate applies has been extended. In particular, it now includes Caspian offshore and the Nenets Autonomous District (the Company has operations in the latter).

Also a zero MET rate applies to the production of highly viscous crude oil (defined as crude oil of more than 200 Megapascal second in reservoir conditions) where the direct (segregated) method of accounting for produced oil is used. Since April 2007, the Company's production of highly viscous crude oil (bitumen) from the Ashalchinskoye, Mordovo-Karmalskoye, Vishnyevo-Polyanskoye and Chernoozerskoye fields is subject to a zero MET rate, resulting in tax benefit during the first quarter of 2012 attributed to that production of RR 217 million (RR 140 million in the corresponding period of 2011).

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 from certain fields located in Tatarstan until 2016. The Company does not expect to be the ultimate beneficiary of this tax break.

**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:

<u>Quoted Urals price (P), US\$ per tonne</u>	<u>Maximum Export Duty Rate</u>
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)

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

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

The export duty rate on crude oil increased by 17% in the first quarter of 2012 to US\$ 400.8 per tonne (US\$ 54.9 per barrel) from US\$ 343.0 per tonne (US\$ 47.0 per barrel) in the corresponding period of 2011. The increase was associated with the rise of the average Urals crude oil prices by 14% to US\$ 116.9 per barrel in the first quarter of 2012 compared to US\$ 102.2 per barrel in the corresponding period of 2011.

**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 and straight-run gasoline.

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

Starting from February 2011, the export duty rate on refined products was determined by the Government by applying coefficients of 0.67 of the export duty for crude oil for light refined products and 0.467 for heavy refined products.

The Russian Government introduced special export duties starting from May 2011 for gasoline and starting from June 2011 for straight-run gasoline, which are underlined in the table below.

Starting from October 2011, the export duty for light refined products was lowered from 0.67 to 0.66 of export duty for crude oil; the export duty for heavy refined products was raised from 0.467 to 0.66 of export duty for crude oil.

	Maximum coefficients (effective until October 1, 2011)	Maximum coefficients effective from October 1, 2011 (per Decree No. 716 of August 26, 2011)
Diesel and jet fuel	0.670	0.660
Fuel oil	0.467	0.660
Oil lubricants	0.467	0.660
Gasoline	0.900	0.900
<u>Straight-run gasoline</u>	<u>0.900</u>	<u>0.900</u>

**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.

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	Three months ended March 31, 2012	Three months ended March 31, 2011	Change, %	Taxable base
(in RR per metric tonne, except for figures in percent)				
<i>Gasoline:</i>				
Low octane gasoline below Euro-3	7,725	5,995	28.9	
High octane gasoline below Euro-3	7,725	5,995	28.9	
High octane gasoline Euro-3	7,382	5,672	30.1	
High octane gasoline Euro-4,5	6,822	5,143	32.6	Metric tonne produced and sold domestically <sup>(1)</sup>
Straight-run gasoline	7,824	6,089	28.5	
<i>Diesel fuel:</i>				
Diesel below Euro- 3	4,098	2,753	48.9	
Diesel Euro-3	3,814	2,485	53.5	
Diesel Euro-4,5	3,562	2,247	58.5	
Motor oils	6,072	4,681	29.7	

<sup>(1)</sup> *The responsibility to pay excise taxes on refined products in Russia is imposed on refined product producers (except for straight-run gasoline).*

Excise taxes on refined products increased in the first quarter of 2012 by 34% on average in comparison to the corresponding period of 2011.

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

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

**Income tax.** Starting from January 1, 2009, the total income tax rate was decreased to 20%, including federal part which decreased to 2.0%, and the regional part, which varies between 13.5% and 18.0%.



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**Three months ended March 31, 2012 compared to the three months ended March 31, 2011**

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

<b>RR millions</b>	<b>Three months ended March 31, 2012 (unaudited)</b>	<b>Three months ended March 31, 2011 (unaudited)</b>	<b>Change,%</b>
<b>Sales and other operating revenues</b>	<b>151,030</b>	<b>131,726</b>	<b>14.7</b>
<b>Costs and other deductions</b>			
Operating	18,368	14,957	22.8
Purchased oil and refined products	12,780	15,914	(19.7)
Exploration	369	184	100.5
Transportation	6,973	3,998	74.4
Selling, general and administrative	7,597	6,258	21.4
Depreciation, depletion and amortization	3,504	3,279	6.9
Loss on disposals of property, plant and equipment and investments and impairments	371	1	-
Taxes other than income taxes	67,284	59,498	13.1
Maintenance of social infrastructure and transfer of social assets	925	782	18.3
<b>Total costs and other deductions</b>	<b>118,171</b>	<b>104,871</b>	<b>12.7</b>
Earnings from equity investments	466	360	29.4
Foreign exchange gain	4,378	4,252	3
Interest income	983	672	46.3
Interest expense, net of amounts capitalized	(795)	(242)	228.5
Other income, net	30	244	(87.7)
<b>Total other income</b>	<b>5,062</b>	<b>5,286</b>	<b>(4.2)</b>
<b>Income before income taxes and non-controlling interest</b>	<b>37,921</b>	<b>32,141</b>	<b>18</b>
Current income tax expense	(8,425)	(6,668)	26.3
Deferred income tax expense	(87)	(444)	(80.4)
<b>Total income tax expense</b>	<b>(8,512)</b>	<b>(7,112)</b>	<b>19.7</b>
<b>Net income</b>	<b>29,409</b>	<b>25,029</b>	<b>17.5</b>
Less: net income attributable to non-controlling interest	(1,348)	(553)	143.8
<b>Net income attributable to Group shareholders</b>	<b>28,061</b>	<b>24,476</b>	<b>14.6</b>

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

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**Sales and other operating revenues**

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

<b>RR millions</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Crude oil	101,896	107,127
Refined products	36,594	12,998
Petrochemicals	7,214	5,999
Corporate and other sales	5,326	5,602
<b>Total sales and other operating revenues</b>	<b>151,030</b>	<b>131,726</b>

Sales and other operating revenues increased in the first quarter of 2012 by 14.7% to RR 151,030 million from RR 131,726 million in the corresponding period of 2011. The increase was mainly attributed to an overall increase in crude oil prices as well as volumes of refined products sold.

***Sales breakdown***

**Sales revenues**

<b>(RR millions)</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>	<b>Change,%</b>
<b>Crude oil</b>			
Non-CIS export sales	77,162	84,990	(9.2)
CIS export sales <sup>(1)</sup>	4,399	3,362	30.8
Domestic sales	20,335	18,775	8.3
	<b>101,896</b>	<b>107,127</b>	<b>(4.9)</b>
<b>Refined products</b>			
Non-CIS export sales	12,762	1,612	691.7
CIS export sales	9,440	75	12,486.7
Domestic sales	14,392	11,311	27.2
	<b>36,594</b>	<b>12,998</b>	<b>181.5</b>
<b>Petrochemical products</b>			
Tires sales	6,914	5,742	20.4
Other petrochemicals sales	300	257	16.7
	<b>7,214</b>	<b>5,999</b>	<b>20.3</b>
<b>Other sales</b>	<b>5,326</b>	<b>5,602</b>	<b>(4.9)</b>
<b>Total sales and other operating revenues</b>	<b>151,030</b>	<b>131,726</b>	<b>14.7</b>

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

**Sales volumes**

<b>(thousands tonnes)</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>	<b>Change,%</b>
<b>Crude oil</b>			
Non-CIS export sales	3,065	3,997	(23.3)
CIS export sales	332	291	14.1
Domestic sales	1,823	1,844	(1.1)
	<b>5,220</b>	<b>6,132</b>	<b>(14.9)</b>
<b>Refined products</b>			
Non-CIS export sales	538	62	767.7
CIS export sales	576	2	28,700.0
Domestic sales	681	603	12.9
	<b>1,795</b>	<b>667</b>	<b>169.1</b>
<b>Total sales volumes of crude oil and refined products</b>	<b>7,015</b>	<b>6,799</b>	<b>3.2</b>

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**Realized average sales prices**

<b>(RR per tonne)</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>	<b>Change,%</b>
<b>Crude oil</b>			
Non-CIS export sales	25,175	21,263	18.4
CIS export sales	13,250	11,553	14.7
Domestic sales	11,155	10,182	9.6
<b>Refined products</b>			
Non-CIS export sales	23,721	26,000	(8.8)
CIS export sales	16,389	37,500	(56.3)
Domestic sales	21,134	18,758	12.7

***Sales of crude oil***

Sales of crude oil decreased by 4.9% to RR 101,896 million in the first quarter of 2012 from RR 107,127 million in the corresponding period of 2011, mainly due to increased volumes of own refining throughput.

***Sales of refined products***

Sales of refined products increased by 181.5% to RR 36,594 million in the first quarter of 2012 from RR 12,998 million in the corresponding period of 2011.

Our revenue from export sales of refined products increased by RR 20,515 million, due to the commencement of TANECO's operations and related sales of refined products.

Decrease in the average realized price on CIS export sales of refined products in the current reporting period in comparison to the corresponding period of 2011 was due to sales, in the current period, of refined products with a lower price.

Our revenue from sales of refined products in Russia increased by RR 3,081 million, or by 27.2% due to an increase in average selling price by 12.7% and sales volumes by 12.9% following an increase of domestic demand.

***Sales of petrochemical products***

The increase in sales of petrochemical products was primarily due to the higher prices of tires sold. The Group's production of tires in the first quarter of 2012 increased by 6.5% to 3.0 million tires.

***Other sales***

Other sales decreased by 4.9% to RR 5,326 million in the first quarter of 2012 from RR 5,602 million in the corresponding period of 2011. Other sales primarily represent sales of materials and equipment, various oilfield services (such as drilling, well construction and repairs, and geophysical works) and sales of energy, water and steam provided by the Group entities to third parties.

**Costs and other deductions**

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

<b>RR millions</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Crude oil extraction expenses	8,606	7,911
Petrochemical production expenses	6,253	4,601
Other operating expenses	3,178	3,381
Operating expenses not attributed to the revenue in the current period <sup>(1)</sup>	331	(936)
<b>Total operating expenses</b>	<b>18,368</b>	<b>14,957</b>

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

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**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 maintenance services, repairs and insurance of extraction equipment, labour costs, expenses on artificial stimulation of reservoirs, fuel and electricity costs, materials and goods consumed in oil and gas production, and other similar costs.

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

Lifting expenses averaged to RR 185.2 per barrel in the first quarter of 2012 compared to RR 172.0 per barrel in the corresponding period of 2011. Higher electricity and other energy costs was the primary reason for a 7.6% increase in lifting expenses in the first quarter of 2012 compared to the corresponding period of 2011.

**Petrochemical production expenses.** Petrochemical production expenses primarily include the costs of raw materials, labour, maintenance and electricity consumed in the production of petrochemical products. Cost of petrochemical products increased to RR 6,253 million by 35.9% in the first quarter of 2012 compared to the corresponding period of the corresponding period of 2011 primarily due to higher costs of raw materials and electricity.

**Other operating expenses** include accretion of the asset retirement obligation and the costs of other services, goods and materials not related to the core oil and gas production activities of the Group. Other operating expenses decreased to RR 3,178 million, or by 6%, compared to the corresponding period of 2011 which related to the decrease of other sales by 4.9%.

**Cost of purchased crude oil and refined products.** A summary of purchased oil and refined products in the first quarter of 2012 and 2011, respectively, are as follows:

<b>RR millions</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Purchased crude oil (RR millions)	4,798	7,462
Volume (thousands tonnes)	240	508
Average price per tonne (RR)	19,992	14,689
Purchased refined products (RR millions)	7,982	8,452
Volume (thousands tonnes)	346	428
Average price per tonne (RR)	23,069	19,748
<b>Total purchased oil and refined products</b>	<b>12,780</b>	<b>15,914</b>

Cost of purchases of crude oil decreased in the first quarter of 2012 compared to the corresponding period of 2011 due to lower volumes of crude oil purchased for resale.

Purchases of refined products decreased by 6% to RR 7,982 million in the first quarter of 2012 from RR 8,452 million in the corresponding period of 2011 due to a decrease in volumes of purchased refined products for trading by 19% partly offset by an increase in average purchase price per tonne by 17%.

**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 to RR 369 million in the first quarter of 2012 from RR 184 million in the corresponding period of 2011.

**Transportation expenses.** Transportation expenses, related to the delivery 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. Transportation costs increased by 74.4% to RR 6,973 million in the first quarter of 2012 from RR 3,998 million in the corresponding period of 2011 due to increase in crude oil transportation tariffs and transportation of refined products by railway.

**Selling, general and administrative expenses.** Certain selling, general and administrative expenses are by nature fixed costs, which are not directly related to production, such as payroll, general business costs, insurance, advertising, share based compensation, legal fees, consulting and audit services, charity and other expenses, including bad debt

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provisions. Selling, general and administrative expenses increased by RR 1,339 million to RR 7,597 million in the first quarter of 2012 compared to the corresponding period of 2011.

**Loss on disposals of property, plant and equipment and impairment of investments.** In the first quarter of 2012 we recorded a loss on disposals of property, plant and equipment and impairment of investments amounted to RR 371 million as a result of disposal of interest in an unquoted company compared to a RR 1 million loss in the corresponding period of 2011.

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

	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Export duties	39,564	38,618
Mineral extraction tax	26,598	19,991
Property tax	557	441
Excise taxes	241	168
Penalties and interest	5	20
Other	319	260
<b>Total taxes other than income taxes</b>	<b>67,284</b>	<b>59,498</b>

Taxes other than income taxes increased by 13.1% to RR 67,284 million in the first quarter of 2012 from RR 59,498 million in the corresponding period of 2011. The increase was primarily a result of higher export duty and mineral extraction tax rates, which are linked to crude oil market prices. In the first quarter of 2012 compared to the corresponding period of 2011, export duties, paid by the Group, increased by 2.4%. The Group's mineral extraction tax expense increased by 33%. Our expenses on excise taxes increased to RR 241 million from RR 168 million in the corresponding period of 2011 due to increase of the statutory excise tax rates. Other taxes include land tax and non-recoverable VAT.

Effective January 1, 2007, the tax rate formula for 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 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 first quarter of 2012 of RR 5.4 billion in comparison to RR 3.8 billion in the corresponding period of 2011, driven mainly by crude oil prices in the respective periods.

Since April 2007, a zero mineral extraction tax rate is applied to the production of highly viscous crude oil (bitumen) from the Company's Ashalchinskoye, Mordovo-Karmalskoye, Vishnyevo-Polyanskoye and Chernoozerskoye fields, resulting in the first quarter of 2012 in tax benefit of RR 217 million in comparison to RR 140 million in the corresponding period of 2011.

**Maintenance of social infrastructure and transfer of social assets.** Social infrastructure expenses relate primarily to housing, schools and cultural buildings in Tatarstan. Maintenance of social infrastructure expenses and transfer of social assets decreased to RR 925 million in the first quarter of 2012 from RR 782 million in the corresponding period of 2011.

**Earnings from equity investments.** The Group recorded a gain from equity investments amounted to RR 466 million in the first quarter of 2012 compared to RR 360 million gain in the corresponding period of 2011. The increase was due to the gain received in the first quarter of 2012 from the Group's investment into a fibreglass manufacturing entity in the amount of RR 64 million, in comparison with a RR 17 million loss in the corresponding period of 2011. Also, the Group had a gain from its investment in Bank Zenit in the amount of RR 199 million, compared to a RR 170 million gain in the corresponding period of 2011.

**Foreign exchange gain.** The Group recorded a foreign exchange gain amounted to RR 4,378 million in the first quarter of 2012 compared to a foreign exchange gain of RR 4,252 million in the corresponding period of 2011, which was due appreciation of Ruble vs US Dollar in the reporting periods, resulting to the corresponding revaluation of US Dollars denominated debt under the long-term credit facilities of the Group.

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**Interest income** increased by 46.3% to RR 983 million in the first quarter of 2012 compared to the corresponding period of 2011 due to increase of interest income received on our certificates of deposit.

**Interest expense**, net of amounts capitalized, increased from RR 242 million to RR 795 million in the first quarter of 2012 in comparison to the corresponding period of 2011, which was mainly due to discontinuance of some interest capitalization on debt related to TANECO refinery.

**Other income, net**, in the first quarter of 2012 amounted to RR 30 million compared with RR 244 million of other income, net, in the corresponding period of 2011.

#### **Income taxes**

The effective income tax rate in the first quarter of 2012 was 22.4%, compared to the statutory tax rate of 20% in the Russian Federation. This difference was due to non-deductible or partially deductible expenses incurred during the reporting period.

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

<b>RR millions</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Net income attributable to Group shareholders	28,061	24,476
Add back:		
Non-controlling interest	1,348	553
Income tax expense	8,512	7,112
Depreciation, depletion and amortization	3,504	3,279
Interest expense	795	242
Interest income	(983)	(672)
<b>EBITDA</b>	<b>41,237</b>	<b>34,990</b>

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

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**Financial Condition Summary Information**

The following table shows certain key financial indicators:

<b>RR millions</b>	<b>At March 31, 2012</b>	<b>At December 31, 2011</b>
Current assets	165,807	155,600
Long-term assets	475,597	472,223
<b>Total assets</b>	<b>641,404</b>	<b>627,823</b>
Current liabilities	87,735	97,061
Long-term liabilities	121,207	127,351
<b>Total liabilities</b>	<b>208,942</b>	<b>224,412</b>
<b>Shareholders' equity</b>	<b>432,462</b>	<b>403,411</b>
Working capital	78,072	58,539

**Working capital position**

As of March 31, 2012 working capital of the Group amounted to RR 78,072 million compared to RR 58,539 million as of December 31, 2011. The increase in the working capital was attributable to an increase of cash and cash equivalents as well as our short-term investments (mainly certificates of deposit).

**Liquidity and Capital Resources**

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

<b>RR millions</b>	<b>Three months ended March 31, 2012</b>	<b>Three months ended March 31, 2011</b>
Net cash provided by operating activities	37,430	22,584
Net cash used for investment activities	(18,757)	(12,951)
Net cash used for financing activities	(7,573)	(7,094)
Increase in cash and cash equivalents	11,100	2,539

**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 65.7% to RR 37,430 million in the first quarter of 2012 from RR 22,584 million in the corresponding period of 2011 which was primarily attributed to changes in working capital, particularly, to change in accounts receivable and inventories.

**Net cash used for investing activities**

Net cash used for investing activities increased by 44.8% to RR 18,757 million in the first quarter of 2012 from RR 12,951 million in the corresponding period of 2011, which was primarily due to the purchases of certificates of deposit.

**Net cash used for financing activities**

Cash flow used for financing activities amounted to RR 7,573 million in the first quarter of 2012 compared to RR 7,094 million in the corresponding period of 2011. This was primarily due to net debt repayments of RR 7,582 million in the first quarter of 2012 compared with net debt repayments of RR 6,954 million in the corresponding period of 2011.

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#### Additions to property, plant and equipment

The following additions to property, plant and equipment (by segment) were made in the first quarter of 2012, compared to the corresponding period of 2011:

RR millions	Three months ended March 31, 2012	Three months ended March 31, 2011
Exploration and production	4,643	3,556
Refining and marketing	3,707 <sup>(1)</sup>	8,960 <sup>(1)</sup>
Petrochemicals	14	51
Corporate and other	835	466
<b>Total additions to property, plant and equipment</b>	<b>9,199</b>	<b>13,033</b>

<sup>(1)</sup> Includes expenditures of RR 2,816 million and RR 7,982 million, in the first quarter of 2012 and 2011, respectively, related to the refinery construction in Nizhnekamsk (TANECO)

#### Analysis of Debt

At March 31, 2012, long-term debt, including the current portion of long-term debt, amounted to RR 84,386 million as compared to RR 100,282 million at December 31, 2011.

In June 2011, the Company entered into a US \$550 million unsecured credit facility with a fixed rate of 3.50% per annum with bullet repayment in three years, arranged by BNP Paribas (Suisse) SA, The Bank Of Tokyo Mitsubishi UFJ, Ltd., Commerzbank Aktiengesellschaft, ING Bank N.V., Natixis, Open Joint Stock Company Nordea Bank, Sumitomo Mitsui Banking Corporation and WestLB AG, London Branch. The amount outstanding under this credit facility as of March 31, 2012 was RR 16,131 million (US \$550 million).

The decrease in the current period's amount of total debt outstanding was mainly attributed to scheduled repayments under a dual (3 and 5 year) tranches secured syndicated pre-export credit facility for up to US\$ 1.5 billion arranged in October 2009 and a triple (3, 5 and 7 year) tranches secured credit facility for up to USD 2 billion arranged in June 2010 partly offset by the foreign exchange gain incurred due the appreciation of Ruble against US Dollar in the reporting period. The amounts outstanding, including the current portion, as of March 31, 2012 and December 31, 2011 were RR 14,783 million (US\$ 504 million) and RR 20,809 million (US\$ 646 million), respectively, under the US\$ 1.5 billion facility, and RR 42,483 million (US\$ 1,449 million) and RR 51,963 million (US\$ 1,614 million), respectively, under the USD 2 billion facility.

In February 2011 the Company reached an agreement with the lenders under the US\$ 2 billion 2010 Facility to decrease the margins. The margins were decreased to LIBOR plus 2.40% and 3.40% for the 3 and 5 year's tranches, respectively.

In February 2011 the Company also reached an agreement with the lenders under the US\$ 1.5 billion 2009 Facility to substantially decrease the amount of crude oil volumes used as collateral for this facility. The crude oil volumes used as collateral decreased from 480,000 to 360,000 metric tons of oil in a calendar quarter.

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 amount outstanding under this credit facility as of March 31, 2012 and December 31, 2011 was RR 2,200 million (US \$75 million) and RR 2,415 million (US \$75 million), including the current portion), respectively.

Also in November 2011, TANECO entered into a US \$144.48 million credit facility with equal semi-annual repayments during ten years with first repayment date as of May 15, 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 amount outstanding under this credit facility as of March 31, 2012 was RR 1,353 million (US \$46 million).



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The aggregate maturities of total long-term debt, including current portion as of March 31, 2012 were as follows:

<b>RR millions</b>	<b>At March 31, 2012</b>
March 2012 - March 2013	31,514
March 2013 - March 2014	18,752
March 2014 - March 2015	26,247
March 2015 -March 2016	3,146
March 2016 - March 2017	1,338
Thereafter	3,389
<b>Total long-term debt</b>	<b>84,386</b>