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

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

As of September 30, 2012 and December 31, 2011 OAO Svyazinvestneftekhim, a company wholly owned by the government of Tatarstan, together with its subsidiary, hold approximately 36% of the Company's voting stock. These shares were contributed to Svyazinvestneftekhim by the Ministry of Land and Property Relations of Tatarstan in 2003. Tatarstan also holds a "Golden Share", a special governmental right, in the Company. The exercise of its powers under the Golden Share enables the Tatarstan government to appoint one representative to the Board of Directors and one representative to the Revision Committee of the Company as well as to veto certain major decisions, including those relating to changes in the share capital, amendments to the Charter, liquidation or reorganization of the Company and "major" and "interested party" transactions as defined under Russian law. The Golden Share currently has an indefinite term.

The 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

	9 months of 2012	Change, %	9 months of 2011
Sales (RR million)	471,504	5.3	447,806
Net income attributable to Group shareholders (RR million)	60,665	34.5	45,092
EBITDA [(1)] (RR million)	95,698	31.4	72,823
Basic and Diluted net income per share of common stock (RR)			
Common…………….	26.72	34.5	19.87
Preferred……………..	26.69	34.5	19.85
Crude oil production by the Group (thousand tonnes)	19,683	0.5	19,588
Crude oil production by the Group (thousand barrels)	140,202	0.5	139,524
Refined products produced (thousand tonnes)	5,282.1	599.7	754.9
Gas production by the Group (million cubic meters)	694.9	0.9	688.7

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

Our net income in the nine months of 2012 was RR 60,665 million, which is RR 15,573 million, or 34.5%, more than in the corresponding period of 2011. Increase of our net income was mostly due to overall better macroeconomic environment in the nine months of 2012 compared to the nine months of 2011, as well as increased efficiency of the Group's downstream operations associated with the launch of 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 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 OAO TANECO, as well as the Company's combined hydrocracker facility construction division ("TANECO refinery"); 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.

Operational highlights

Crude oil and gas production

Tatneft carries out exploration and production activities in Tatarstan and other regions 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):

	9 months of 2012	9 months of 2011
Crude oil daily production (thousand bbl per day)	511.7	511.1
Gas daily production (thousand boe per day)	14.9	14.8
Crude oil extraction expenses (RR per bbl)	207.7	186.1
	(RR million)	
Sales of crude oil	290,163	363,370
Crude oil extraction expenses	29,127	25,960
Exploration expenses	1,366	1,427
Mineral extraction tax	78,061	70,995

Crude oil production of the Group (including production of consolidated subsidiaries OAO Ilekneft, OOO Tatneft-Samara, OOO Tatneft-Severny) increased by 0.5% to 19.7 million metric tonnes in the nine months of 2012 compared to the corresponding period of 2011. Our gas production increased by 0.9% to 694.9 million cubic meters in the nine months of 2012 from 688.7 million cubic meters in the corresponding period of 2011.

Refining and marketing

	9 months of 2012	9 months of 2011
Refining throughput (thousand bbl per day)	145.29	26.36
Refined products produced (thousand tonnes)	5,282.1	754.9
Gas products produced (thousand tonnes)	879.6	825.6
Number of petrol (gas) stations in Russia(1)	507	506
Number of petrol (gas) stations outside of Russia(1)	131	128

(1) Including rented stations

Increase of refining throughput in the nine months 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. During the nine months of 2012, the Group exported from Russia approximately 68% of all its crude oil sold compared to approximately 71% in the corresponding period of 2011.

In the nine months of 2012 the Company delivered 34% (56% in the corresponding period of 2011) of its own crude oil for export through Transneft's Druzhba pipeline (mainly to Poland, Hungary and Slovakia); 41% (35% in the corresponding period of 2011) of crude oil was shipped through Russian Black Sea ports (mainly Novorossiysk) and 25% (9% in the corresponding period of 2011) of crude oil exported through Russian Baltic Sea ports (mainly Primorsk).

In the nine months of 2012 the Group exported from Russia 4,096 thousand tonnes of refined products (including 30 thousand tonnes of purchased refined products) in comparison to 492 thousand tonnes in the corresponding period of 2011 (including 16 thousand tonnes of purchased refined products).

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. During the nine months of 2012, Brent crude oil price fluctuated between $88 and $128 per barrel and averaged $112.1 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 nine months of 2012 and 2011, respectively.

	Average for 9 months of		Change,	At September 30		Change,
	2012	2011	%	2012	2011	%
	(US Dollars per barrel, except for figures in percent)					
World market [1]						
Brent crude	112.1	111.9	*0.2*	111.0	105.2	*5.5*
Urals crude *(CIF Mediterranean)*	111.0	109.2	*1.6*	110.0	102.4	*7.4*
Urals crude *(CIF Rotterdam)*	110.6	109.2	*1.3*	109.9	102.2	*7.5*
Russian market [1]	(RR per tonne (incl.excise tax and VAT), except for figures in percent)					
Crude oil	12,342	10,595	*16.5*	13,950	10,300	*35.4*

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 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 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.

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.

	9 months of 2012	9 months of 2011
Ruble inflation, %	5.2	4.7
Period-end exchange rate (Ruble to US$)	30.92	31.88
Average exchange rate (Ruble to US$)	31.10	28.77

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:

Tax	9 months of 2012	9 months of 2011	Change, %	Taxable base
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
	(RR per metric tonne, except for figures in percent)			
Mineral extraction tax, average rates[1]	5,086	4,368	*16.4*	Metric tonne produced (crude oil)
	(US $ per metric tonne, except for figures in percent)			
Crude oil export duty, average rates	403.5	410.7	*(1.7)*	Metric tonne exported
Refined products export duty average rates:				
Gasoline	363.1	334.0	*8.7*	
Straight-run gasoline	363.1	322.4	*12.6*	
Light and middle distillates, gasoils	266.2	276.6	*(3.8)*	Metric tonne exported
Fuel oil	266.2	188.8	*41.0*	

(1) *Without taking into account differentiated taxation*

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 materially affected by these special export duties.

In the nine months of 2012 mineral extraction tax rate increased by 16% and average refined products export duty rate by 12% (mainly due to unification of duties paid upon export of majority of refined products effective from October 2011). Average crude oil export duty rate decreased by 2%.

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 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 Group receives a benefit of 3.5% per field for each percent of depletion in excess of the 80% threshold. 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 nine months of 2012 of RR 16.1 billion (RR 12.6 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 Group's production of highly viscous crude oil (bitumen) from the Ashalchinskoye, Mordovo-Karmalskoye, Vishnyevo-Polyanskoye, Chernoozerskoye and Yagodnoye fields is subject to a zero MET rate, resulting in tax benefit during the nine months of 2012 attributed to that production of RR 844 million (RR 468 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 is not 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:

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)

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 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 decreased by 2% in the nine months of 2012 to US$ 403.5 per tonne (US$ 55.3 per barrel) from US$ 410.7 per tonne (US$ 56.3 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 * (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 * (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
Straight-run gasoline	0.900	0.900

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.

	2012		2011
(RR per tonne)	01.01-30.06	01.07-31.12	
Gasoline:			
High octane gasoline below Euro-3,4,5	7,725	8,225	5,995
High octane gasoline Euro-3	7,382	7,882	5,672
High octane gasoline Euro-4	6,822	6,822	5,143
High octane gasoline Euro-5	6,822	5,143	5,143
Straight-run gasoline	7,824	7,824	6,089
Diesel fuel:			
Diesel below Euro- 3,4,5	4,098	4,300	2,753
Diesel Euro-3	3,814	4,300	2,485
Diesel Euro-4	3,562	3,562	2,247
Diesel Euro-5	3,562	2,962	2,247
Motor oils	6,072	6,072	4,681

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 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%.

Nine months ended September 30, 2012 compared to the nine months ended September 30, 2011

The table below presents our consolidated interim condensed statements of income for the periods indicated.

(RR million)	9 months of 2012 (unaudited)	9 months of 2011 (unaudited)	Change, %
Sales and other operating revenues	471,504	447,806	5.3
Costs and other deductions			
Operating	65,809	54,840	20.0
Purchased oil and refined products	39,970	53,872	(25.8)
Exploration	1,366	1,427	(4.3)
Transportation	21,686	14,359	51.0
Selling, general and administrative	27,945	22,028	26.9
Depreciation, depletion and amortization	12,392	10,053	23.3
Loss on disposals of property, plant and equipment and investments and impairments	985	1,696	(41.9)
Taxes other than income taxes	217,710	221,702	(1.8)
Maintenance of social infrastructure and transfer of social assets	3,069	2,733	12.3
Total costs and other deductions	390,932	382,710	2.1
Earnings from equity investments	531	744	(28.6)
Foreign exchange gain/ (loss)	1,255	(2,541)	149.4
Interest income	3,257	2,195	48.4
Interest expense, net of amounts capitalized	(2,296)	(648)	254.3
Other income/(expense), net	948	(529)	279.2
Total other income/ (expense)	3,695	(779)	574.3
Income before income taxes and non-controlling interest	84,267	64,317	31.0
Current income tax expense	(19,405)	(16,065)	20.8
Deferred income tax benefit/ (expense)	485	(1,202)	140.3
Total income tax expense	(18,920)	(17,267)	9.6
Net income	65,347	47,050	38.9
Less: net income attributable to non-controlling interest	(4,682)	(1,958)	139.1
Net income attributable to Group shareholders	60,665	45,092	34.5

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

Sales and other operating revenues

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

(RR million)	9 months of 2012	9 months of 2011
Crude oil	290,163	363,370
Refined products	136,597	46,342
Petrochemicals	27,603	23,296
Corporate and other sales	17,141	14,798
Total sales and other operating revenues	471,504	447,806

Increase in sales and other operating revenues in the nine months of 2012 in comparison to the corresponding period of 2011 was mainly due to an overall increase in crude oil prices and change in structure of products.

Sales breakdown

Sales revenues

(RR million)	9 months of 2012	9 months of 2011	Change, %
Crude oil			
Non-CIS export sales	237,703	290,596	*(18.2)*
CIS export sales[1]	5,342	17,265	*(69.1)*
Domestic sales	47,118	55,509	*(15.1)*
	290,163	363,370	*(20.1)*
Refined products			
Non-CIS export sales	56,462	9,182	514.9
CIS export sales	26,501	1,798	1,373.9
Domestic sales	53,634	35,362	51.7
	136,597	46,342	*194.8*
Petrochemical products			
Tires sales	26,744	22,348	*19.7*
Other petrochemicals sales	859	948	*(9.4)*
	27,603	23,296	*18.5*
Other sales	17,141	14,798	*15.8*
Total sales and other operating revenues	471,504	447,806	*5.3*

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

Sales volumes

(thousand tonnes)	9 months of 2012	9 months of 2011	Change, %
Crude oil			
Non-CIS export sales	9,738	12,927	(24.7)
CIS export sales	400	1,569	(74.5)
Domestic sales	4,806	5,934	(19.0)
	14,944	20,430	*(26.9)*
Refined products			
Non-CIS export sales	2,476	401	517.5
CIS export sales	1,620	91	1,680.2
Domestic sales	2,766	1,899	45.6
	6,862	2,391	*187.0*
Total sales volumes of crude oil and refined products	21,806	22,821	*(4.4)*

Realized average sales prices

(RR per tonne)	9 months of 2012	9 months of 2011	Change, %
Crude oil			
Non-CIS export sales	*24,410*	*22,480*	*8.6*
CIS export sales	*13,355*	*11,004*	*21.4*
Domestic sales	*9,804*	*9,354*	*4.8*
Refined products			
Non-CIS export sales	*22,804*	*22,898*	*(0.4)*
CIS export sales	*16,359*	*19,758*	*(17.2)*
Domestic sales	*19,390*	*18,621*	*4.1*

Sales of crude oil

Sales of crude oil decreased by 20.1% to RR 290,163 million in the nine months of 2012 from RR 363,370 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 194.8% to RR 136,597 million in the nine months of 2012 from RR 46,342 million in the corresponding period of 2011.

Our revenue from export and domestic sales of refined products increased by RR 71,983 million and RR 18,272 million, respectively, due to the commencement of TANECO's operations and related sales of refined products.

Sales of petrochemical products

The increase in sales of petrochemical products was primarily due to the higher volumes and prices of tires sold. The Group's production of tires in the nine months of 2012 increased by 17.4% to 9.7 million tires.

Other sales

Other sales increased by 15.8% to RR 17,141 million in the nine months of 2012 from RR 14,798 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:

(RR million)	9 months of 2012	9 months of 2011
Crude oil extraction expenses	29 127	25,960
Refining expenses	1,833	-
Petrochemical production expenses	23,529	19,626
Other operating expenses	10,756	9,556
Operating expenses not attributed to the revenue in the current period[1]	564	(302)
Total operating expenses	**65,809**	**54,840**

[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 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 207.7 per barrel in the nine months of 2012 compared to RR 186.1 per barrel in the corresponding period of 2011. Higher equipment services and other overhead costs were primary the reasons for 11.7% increase in lifting expenses in the nine months of 2012 compared to the corresponding period of 2011.

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. Due to the start of production at TANECO refinery the refining expenses incurred in the nine months of 2012 were RR 351.3 per tonne of crude oil throughput (RR 356.1 per tonne of products output).

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 23,529 million by 19.9% in the nine months of 2012 compared to the corresponding period of 2011 primarily due to increase in volumes of petrochemicals produced as well as 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 increased to RR 10,756 million, or by 12.6%, compared to the corresponding period of 2011 which related to the increase of other sales by 15.8%.

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

(RR million)	9 months of 2012	9 months of 2011
Purchased crude oil (RR million)	14,250	28,235
Volume (thousand tonnes)	*668*	*1,994*
Average price per tonne (RR)	*21,332*	*14,160*
Purchased refined products (RR million)	25,720	25,637
Volume (thousand tonnes)	*1,076*	*1,159*
Average price per tonne (RR)	*23,903*	*22,120*
Total purchased oil and refined products	39,970	53,872

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

Purchases of refined products in the nine months of 2012 were at the same level as in the corresponding period of 2011 mainly due to the fact that an increase in average purchase price per tonne by 8% was offset by a decrease in volumes of purchased refined products for trading by 7%.

Exploration expenses. Exploration expenses consist primarily of exploratory drilling, geological and geophysical costs, and the costs of carrying and retaining undeveloped properties. Exploration expenses decreased to RR 1,366 million in the nine months of 2012 from RR 1,427 million in the corresponding period of 2011.

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 railway. Transportation costs increased by 51% to RR 21,686 million in the nine months of 2012 from RR 14,359 million in the corresponding period of 2011 due to transportation of refined products by railway and increase in transportation tariffs.

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. Increase in selling, general and administrative expenses by RR 5,917 million to RR 27,945 million in the nine months of 2012 was attributed, among other factors, to an increase in amortization of bank's commissions related to the main credit facilities and certain administrative expenses at TANECO as well as other expenses of the Group compared to the corresponding period of 2011.

Loss on disposals of property, plant and equipment and impairment of investments. In the nine months of 2012 we recorded a loss on disposals of property, plant and equipment and impairment of investments amounted to RR 985 million (mainly as a result of disposal of interest in an unquoted company) compared to a RR 1,696 million loss in the corresponding period of 2011.

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

(RR million)	9 months of 2012	9 months of 2011
Export duties	136,542	147,677
Mineral extraction tax	78,061	70,995
Property tax	1,660	1,518
Excise taxes	686	459
Penalties and interest	(265)	4
Other	1,026	1,049
Total taxes other than income taxes	217,710	221,702

Decrease in taxes other than income taxes by 1.8% to RR 217,710 million in the nine months of 2012 from RR 221,702 million in the corresponding period of 2011 was mainly due to lower export duties, paid by the Group. In the nine months of 2012 compared to the corresponding period of 2011, export duties, paid by the Group, decreased by

7.5%, due to lower volumes of crude oil sold for export. The Group's mineral extraction tax expense increased by 10%, due to increase in mineral extraction tax base rate. Our expenses on excise taxes increased to RR 686 million from RR 459 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 Group receives a benefit of 3.5% per field for each percent of depletion in excess of the 80% threshold. As Romashkinskoye field, the Group's largest, along with certain other fields is more than 80% depleted, the Group received a benefit in the nine months of 2012 of RR 16.1 billion in comparison to RR 12.6 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 Group's Ashalchinskoye, Mordovo-Karmalskoye, Vishnyevo-Polyanskoye, Chernoozerskoye and Yagodnoye fields, resulting in the nine months of 2012 in tax benefit of RR 844 million in comparison to RR 468 million in the corresponding period of 2011.

Maintenance of social infrastructure and transfer of social assets. Maintenance of social infrastructure expenses and transfer of social assets increased to RR 3,069 million in the nine months of 2012 from RR 2,733 million in the corresponding period of 2011. These social infrastructure expenses relate primarily to housing, schools and cultural buildings in Tatarstan.

Earnings from equity investments. The Group recorded a gain from equity investments amounted to RR 531 million in the nine months of 2012 compared to RR 744 million gain in the corresponding period of 2011.

Foreign exchange gain/ (loss). The Group recorded a foreign exchange gain amounted to RR 1,255 million in the nine months of 2012 compared to a foreign exchange loss of RR 2,541 million in the corresponding period of 2011, which was 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 48.4% to RR 3,257 million in the nine months of 2012 compared to the corresponding period of 2011 due to increase of certificates of deposit.

Interest expense, net of amounts capitalized, increased from RR 648 million to RR 2,296 million in the nine months 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 nine months of 2012 amounted to RR 948 million compared with RR 529 million of other expense, net, in the corresponding period of 2011.

Income taxes

The effective income tax rate in the nine months of 2012 was 22.5%, 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)

(RR million)	9 months of 2012	9 months of 2011
Net income attributable to Group shareholders	60,665	45,092
Add back:		
Non-controlling interest	4,682	1,958
Income tax expense	18,920	17,267
Depreciation, depletion and amortization	12,392	10,053
Interest expense	2,296	648
Interest income	(3,257)	(2,195)
EBITDA	95,698	72,823

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.

Financial Condition Summary Information

The following table shows certain key financial indicators:

(RR million)	At September 30, 2012	At December 31, 2011
Current assets	159,118	155,600
Long-term assets	494,653	472,223
Total assets	653,771	627,823
Current liabilities	88,157	97,061
Long-term liabilities	113,079	127,351
Total liabilities	201,236	224,412
Shareholders' equity	452,535	403,411
Working capital	70,961	58,539

Working capital position

As of September 30, 2012 working capital of the Group amounted to RR 70,961 million compared to RR 58,539 million as of December 31, 2011. The increase in the working capital was attributable to a decrease of current liabilities (mainly in current portion of long-term debt).

Liquidity and Capital Resources

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

(RR million)	9 months of 2012	9 months of 2011
Net cash provided by operating activities	78,752	67,677
Net cash used for investment activities	(37,213)	(36,424)
Net cash used for financing activities	(41,583)	(23,105)
Increase in cash and cash equivalents	(44)	8,148

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 16.4% to RR 78,752 million in the nine months of 2012 from RR 67,677 million in the corresponding period of 2011 which is explained primarily through higher net income earned in the nine months of 2012.

Net cash used for investing activities

Net cash used for investing activities increased by 2.2% to RR 37,213 million in the nine months of 2012 from RR 36,424 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 41,583 million in the nine months of 2012 compared to RR 23,105 million in the corresponding period of 2011. This was primarily due to net debt repayments of RR 25,341 million in the nine months of 2012 compared with net debt repayments of RR 11,536 million in the corresponding period of 2011.

Additions to property, plant and equipment

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

(RR million)	9 months of 2012	9 months of 2011
Exploration and production	18,522	14,523
Refining and marketing	18,784 [(1)]	25,617 [(1)]
Petrochemicals	263	283
Corporate and other	2,299	1,386
Total additions to property, plant and equipment	39,868	41,809

[(1)] *Includes expenditures of RR 18,023 million and RR 23,692 million, in the nine months of 2012 and 2011, respectively, related to the refinery construction in Nizhnekamsk (TANECO)*

Analysis of Debt

At September 30, 2012, long-term debt, including the current portion of long-term debt, amounted to RR 71,229 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 September 30, 2012 and December 31, 2011 was RR 17,004 million (US $550 million) and RR 17,708 million (US $550 million), respectively.

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. The amounts outstanding, including the current portion, as of September 30, 2012 and December 31, 2011 were RR 6,786 million (US$ 220 million) and RR 20,809 million (US$ 646 million), respectively, under the US$ 1.5 billion facility, and RR 34,554 million (US$ 1,118 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 September 30, 2012 and December 31, 2011 was RR 2,203 million (US $71 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 September 30, 2012 was RR 1,427 million (US $46 million).

In October 2009, P-D Tatneft-Alabuga Steklovolokno entered into a EUR 44 million credit facility with fourteen equal semi-annual repayments with the first repayment date as of February 28, 2012. The loan was arranged by Landesbank Baden-Wurttemberg. The loan bears interest at EURIBOR plus 1.5% per annum. The amount outstanding under this credit facility as of September 30, 2012 was RR 1,472 million (EUR 36.9 million).

The aggregate maturities of total long-term debt, including current portion as of September 30, 2012 were as follows:

(RR million)	At September 30, 2012
October 1, 2012 - September 30, 2013	28,323
October 1, 2013 - September 30, 2014	28,697
October 1, 2014 - September 30, 2015	7,748
October 1, 2015 - September 30, 2016	1,667
October 1, 2016 - September 30, 2017	1,383
Thereafter	3,411
Total long-term debt	71,229