O A O TATNEFT
Form 20-F
June 26, 2006
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As filed with the Securities and Exchange Commission on June 26, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2004

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report

For the transition period from N/A to N/A

Commission file number 1-14804

OAO TATNEFT

(also known as JSC TATNEFT, AO TATNEFT and TATNEFT)

(Exact name of Registrant as specified in its charter)

TATNEFT

(Translation of Registrant’s name into English)

Republic of Tatarstan
Russian Federation
(Jurisdiction of incorporation or organization)

75 Lenin Street
Almetyevsk
Tatarstan 423450
Russian Federation
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Ordinary Shares, nominal value 1 Russian ruble per share	New York Stock Exchange, Inc.*
American Depositary Shares (''ADSs'') each representing 20 Ordinary Shares	New York Stock Exchange, Inc.

*Not for trading, but only in connection with the registration of the American Depositary Shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Ordinary Shares, nominal value 1 Russian ruble per share[1]	2,178,690,700
Preferred Shares, nominal value 1 Russian ruble per share	147,508,500

[1] Including 185,559,889 Ordinary Shares held in treasury as of December 31, 2004. Under Russian law, shares held by subsidiaries may vote and receive dividends.

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act:

Yes No

If this report is an annual or transition report, indicate by checkmark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934:

Yes No

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer Accelerated filer Non-accelerated filer

Indicate by check mark which financial statement item the Registrant has elected to follow:

Item 17 Item 18

If this is an annual report, indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes No

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*The registrant has responded to Item 18 in lieu of responding to Item 17.

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EXPLANATORY NOTE

The filing of this annual report on Form 20-F has been delayed due to the late finalization of our U.S. Generally Accepted Accounting Principles (''U.S. GAAP'') financial statements for the year ended December 31, 2004 and time required to complete the audit of these financial statements. The audit of our U.S. GAAP financial statements for the year ended December 31, 2004 commenced only in the fall of 2005 due to the late filing of our annual report on Form 20-F for the year ended December 31, 2003, which was made with the U.S. Securities and Exchange Commission (the ''SEC'') on July 14, 2005. The late filing of our annual report on Form 20-F for the year ended December 31, 2003 was caused by an investigation into certain transactions identified by our independent auditor, Ernst & Young LLC (''Ernst & Young''), in the course of the audit of our U.S. GAAP financial statements for the year ended December 31, 2003. As Ernst & Young conducted their audit for the year ended December 31, 2003, they identified weaknesses in our control environment, some of which had also been noted by ZAO PricewaterhouseCoopers Audit (''PricewaterhouseCoopers''), their predecessor, and reported in our annual reports on Form 20-F for prior periods. In addition, Ernst & Young identified certain transactions the nature and business purposes of which were not immediately apparent. Ernst & Young notified the Audit Committee of the Board of Directors (the ''Audit Committee'') and advised them to retain independent counsel to conduct an investigation of these transactions. Our Audit Committee retained Kennedys as its independent legal counsel to conduct the investigation. Based on the documentation, information and evidence obtained by it, Kennedys' investigation, completed in April 2005, found no evidence of fraud but also found that our control environment (including our maintenance of books and records and internal controls) was inadequate under the applicable requirements of the Securities Exchange Act of 1934, as amended (the ''Exchange Act''). We have taken and continue to take certain remedial measures to deal with these inadequacies. See ''Item 3—Risk Factors—Risks Relating to the Company—Our independent registered public accounting firm reported material weaknesses in our internal controls and we may not be able to remedy these material weaknesses or prevent future weaknesses'' and ''Item 15—Controls and Procedures.''

We revised our estimate of the net oil reserves as of January 1, 2005, as set out in the revised report issued by Miller and Lents, Ltd. (''Miller and Lents'') on March 20, 2006 (the ''Revised Reserves Report''), furnished to the SEC on Form 6-K on March 28, 2006. The revised report reflected a change in our oil price to U.S.$17.47 per barrel (rather than the price of U.S.$21.53 per barrel that had previously been used) and a change in the ownership interest in our Stepnoozerskoye and Yelginskoye fields. As a result, the estimate of our total proved reserves, previously 5,962.6 million barrels (''mmbbl''), was revised to 5,801.1 mmbbl through the economic lives of our licensed fields, and the estimate of our total proved reserves through the current license expiration was revised from 1,499.1 mmbbl to

1,476.1 mmbbl, as presented in the Revised Reserves Report. This revision may affect our future net revenues subsequent to January 1, 2005. See ‘‘Exhibit 15.1—Report of Reserve Consultants, Miller and Lents, Ltd., dated March 20, 2006.’’

INTRODUCTION

This annual report on Form 20-F includes audited consolidated financial statements of OAO Tatneft (‘‘Tatneft’’) and its consolidated subsidiaries (together with Tatneft, the ‘‘Group’’) as at December 31, 2004 and 2003, and for each of the years in the three-year period ended December 31, 2004. These financial statements have been prepared in accordance with U.S. GAAP. Information contained in such financial statements for periods prior to January 1, 2003 is expressed in constant rubles of December 31, 2002 purchasing power, except as otherwise indicated.

On December 31, 2004, the official ruble/U.S. dollar exchange rate reported by the Central Bank of the Russian Federation (the ‘‘Central Bank’’) was U.S.$1.00 = RR27.75. On June 23, 2006 the official ruble/U.S. dollar exchange rate reported by the Central Bank was U.S.$1.00 = RR26.97. The Federal Reserve Bank of New York does not report a noon buying rate for rubles. In providing an exchange rate, we do not represent that ruble amounts have been, could have been or could be converted into U.S. dollars at that or any other exchange rate on that or any other date. See ‘‘Item 3—Key Information—Exchange Rates.’’

Our records and financial statements for Russian purposes are prepared in accordance with the Regulations on Accounting and Reporting of the Russian Federation (‘‘RAR’’). RAR differ in significant respects from U.S. GAAP, and financial statements prepared in accordance with RAR are not included in this annual report.

Unless the context otherwise requires, in this annual report all references to the ‘‘Company’’ or ‘‘Tatneft’’ are to OAO Tatneft, and all references to ‘‘we,’’ ‘‘us’’ or ‘‘our’’ are to Tatneft and its consolidated subsidiaries and references to ‘‘you’’ or ‘‘your’’ are to holders of our ADSs.

Certain information presented in this annual report is presented on the basis of official public documents published by Russian federal, regional and local governments and federal agencies, and has been presented on the authority of such documents. In addition, certain information presented herein is based on other third-party published sources. We have not independently verified the accuracy of such information.

This annual report contains information concerning our oil reserves derived from the reports of Miller and Lents, oil and gas consultants based in Houston, Texas, dated May 28, 2004 and the Revised Reserves Report (collectively, the ‘‘Reserves Reports’’), incorporated by reference from our reports on Form 6-K furnished to the SEC on July 23, 2004 and March 28, 2006, respectively. While the Reserves Reports have been prepared as set out in the definitions contained in SEC Regulation S-X, Rule 4-10(a), they are based on economic assumptions that may prove to be incorrect. For instance, as discussed above, estimates of our net oil reserves as of January 1, 2005 have been revised, as set out in the Revised Reserves Report. As a result, the estimate of our total proved reserves, previously 5,962.6 mmbbl, was revised to 5,801.1 mmbbl through the economic lives of our licensed fields, and the estimate of our total proved reserves through the current license expiration were revised from 1,499.1 mmbbl to 1,476.1 mmbbl. See ‘‘Exhibit 15.1—Report of Reserve Consultants, Miller and Lents, Ltd., dated March 20, 2006.’’ Our oil reserves could be further revised, as the economic assumptions on which the Reserves Reports are based may prove to be incorrect. In addition, the Russian economy is more unstable and subject to more significant and sudden changes than the economies of many other countries and, therefore, economic assumptions in the Russian Federation are subject to a high degree of uncertainty. Readers should not place undue reliance on the forward-looking statements in the Reserves Reports, on the ability of the Reserves Reports to predict actual reserves or on comparisons of similar reports concerning companies established in countries with more mature economic systems. As indicated in the Reserves Reports, the reserves information is based on the reserves of 63 and 73 developed and producing and seven undeveloped oil fields covered by exploration, production or combined exploration and production licenses as of January 1, 2004 and 2005, respectively.

Like many other Russian and European oil companies, we use the metric ton as the standard unit of measurement for quantities of crude oil. For convenience, certain amounts of crude oil have been translated from tons to barrels. These translations were made at the rate of 7.123 barrels per ton of crude oil, reflecting the weighted average density of our crude oil reserves. However, the actual density of our crude oil reserves may vary by approximately 10% above and below this weighted average, such that actual barrel amounts may vary from this convenience translation. See ‘‘Item 4—Information on the Company—Exploration and Production.’’

Columns in tables may not add to the stated totals due to rounding.

FORWARD-LOOKING STATEMENTS

Certain statements in this annual report are not historical facts and are ‘‘forward-looking’’ (as such term is defined in the U.S. Private Securities Litigation Reform Act of 1995). We may from time to time make written or oral forward-looking statements in reports to shareholders and in other communications. This annual report contains forward-looking statements under the headings ‘‘Item 4—Information on the Company,’’ ‘‘Item 5—Operating and Financial Review and Prospects’’ and ‘‘Item 11—Quantitative and Qualitative Disclosures About Market Risk.’’ Examples of such forward-looking statements include, but are not limited to:

- projections of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios;

- statements of our plans, objectives or goals, including those related to products or services;
- statements of future economic performance; and
- statements of assumptions underlying such statements.

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

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

- inflation, interest rate, and exchange rate fluctuations;
- the price of oil;
- the effect of, and changes in, Russian or Tatarstan government policy;

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

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

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PART I

ITEM 1—IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

This Item is not applicable.

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ITEM 2—OFFER STATISTICS AND EXPECTED TIMETABLE

This Item is not applicable.

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ITEM 3—KEY INFORMATION

SELECTED FINANCIAL DATA

The selected financial data set forth below is derived from the consolidated financial statements of Tatneft for each of the years in the five-year period ended December 31, 2004. The financial statements for the years ended December 31, 2004 and 2003 have been audited by Ernst & Young, independent auditors. The financial statements for each of the years in the three-year period ended December 31, 2002 have been audited by PricewaterhouseCoopers, independent auditors. The selected financial data as at December 31, 2004 and 2003 and for each of the years in the three-year period ended December 31, 2004 should be read in conjunction with, and are qualified in their entirety by reference to, our consolidated financial statements and the notes thereto included elsewhere in this annual report. The information below should also be read in conjunction with ''Item 5—Operating and Financial Review and Prospects.''

U.S. GAAP recognizes that the degree of inflation in a country's economy may become so great that conventional financial statements prepared in historical local currency lose much of their significance and general price-level financial statements become more meaningful. General price-level financial statements are financial statements that have been restated to account for inflation, and such financial statements are required by U.S. GAAP when a country's economy experiences ''hyperinflation.''

As measured by Russia's consumer price index, annual inflation in Russia was 10.9%, 11.7%, 12%, 15.1%, 18.8% and 20.1% in 2005, 2004, 2003, 2002, 2001 and 2000, respectively. Given Russia's past inflation history, Russia's economy was considered hyperinflationary for purposes of our consolidated financial statements for the year ended December 31, 2002 and prior periods, and such consolidated financial statements were prepared in accordance with Accounting Principles Board Statement No. 3, ''Financial Statements Restated for General Price-Level Changes'' (''APB 3''). These figures were thus expressed in millions of constant rubles as of December 31, 2002 purchasing power. At a meeting of the American Institute of Certified Public Accounts (''AICPA'') International Practices Task Force on November 25, 2002, the Task Force concluded that Russia would no longer be considered highly inflationary effective from January 1, 2003. See ''Item 5—Operating and Financial Review and Prospects—Overview—Inflation and foreign currency exchange rate fluctuations.''

The monetary gain included in our consolidated statements of operations for periods prior to January 1, 2003 reflects gains attributable to the effect of Russian inflation on the monetary liabilities we owed during each period, net of the loss attributable to the effect of inflation on monetary assets held. Assets and liabilities are called ''monetary'' for purposes of general price level accounting if their amounts are fixed by contract or otherwise in terms of numbers of currency units regardless of changes in specific prices or in the general price level. Examples of monetary assets and liabilities include accounts receivable, accounts payable and cash.

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	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(in RR millions, except per share information)				
CONSOLIDATED STATEMENT OF OPERATIONS DATA					
Sales and other operating revenues, including excise tax and export duties[(1)]	206,782	155,818	146,328	156,861	199,503
Exploration and production[(1)]	124,076	93,155	84,394	91,528	108,615
Intersegment sales	124,076	93,155	84,394	91,528	108,615
Refining and marketing[(1)]	182,444	134,158	125,673	139,082	184,085
Domestic sales	47,790	34,891	36,279	51,342	56,056
Export sales (CIS)	20,436	9,806	11,540	7,702	1,757

Export sales (Non-CIS)	114,218	89,461	77,854	80,038	126,272
Petrochemicals[1]	13,614	11,816	10,242	5,444	2,427
Intersegment sales	294	233	322	1,311	54
Tire sales (Domestic)	9,510	7,764	7,046	2,517	—
Tire sales (CIS)	1,875	1,799	908	38	—
Tire sales (Non-CIS)	977	739	814	163	—
Refined products	958	1,281	1,152	1,415	2,373
Banking[2]	1,851	1,531	1,180	1,615	—
Net interest income intersegment	241	530	335	265	—
Net interest income	1,610	1,001	845	1,350	—
Other sales	10,156	9,177	10,038	12,797	13,959
Elimination of income from equity investments reported separately in the consolidated statements of operations and comprehensive income	(748)	(101)	(148)	(501)	(914)
Elimination of intersegment sales	(124,611)	(93,918)	(85,051)	(93,104)	(108,669)
Total costs and other deductions	(169,818)	(141,474)	(128,549)	(132,830)	(148,934)
Operating	(34,227)	(31,799)	(36,389)	(31,297)	(24,836)
Purchased oil and refined products	(39,107)	(28,997)	(28,372)	(34,104)	(61,587)
Exploration	(861)	(812)	(463)	(839)	(740)
Transportation	(9,142)	(7,635)	(5,683)	(5,183)	(4,349)
Selling, general and administrative	(16,941)	(15,499)	(16,031)	(17,282)	(11,293)
Bad debt charges and credits, net	714	262	261	1,027	233
Depreciation, depletion and amortization	(9,237)	(8,850)	(7,541)	(6,139)	(5,963)
Loss on disposals of property, plant and equipment and impairment of investments	(726)	(2,325)	(851)	(2,502)	(2,604)
Taxes other than income taxes[3]	(59,587)	(43,378)	(31,988)	(33,373)	(37,415)
Maintenance of social infrastructure	(249)	(279)	(199)	(491)	(252)
Transfer of social assets	(455)	(2,162)	(1,293)	(593)	(128)
Other income (expenses)	(1,668)	313	1,525	567	1,406
Earnings from equity investments	748	101	148	501	914
Exchange gain (loss)	41	(225)	(1,042)	(851)	(591)
Monetary gain[3]	—	—	871	1,764	3,706
Interest income	746	303	804	1,517	—
Interest expense	(1,386)	(1,827)	(2,855)	(2,875)	(3,509)
Other income, net	(1,817)	1,961	3,599	511	886
Income (loss) before income taxes and minority interest	35,296	14,657	19,304	24,598	51,975

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	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(in RR millions, except per share information)				
Total income tax (expense) benefit	(10,861)	(4,582)	(5,363)	(1,244)	(19,482)
Current[3]	(10,032)	(6,070)	(4,743)	7,072	(10,822)
Deferred	(829)	1,488	(620)	(8,316)	(8,660)
Income (loss) before minority interest	24,435	10,075	13,941	25,842	32,493

Minority interest	(1,025)	63	(471)	(1,698)	(475)
Cumulative effect of change in accounting principle, net of RR1,498 million tax	—	4,742	—	—	—
Net income (loss)	23,410	14,880	13,470	24,144	32,018
Foreign currency translation adjustments	15	3	(20)	163	—
Unrealized holding gains on available-for-sale securities, net of RR nil tax	19	43	33	2,329	763
Less: reclassification adjustment for realized gains included in net income	(43)	(33)	(2,981)	(622)	—
Comprehensive income (loss)	23,401	14,893	10,502	26,014	32,781
Basic net income (loss) per Ordinary Share(4)	10.88	4.70	6.24	10.94	14.33
Diluted net income (loss) per Ordinary Share(4)	10.84	4.68	6.23	10.92	14.33
Net income (loss) per ADS(5)	217.6	139	125	219	287
Dividends declared per Ordinary Share(6)	0.90	0.30	0.10	0.10	0.30
Equivalent U.S.$ per Ordinary Share(7)	0.0325	0.0102	0.0031	0.0031	0.0094
Dividends declared per Preferred Share(6)	1.00	1.00	1.00	1.00	0.60
Equivalent U.S.$ per Preferred Share(7)	0.0360	0.0340	0.0315	0.0315	0.0189

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(in RR millions)				
CONSOLIDATED STATEMENT OF CASH FLOWS DATA					
Net cash provided by operating activities	27,791	20,000	8,683	15,259	21,466
Net cash used in investing activities	(22,105)	(19,150)	(11,770)	(17,512)	(17,907)
Net cash provided by financing activities	3,969	533	5,563	4,024	(2,579)
Effect of foreign exchange on cash and cash equivalents	(5)	(3)	10	(37)	96
Effect of inflation accounting	—	—	(288)	(393)	(611)
Net change in cash and cash equivalents	9,650	1,380	2,198	1,341	465

	Year Ended December 31,				
	2004	2003	2002	2001	2000
	(in RR millions)				
CONSOLIDATED BALANCE SHEET DATA					
Total assets	309,561	262,717	226,288	229,069	201,937
Total current assets	106,192	73,500	64,903	72,747	63,511
Property, plant and equipment, net	183,927	177,008	152,448	147,858	127,952
Other assets	19,442	12,209	8,937	8,464	10,474
Total liabilities	132,431	108,436	86,067	95,683	96,331
Total current liabilities(8)	71,713	54,233	48,140	66,789	51,310
Total long-term liabilities(9)	60,718	54,203	37,927	28,894	45,021
Minority interest	6,654	5,101	5,069	5,302	2,521
Total shareholders' equity	170,476	149,180	135,152	128,084	103,085

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	As of December 31,				
	2004	2003	2002	2001	2000
Capital Stock	2,327	2,327	2,327	2,327	2,327
Ordinary Shares	2,179	2,179	2,179	2,179	2,179
Preferred Shares	148	148	148	148	148

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(1)For a discussion of certain important features of our crude oil and refined products sales reported under the exploration and production, refining and marketing and petrochemicals segments, see ‘‘Item 5—Operating and Financial Review and Prospects—Overview.’’

(2)For a discussion of certain features of our banking operations, see ‘‘Appendix A—Tatneft’s Banking Operations.’’

(3)See ‘‘Item 5—Operating and Financial Review and Prospects—Overview.’’

(4)Based on the number of Ordinary and Preferred Shares outstanding at December 31, 2004, 2003, 2002, 2001 and 2000 respectively. Per share data are calculated based on the two-class method. Under the two-class method of computing net income per share, net income is computed for common and preferred shares according to dividends declared and participation rights in undistributed earnings. Under this method, net income is reduced by the amount of dividends declared in the current period for each class of shares, and the remaining income is allocated to common and preferred shares to the extent that each class may share in income if all income for the period had been distributed.

(5)Per ADS data reflects a ratio of 20 Ordinary Shares per ADS.

(6)Dividends declared are stated in nominal rubles. Dividends are stated as approved for a specific year, at the shareholders' meeting held in the following year.

(7)2004 dividends are presented at the exchange rate of U.S.$1.00 = RR27.75 reported by the Central Bank on December 31, 2004. Dividends for 2000-2003 are presented at the exchange rate of U.S.$1.00 = RR29.45 reported by the Central Bank on December 31, 2003.

(8)Includes short-term debt, notes payable and banking customer deposits of RR45,268 million, RR36,826 million, RR31,508 million, RR44,327 million and RR25,914 million at December 31, 2004, 2003, 2002, 2001 and 2000, respectively.

(9)Includes long-term debt, notes payable and banking customer deposits of RR13,645 million, RR15,618 million, RR16,640 million, RR8,632 million and RR21,739 million at December 31, 2004, 2003, 2002, 2001 and 2000, respectively.

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EXCHANGE RATES

The following table shows, for the periods indicated, certain information regarding the exchange rate between the ruble and the U.S. dollar, based on the official exchange rate quoted by the Central Bank and rounded to the nearest 1/100th of a ruble. These rates may differ from the actual rates used in the preparation of our consolidated financial statements and other financial information appearing herein.

Year Ended December 31,	Period end	Average(1)	High	Low
2000	28.16	28.13	28.87	26.90
2001	30.14	29.18	30.30	28.16
2002	31.78	31.35	31.86	30.14
2003	29.45	30.68	31.88	29.24
2004	27.75	28.81	29.45	27.75
2005	28.78	28.31	28.99	27.46
2006				
January	28.12	28.41	28.48	27.97
February	28.12	28.20	28.26	28.10
March	27.76	27.88	28.12	27.66
April	27.27	27.57	27.77	27.27
May	26.98	27.06	27.27	26.94

(1) The average of the exchange rates on the last business day of each month for the relevant annual period, and on each business day for which the Central Bank quotes the ruble to U.S. dollar exchange rate for the relevant monthly period.

On June 23, 2006, the exchange rate of ruble to U.S. dollar established by the Central Bank was U.S.$1.00 = RR26.97. The Federal Reserve Bank of New York does not report a noon buying rate for rubles. No representation is made that ruble or U.S. dollar amounts stated herein could have been converted into U.S. dollars or rubles, as the case may be, at any particular rate or at all. The ruble is generally not convertible outside Russia. See ''Item 10—Additional Information—Exchange Controls'' for a description of Russian currency exchange controls.

CAPITALIZATION AND INDEBTEDNESS

This Item is not applicable.

REASONS FOR THE OFFER AND USE OF PROCEEDS

This Item is not applicable.

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RISK FACTORS

We have described below the risks and uncertainties that our management believes are material, but these risks and uncertainties may not be the only ones we face. Additional risks and uncertainties, including those we currently do not know or deem immaterial, may also result in decreased revenues, increased expenses, or other events that could result in a decline in the price of our ADSs.

Risks Relating to the Russian Federation

Political and social risks

Political and governmental instability could adversely affect the value of investments in Russia and the value of our ADSs

Since 1991, Russia has sought to transform itself from a one-party state with a centrally planned economy to a pluralist democracy with a market-oriented economy. As a result of the sweeping nature of the reforms, and the failure of some of them, the Russian political system remains vulnerable to popular dissatisfaction, as well as to unrest by particular social and ethnic groups. The composition of the Russian Government—the prime minister and the other heads of federal ministries—has at times been highly unstable. Six different prime ministers, for example, headed Governments between March 1998 and May 2000. On December 31, 1999, President Yeltsin unexpectedly resigned and Vladimir Putin was subsequently elected President on March 26, 2000. Mr. Putin was reelected for a second four-year term on March 14, 2004. While President Putin has maintained governmental stability and even accelerated the reform process in some areas, he may adopt a different approach over time. In late February 2004, President Putin dismissed Mr. Kasyanov’s Government and appointed Mikhail Fradkov as Prime Minister. Shortly after the appointment of Mr. Fradkov as Prime Minister, a Presidential decree significantly reduced the number of federal ministries, redistributed certain functions amongst various government agencies and announced plans for a major overhaul of the federal administrative system. For example, the Ministry of Energy, which had been responsible for implementing fuel and energy policy, was abolished, and its functions were divided between the Ministry of Industry and Energy and the Federal Energy Agency. In addition, from December 31, 2004, federal law gives the President a significant role in choosing regional governors. See ‘‘—Risks Relating to Tatarstan—Relations between Tatarstan and Russia may deteriorate, adversely affecting our business’’ under this Item. Additionally, pursuant to legislation that was adopted in 2005 and took effect on December 7, 2005, single-member-district elections for the State Duma are to be eliminated, and all votes are instead to be cast on a party-list basis. Future changes in government, major policy shifts or lack of consensus among President Putin, the prime minister, Russia’s parliament, regional governors and legislatures and powerful economic groups could also disrupt or reverse economic and regulatory reforms. Any disruption or reversal of the reform policies, recurrence of political or governmental instability or occurrence of conflicts with powerful economic groups could have a material adverse effect on our company and the value of investments in Russia, including our ADSs.

Conflicts between federal and regional authorities and other political conflicts could create an uncertain operating environment that could hinder our long-term planning ability and could adversely affect the value of investments in Russia

The Russian Federation is a federation of 88 sub-federal political units (reduced from 89 units on December 1, 2005, and to be further reduced to 86 on January 1, 2007), consisting of republics, territories, regions, cities of federal importance and autonomous areas. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal governmental authorities is often unclear and contested. Some of these sub-federal political units, such as Tatarstan, exercise considerable power over their internal affairs pursuant to the Russian Constitution or, in certain cases, pursuant to agreements with the federal authorities. Such an agreement was signed in 1994 between Tatarstan and the federal authorities, which expired in July 2005. A new agreement is currently under negotiation. See ‘‘—Risks Relating to Tatarstan—Relations between Tatarstan and Russia may deteriorate, adversely affecting our business’’ under this Item. The Russian political system is therefore vulnerable to tension and conflict

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between federal and regional authorities, and between different authorities within the federal government over various issues, including tax revenues, authority for regulatory matters and regional autonomy. Such tension and conflict have in the past often resulted in the enactment of conflicting legislation at various levels. Although the balance of authority between the federal government and sub-federal units has, with some exceptions, stabilized in recent years, a return to lack of consensus could hinder our long-term planning efforts and create uncertainties in our operating environment, both of which may prevent us from effectively and efficiently carrying out our business strategy and adversely affect our operations. See ''—Risks Relating to the Russian Legal System and Russian Legislation—Weaknesses relating to the Russian legal system and Russian legislation create an uncertain environment for investment and for business activity and thus could have a material adverse effect on the value of our ADSs'' under this Item.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions, and in certain cases, to military conflict, such as the continuing conflict in Chechnya, which has brought normal economic activity within Chechnya to a halt and disrupted the economies of neighboring regions. Various armed groups in Chechnya have regularly engaged in guerrilla attacks in that area. Violence and attacks relating to this conflict have also spread to other parts of Russia, and several terrorist attacks were carried out by Chechen terrorists in Moscow in recent years. For example, in October 2002, a large group of Chechen guerrillas seized a Moscow theatre and held 700 people hostage for three days until Russian special forces overpowered them, leading to the death of 129 hostages and 41 terrorists. Terrorists, allegedly linked to Chechen guerillas, also seized a school in Beslan, North Ossetia in September 2004, leading to the deaths of over 330 persons. The further intensification of violence, including terrorist attacks and suicide bombings, or its continued spread to other parts of Russia, could have significant political consequences, including the imposition of a state of emergency in some or all of Russia. Moreover, any terrorist attacks and the resulting heightened security measures may cause disruptions to domestic commerce and exports from Russia, and could materially adversely affect our business and the value of investments in Russia, including our ADSs.

Crime and corruption could disrupt our ability to conduct our business and could adversely affect our financial condition and results of operations

The political and economic changes in Russia since 1991 resulted in significant dislocations of authority, reduced policing and increased lawlessness. The local and international press has reported that significant organized criminal activity has arisen, particularly in large metropolitan centers. Property crimes in large cities have increased substantially. In addition, the local and international press has reported high levels of official corruption, including the bribing of officials for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials engaged in selective investigations and prosecutions to further commercial interests of government officials or certain companies or individuals. Additionally, published reports have indicated that a significant number of Russian media outlets regularly publish disparaging articles in return for payment. The depredations of organized or other crime, demands of corrupt officials or claims that we have been involved in official corruption or illegal activities may in the future bring negative publicity, which could disrupt our ability to conduct our business effectively and could thus materially adversely affect our financial condition, results of operations or prospects and the value of our ADSs.

Social instability in Russia could lead to increased support for renewed centralized authority and a rise in nationalism or violence, which could adversely affect our ability to conduct our business effectively

The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living in Russia have led in the past, and could lead in the future, to labor and social unrest and increased support for a renewal of centralized authority, increased nationalism, restrictions on foreign involvement in the Russian economy, and increased violence. For example, in 2005, Russian pensioners organized street protests against government proposals to monetize in-kind benefits. These protests periodically blocked highways and streets in major Russian cities. Such sentiments could lead to large-scale nationalization or expropriation of foreign-owned assets or businesses or to restrictions on foreign ownership of Russian companies in the oil and gas industry. Any of these or similar consequences of social instability could restrict our operations and lead to the loss of revenue, materially adversely affecting us.

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Economic risks

Economic instability in Russia could adversely affect our business

Since the dissolution of the Soviet Union, the Russian economy has experienced at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to Russian enterprises;
- a large number of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- growth of black and grey market economies;
- pervasive capital flight;
- high levels of corruption and the penetration of organized crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the Russian population.

The Russian economy has been subject to abrupt downturns. In particular, on August 17, 1998, in the face of a rapidly deteriorating economic situation, the Russian government defaulted on its ruble-denominated securities, the Central Bank stopped its support of the ruble, and a temporary moratorium was imposed on certain hard currency payments. These actions resulted in an immediate and severe devaluation of the ruble and a sharp increase in the rate of inflation; a dramatic decline in the prices of Russian debt and equity securities; and an inability of Russian issuers to raise funds in the international capital markets. These problems were aggravated by the near collapse of the Russian banking sector after the events of August 17, 1998, as evidenced by the revocation of the banking licenses of a number of major Russian banks. This further impaired the ability of the banking sector to act as a consistent source of liquidity to Russian companies, and resulted in the losses of bank deposits in some cases.

Russia's inexperience with a market economy compared to more developed economies also poses numerous risks. The failure to satisfy liabilities is widespread among Russian businesses and the government. Furthermore, it is difficult for us to gauge the creditworthiness of some of our customers, as there are no reliable mechanisms, such as reliable credit reports or credit databases, for evaluating their financial condition. Consequently, we face the risk that some of our customers or other debtors will fail to pay us or fail to comply with the terms of their agreements with us, which could adversely affect our results of operations.

We also cannot assure you that recent trends in the Russian economy—such as the increase in the gross domestic product, a relatively stable ruble and a reduced rate of inflation—will continue or will not be abruptly reversed. Additionally, because Russia produces and exports large quantities of oil and natural gas, the Russian economy is especially vulnerable to fluctuations in the price of such commodities on the world market and a decline in the price of oil or natural gas could significantly slow or disrupt the Russian economy. Recent military conflicts and international terrorist activity have created significant uncertainty about the supply of oil and natural gas and such future events may continue to adversely affect the global economic environment, which could result in a decline in the demand for oil and natural gas. A strengthening of the ruble in real terms relative to the U.S. dollar, changes in monetary policy, inflation or other factors could adversely affect Russia's economy and our business in the future. Any such market

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downturn or economic slowdown could also severely limit our and our customers' access to capital, also adversely affecting our and our customers' businesses in the future.

Russia's physical infrastructure is in poor condition, which could disrupt normal business activity

Russia's physical infrastructure largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks; power generation and transmission; communication systems; and building stock. For example, a cold spell in Russia in January 2006 placed enormous pressure on Russia's power systems leading Moscow's authorities to force power cutbacks to nonessential companies in the region to prevent a massive power blackout. In May 2005, a fire and explosion in one of the Moscow power substations built in 1963 caused a major multi-hour outage in a large section of Moscow and some surrounding regions. During the winter of 2000-2001, electricity and heating shortages in Russia's far-eastern Primorye region seriously disrupted the local economy. In August 2000, a fire at the main communications tower in Moscow interrupted television and radio broadcasting and the operation of mobile telephones for several weeks. Road conditions throughout Russia are poor, with many roads not meeting minimum quality requirements. In addition, the Russian railway system is a state-owned railroad transportation services monopoly. Our use of the railways exposes us to risks such as potential delivery disruptions due to the deteriorating physical condition of the railway infrastructure. The federal government is actively considering plans to reorganize the nation's telephone system, and restructuring of the electricity and rail sectors is in progress. Any such reorganization or restructuring may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems.

Russia's poor physical infrastructure harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business in Russia and can interrupt regular business operations. Further deterioration in the physical infrastructure could have a material adverse effect on our business and the value of our ADSs.

Fluctuations in the global economy may adversely affect Russia's economy and our business

Russia's economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and adversely affect the Russian economy. Additionally, because Russia produces and exports large amounts of oil and natural gas, the Russian economy is especially vulnerable to changes in the prices of such commodities on world markets, and a decline in their prices could slow or disrupt the Russian economy. These developments could severely limit our access to capital and could adversely affect the purchasing power of our customers and thus our business.

We face inflation risks that could adversely affect our results of operations

The Russian economy has been characterized by high rates of inflation, including a rate of 84.4% in 1998, which subsided to 11.7% in 2004 and 10.9% in 2005. Certain of our costs, such as salaries, are sensitive to increases in the general price level in Russia. A significant portion of our revenues are either denominated in U.S. dollars or tightly linked to the U.S. dollar, and are affected primarily by international oil prices. Accordingly, our operating margins could be adversely affected if the inflation of our ruble costs in Russia is not balanced by a corresponding devaluation of the ruble against the U.S. dollar or an increase in oil prices.

Risks Relating to the Russian Legal System and Russian Legislation

Weaknesses relating to the Russian legal system and Russian legislation create an uncertain environment for investment and for business activity and thus could have a material adverse effect on the value of our ADSs

Russia is still developing the legal framework required to support a market economy. The following aspects of the Russian legal system create uncertainty with respect to many of the legal and business decisions that we make:

- conflicting local, regional and federal rules and regulations;

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- a lack of judicial and administrative guidance on interpreting Russian legislation;
- substantial gaps in the regulatory structure created by the delay or absence of implementing regulations for certain legislation;
- the relative inexperience of judges and courts in interpreting Russian legislation;
- corruption within the judiciary;
- lack of independence of the judiciary from other political branches;
- a high degree of discretion on the part of governmental authorities; and
- bankruptcy procedures that are not well developed and are subject to abuse.

All of these weaknesses could affect our ability to enforce our rights under our licenses and our contracts, or to defend ourselves against claims by others. Furthermore, due to these risks we cannot assure you that regulators, judicial authorities or third parties will not challenge our compliance with applicable laws, decrees and regulations.

Russian laws and regulations may change in ways that adversely affect our business

The Russian legal system and the body of laws on private enterprises continue to experience frequent changes. We cannot assure you that the legislature, federal or local regulators, or the President will not issue new edicts, decrees, laws or regulations adversely affecting our business, including:

- increasing state control over the activities of private companies;
- restricting exports of oil;
- increasing tariffs on oil exports;
- increasing governmental control over, or imposing limitations or restrictions, on foreign investment, imports and foreign personnel employed in business;
- increasing financial and currency controls relating to mandatory conversion of export proceeds and repatriation of profits;
- imposing limits on dividends and other payments;
- increasing protection of state-owned companies;
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increasing anti-monopoly controls that may limit our ability to consummate certain acquisitions; and

• raising the standards of environmental regulations to conform to more stringent international standards that may subject us to increased costs and expenses.

Lack of independence and inexperience of some members of the Russian judiciary, the difficulty of enforcing court decisions and governmental discretion in instigating, joining and enforcing claims could prevent us or you from obtaining effective redress in a court proceeding, which could have a material adverse effect on our business or on the value of our ADSs

The independence of the judicial system and the prosecutor general's office, and their immunity from economic, political and nationalistic influences in Russia, remain largely unsatisfying. The court system is understaffed and underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. As in other civil law countries, judicial precedents generally have no binding effect on subsequent decisions. Not all Russian legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. The Russian judicial system can be slow, and court orders are not always enforced or followed by law enforcement agencies. All of these factors make judicial decisions in Russia difficult to predict and effective redress uncertain. Additionally, court claims and governmental prosecutions are often used in furtherance of political aims. We may be subject to such claims or prosecutions and may not be able to receive a fair hearing.

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These uncertainties also extend to property rights. During Russia's transformation from a centrally planned economy to a market economy, legislation was enacted to protect private property against expropriation and nationalization. However, it is possible that due to the lack of experience in enforcing these provisions and potential political factors, these protections would not be enforced in the event of an attempted expropriation or nationalization. Some government entities have tried to renationalize privatized businesses. Expropriation or nationalization of any of our entities, their assets or portions thereof, potentially without adequate compensation, could have a material adverse effect on us.

Unlawful, selective or arbitrary government action may have an adverse effect on our business and results of operations and the value of our ADSs

We operate in an uncertain regulatory environment. Governmental authorities have a high degree of discretion in Russia and at times exercise their discretion selectively or arbitrarily, without hearing or prior notice, and sometimes in a manner that is inconsistent with or contrary to law. Moreover, government authorities also have the power in certain circumstances to interfere with the performance of, nullify or terminate contracts. Standard & Poor's, a division of the McGraw-Hill Companies, Inc., has expressed concerns that ''Russian companies and their investors can be subjected to government pressure through selective implementation of regulations and legislation that is either politically motivated or triggered by competing business groups.'' In this environment, our competitors may receive preferential treatment from the government, potentially giving them a competitive advantage over us.

Unlawful, selective or arbitrary governmental actions have reportedly included denial or withdrawal of licenses, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities have also used common defects in matters surrounding share issuances and registration as pretexts for court claims and other demands to invalidate such issuances and registrations and/or to void transactions, often for political purposes. Unlawful, selective or arbitrary government action, if directed at us, could have a material adverse effect on our business and on the value of our ADSs.

Shareholder liability under Russian legislation could cause us to become liable for the obligations of our subsidiaries

The Civil Code and the Russian Federal Law on Joint-Stock Companies of December 26, 1995 (the ‘‘Joint-Stock Companies Law’’) generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one person is capable of determining decisions made by another person. The person capable of determining such decisions is called an ‘‘effective parent.’’ The person whose decisions are capable of being so determined is called an ‘‘effective subsidiary.’’ The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between such entities; and
- the effective parent gives obligatory directions to the effective subsidiary.

In addition, an effective parent may be secondarily liable for an effective subsidiary’s debts if an effective subsidiary becomes insolvent or bankrupt as a result of the action or inaction of an effective parent. This is the case without regard to how the effective parent’s capability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary’s losses from the effective parent that caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Until very recently, there were no decisions of the Russian courts based on this provision of the law. However, on January 26, 2006, a commercial arbitration state court (‘‘arbitrazh court’’) of the Moscow region, reviewing a case on appeal, rendered a decision that imposed a liability on the shareholders of a bankrupt company. Accordingly, in our position as an effective parent company, we could be liable in some cases for the debts of our effective subsidiaries. This potential shareholder liability, which, where applicable, is joint and several with the liability of the subsidiary, could materially adversely

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affect us. As of December 31, 2004, the total liabilities of our consolidated Russian subsidiaries were U.S.$18.9 million, excluding intercompany indebtedness.

A shareholder of an effective parent should not itself be liable for the debts of the effective parent’s effective subsidiary, unless that shareholder is itself an effective parent of the effective parent. Accordingly, a shareholder of ours is not personally liable for our debts or those of our effective subsidiaries unless it controls our business.

Because of the weaknesses in Russian minority shareholder protection legislation, your ability to bring, or to recover in, an action against us will be limited

In general, minority shareholder protection under Russian law derives from supermajority shareholder approval requirements for certain corporate actions, as well as from the ability of a shareholder to demand that the company purchase the shares held by that shareholder if that shareholder voted against or did not participate in voting on certain types of action. Companies are also required by Russian law to obtain the approval of disinterested shareholders for certain transactions with interested parties. While these protections are similar to the types of protections available to minority shareholders in U.S. corporations, in practice corporate governance standards for many Russian companies have proven to be poor, and minority shareholders in Russian companies have suffered losses due to abusive share dilutions, asset transfers and transfer pricing practices. Shareholders' meetings of certain Russian companies have been irregularly conducted, and shareholder resolutions have not always been respected by management. Shareholders of some companies have also suffered as a result of fraudulent bankruptcies initiated by hostile creditors.

In addition, the supermajority shareholder approval requirement is met by a vote of 75% of all voting shares that are present at a shareholders' meeting. Thus, controlling shareholders owning less than 75% of the outstanding shares of a company may have a 75% or more voting power if certain minority shareholders are not present at the meeting. In situations where controlling shareholders effectively have 75% or more of voting power at a shareholders' meeting, they are in a position to approve amendments to the charter of the company and other measures requiring supermajority shareholder approval, which could be prejudicial to the interests of minority shareholders.

Disclosure and reporting requirements and anti-fraud legislation have only recently been enacted in Russia. Most Russian companies and managers are not accustomed to restrictions on their activities arising from these requirements. The concept of fiduciary duties of management or directors to their companies and shareholders is also relatively new and is not well developed. Violations of disclosure and reporting requirements or breaches of fiduciary duties to us and our subsidiaries or to our shareholders could materially adversely affect the value of your investment in our ADSs.

While the Joint-Stock Companies Law provides that shareholders owning not less than one percent of the Company's stock may bring an action for damages on behalf of the company, Russian courts to date have very limited experience with respect to such lawsuits. Russian law does not contemplate class action litigation. Accordingly, your ability to pursue legal redress against us may be limited, reducing the protections available to you as a holder of ADSs.

You could be subject to a mandatory buy-out procedure initiated by any person acquiring more than 95% of our Ordinary Shares

The newly adopted Federal Law No. 7-FZ ''On the Amendments to the Federal Law On Joint Stock Companies and other Legal Acts of the Russian Federation,'' dated December 27, 2005, which amends the Joint-Stock Companies Law, provides for the possibility of a squeeze-out of minority shareholders. Under this law, effective from July 1, 2006, a person acquiring, together with its affiliates, more than 95% of a company's shares is entitled to request, under certain conditions, a mandatory buy-out of the remaining shares purchased at market price from all the other shareholders. For a more detailed discussion on the provisions of this law, see ''Item 10—Additional Information—Memorandum And Articles Of Association—Change of Control Provisions.'' Therefore, you could be subject to a mandatory buy-out procedure upon request of a person acquiring more than 95% of our Ordinary Shares.

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Shareholder rights provisions under Russian law may impose additional costs on us, which could cause our financial results to suffer

Russian law provides that shareholders, including holders of our ADSs, that voted against or did not participate in voting on certain matters, have the right to sell their shares to the company at market value, as determined in accordance with Russian law. The decisions that trigger this right to sell shares include:

- reorganization;
- approval by shareholders of a ‘‘major transaction,’’ which, in general terms, is a transaction involving property worth more than 50% of the book value of our assets calculated according to RAR; and
- amendment of our charter that restricts the shareholder’s rights.

Our obligation to purchase the shares in these instances is limited to 10% of our net assets calculated according to RAR, at the time the matter at issue is voted upon. Our or our subsidiaries’ obligation to purchase shares in these circumstances could have an adverse effect on our cash flows and on our business.

Some transactions between us and interested parties require the approval of disinterested directors or shareholders and our failure to obtain approvals could cause our business to suffer

We are required by Russian law and our charter, as amended, most recently on June 30, 2005 (the ‘‘Charter’’), and provisions on the Board of Directors to obtain the approval of disinterested directors or shareholders for certain transactions with ‘‘interested parties.’’

Under Russian law, the definition of an ‘‘interested party’’ includes members of our Board of Directors, our General Director, members of any of our management bodies, any person that owns, together with that person’s close relatives and affiliates, at least 20% of our voting shares and any person who otherwise has the right to give mandatory instructions to the company if any of the above-listed persons, or a close relative or affiliate of such person, is:

- a party to a transaction with the company, whether directly or as a representative or intermediary, or a beneficiary of the transaction;
- the owner, together with any close relatives and affiliates, of at least 20% of the shares in the company that is a counterparty to a transaction, whether directly or as a representative or intermediary, or a beneficiary of the transaction; or
- a member of the board of directors or any management body of the company which is a counterparty to a transaction, whether directly or as a representative or intermediary, or a beneficiary of the transaction.

Due to the technical requirements of Russian law, entities within our consolidated group and other entities with which we deal on a regular basis may be deemed to be ‘‘interested parties’’ with respect to certain transactions between themselves. The failure to obtain approvals for interested party transactions when required to do so could adversely affect our business.

In addition, the concept of ‘‘interested parties’’ is defined with reference to the concepts of ‘‘affiliated persons’’ and ‘‘group of persons’’ under Russian law. These terms are subject to many different interpretations. Moreover, the provisions of Russian law that define which transactions must be approved as ‘‘interested party’’ transactions are subject to different interpretations, and we cannot be certain that our application of these concepts will not be subject to challenge. Any successful challenge could result in the invalidation of transactions that are important to our business.

Developing and uncoordinated regulation of Russian capital markets and corporate and securities laws could lead to insufficient protection of your rights as an investor in our ADSs

The regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in Russia than in the United States and Western Europe. Securities laws, including those relating to corporate governance, disclosure and reporting requirements have only

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recently been adopted and laws relating to anti-fraud safeguards, insider trading restrictions and fiduciary duties are rudimentary. In addition, the Russian securities market is regulated by several different authorities, which are often in competition with each other. These include:

- the Ministry of Finance;
- the Federal Antimonopoly Service;
- the Federal Service for Financial Markets (the ‘‘FSFM’’);
- the Central Bank; and
- various professional self-regulatory organizations.

The regulations of these various authorities are not always coordinated and may be contradictory. In addition, Russian corporate and securities rules and regulations can change rapidly, which may adversely affect our ability to conduct securities-related transactions. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often unclear whether, or how, regulations, decisions and letters issued by the various regulatory authorities apply to our company. As a result, we may be subject to fines or other enforcement measures despite our best efforts at compliance.

The lack of a central and rigorously regulated share registration system in Russia may result in improper record ownership of our shares, including the shares underlying your ADSs

Ownership of shares in Russian joint stock companies is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no central registration system in Russia. Share registration is carried out by the companies themselves or, as in our case, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout Russia. In addition, shareholders may elect to hold their shares through a depositary, which in turn is registered as the nominal holder of the shares in the registrar’s records. Regulations have been issued by the Federal Commission on the Securities Market, the predecessor of the FSFM, regarding the licensing conditions for such registrars and depositaries and the procedures to be followed by them when performing the functions of a registrar or a depositary. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars and depositaries are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company’s shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence, official and unofficial governmental actions or oversight by registrars or depositaries incapable of compensating shareholders for their misconduct. In addition, Russian courts have recently ruled that effectively no party shall be held liable in case of unlawful and fraudulent transfer of shares from owner’s depositary account or account with the registrar.

You may be subject to Russian tax that might be withheld on trades of our Ordinary Shares, reducing their value

Russian withholding tax on capital gains may arise from the disposition of Russian shares and securities, such as Ordinary Shares, by non-resident holders. Russian tax authorities may attempt to apply withholding tax on capital gains derived from trading our shares (but not ADSs which are listed and traded on exchanges outside Russia). However, no procedural mechanism currently exists to collect any tax from capital gains with respect to sales of shares made between non-resident holders.

The Russian tax authorities currently require Russian residents to withhold 20% of the entire disposal proceeds or 24% of disposal proceeds less the original cost and certain expenses (in case of holders that are legal entities) or 30%

(in case of holders who are individuals) of the capital gain earned by a non-resident on any shares sold by such non-resident to a Russian resident if more than 50% of the assets in the Russian company whose securities are being sold consist of immovable property and such Russian company's shares are not listed and sold on exchanges outside Russia. A refund of all or a portion of the tax withheld may be available if an applicable tax treaty provides for an exemption or lower rate of

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withholding tax. However, obtaining the refund under any relevant tax treaties can be difficult due to the documentary requirements imposed by the Russian tax authorities. If any such tax is assessed, the value of our shares could be materially adversely affected. See ‘‘Item 10—Additional Information—Taxation.’’

Restrictive currency regulations may adversely affect our business and financial condition

We have significant ruble-denominated revenues. Over the past decade, the ruble has at times fluctuated dramatically against the U.S. dollar. The Central Bank has from time to time imposed various currency control regulations in attempts to support the ruble, and may take further actions in the future. Although Russian companies are currently required only to repatriate their proceeds from export sales but not to convert them into rubles (mandatory conversion of 10% of such proceeds was abolished in May 2006), in the past Russian companies were required to convert as much as 75% of such repatriated proceeds, and under existing regulations the percentage of proceeds we are required to convert into rubles may be increased or decreased from time to time by the Russian authorities but may not exceed 30%. The restrictions on our ability to convert our ruble revenues into foreign currencies, or to reconvert to foreign currency the rubles we obtain pursuant to the mandatory repatriation and conversion requirements, may adversely affect our ability to pay overhead expenses outside Russia, meet debt obligations and efficiently carry on our business.

Federal Law No. 173-FZ ‘‘On Currency Regulation and Currency Control,’’ dated December 10, 2003 (the ‘‘Currency Law’’), introduced a new currency control regime, which broadly came into force in June 2004. The Currency Law empowered the Russian Government and the Central Bank to further regulate and restrict currency control matters, including operations involving foreign securities and foreign currency borrowings by Russian companies. It also abolished the need for Russian companies to obtain transaction-specific licenses from the Central Bank, envisaging instead the implementation of generally applicable restrictions on currency control operations, such as the deposit of mandatory reserves with authorized banks for certain currency operations, prior registration to open residents' foreign accounts, and the use of special accounts for certain currency operations. The Central Bank has issued some regulations that introduce currency controls, such as rules with respect to opening offshore bank accounts. Effective from July 2006, the Central Bank requirements to use special-purpose accounts and deposit mandatory reserves in connection with loans, operations with securities and residents' offshore bank accounts will be abolished. However, Central Bank practice has been subject to frequent changes and has not yet developed with respect to the application and enforcement of these new regulations.

The ruble is not convertible outside Russia and the Commonwealth of Independent States (the ‘‘CIS’’), and the ability of companies operating in Russia to convert rubles into other currencies may be subject to a special account and/or mandatory reserve requirements from time to time. Because of the limited development of the foreign currency market in Russia, we may experience difficulty converting rubles into other currencies. Furthermore, the Central Bank and the Russian Government may impose from time to time additional requirements under the Currency Law, such as restricting any grant by Russian companies of payment deferments of more than 180 days for commodities exports or requiring the deposit, interest free, of mandatory reserves where a Russian company receives a loan from a foreign entity the maturity of which is less than three years.

Additionally, any delay or other difficulty in converting rubles into a foreign currency to make a payment or any practical difficulty in the transfer of foreign currency could limit our ability to meet our payment and debt obligations, which could result in the acceleration of debt obligations and cross-defaults.

Furthermore, there are only a limited number of available ruble-denominated instruments in which we may invest our excess cash. Any balances maintained in rubles will give rise to losses if the ruble devalues against major foreign currencies. Moreover, these restrictions may prevent or delay our efforts to pursue attractive acquisition opportunities outside of Russia.

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Possible restrictions of foreign investments in strategic industries may limit your ability to hold or sell our ADSs

According to Russian and international press reports, the Russian Ministry of Industry and Energy has prepared a draft law restricting foreign investments in certain ‘‘strategic’’ Russian industries. This draft law has not been submitted to, or approved by, the State Duma and therefore has not become public. The draft law reportedly provides that foreign investors may not own, directly or through a chain of affiliated companies, 50% or more of the share capital of a company involved in a ‘‘strategic’’ industry. In addition, a governmental approval will reportedly be required for acquisition by a foreign investor of more than 25% of a company involved in a ‘‘strategic’’ industry. On March 2, 2006, the Kommersant daily newspaper published a list of 39 ‘‘strategic’’ industries that might be influenced by the proposed law, which included production of natural resources. It is not clear whether foreign investors holding shares in a company involved in a ‘‘strategic’’ industry at the time of the entry into force of any such law would be affected by the provisions of the law. The entry into force of the discussed law could limit your ability to hold, sell or otherwise dispose our ADSs, and, as a result, could adversely affect the value of your investment in our ADSs and your position as a holder of our ADSs.

Risks Relating to Tatarstan

Relations between Tatarstan and Russia may deteriorate, adversely affecting our business

After the dissolution of the Soviet Union in 1991, certain politicians in Tatarstan, which has a significant non-Russian ethnic population that is predominantly Muslim, called for an independent Tatarstan state. In February 1994, Tatarstan and Russia signed a treaty under the terms of which Tatarstan enjoyed a high degree of autonomy. Since the treaty was signed, Tatarstan has existed peacefully within the Russian Federation. Russian authorities have repeatedly insisted on the revision of the treaty, claiming that it gives too much power to Tatarstan. This treaty expired in July 2005, as it has not been approved by the State Duma as required by Federal Law 95-FZ dated July 4, 2003 (as amended). A new agreement is currently under negotiation. See ‘‘—Risks relating to the Russian Federation—Political and social risks—Conflicts between federal and regional authorities and other political conflicts could create an uncertain operating environment that could hinder our long-term planning ability and could adversely affect the value of investments in Russia’’ under this Item. No assurance can be given that nationalism or other political, economic or religious tensions will not cause the relationship between Tatarstan and Russia to deteriorate, which would likely have a negative impact on us. For example, because Tatarstan is entirely surrounded by other regions of Russia and our principal markets are located outside of Tatarstan in Russia and in Europe, we ship substantially all of our crude oil to or through Russia and therefore rely on the cooperation of Russian authorities and the maintenance of good relations between Tatarstan and Russia.

Until December 31, 2004, the heads of the 88 sub-federal political units were directly elected by the residents of the relevant region. However, pursuant to Federal Law No. 184-FZ ‘‘On General Principles of Organization of Legislative (Representative) and Executive Bodies of Sub-Federal Political Units of the Russian Federation,’’ the heads of the 88 sub-federal political units, including the President of Tatarstan, are nominated by the President of the Russian Federation and then confirmed by the region’s legislative body. In March 2005, President Putin first exercised this authority, dismissing Vladimir Loginov as the governor of Koryaksky autonomous district, after the region suffered a heating shortage. President Shaimiev was nominated by President Putin, and subsequently confirmed by the legislature of Tatarstan, in March 2005. Nonetheless, future appointments may cause a deterioration of the relationship between Tatarstan and Russia.

The Tatarstan government has the power to exercise significant influence over our operations

The Tatarstan government is able to exercise considerable influence over our operations through its indirect ownership interest in Tatneft, its legislative, taxation and regulatory powers, and significant informal pressures. As of May 15, 2006, OAO Svyazinvestneftekhim (‘‘Svyazinvestneftekhim’’), an entity wholly owned by the Tatarstan government, held, directly and through its subsidiary OOO Investneftekhim (‘‘Investneftekhim’’), approximately 33.59% of our capital stock and 35.87% of our Ordinary Shares. As of the date of this annual report, four members of our Board of Directors are members of the Tatarstan government.

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Tatarstan also holds a ‘‘Golden Share’’—a special governmental right—in Tatneft. The exercise of its powers under the Golden Share enables the Tatarstan government to appoint one representative to our Board of Directors and Revision Committee and to veto certain major decisions, including those relating to changes in our share capital, amendments to our Charter, our liquidation or reorganization and ‘‘major’’ as well as ‘‘interested party’’ transactions as defined under Russian law. See ‘‘Item 7—Major Shareholders and Related Party Transactions—Major Shareholders’’ for a description of the Golden Share rights of the Tatarstan government.

We may face pressures from the Tatarstan government to engage in certain business practices that we may not have independently chosen and that may not maximize shareholder value

The President of Tatarstan has publicly encouraged us to create a vertically integrated oil company in Tatarstan and also to construct an oil refinery in Tatarstan, and we have made significant investments in new refining facilities in Nizhnekamsk, Tatarstan. The Tatarstan government also controls a number of our suppliers and contractors, such as the electricity producer OAO Tatenergo (‘‘Tatenergo’’) and the petrochemicals company OAO Nizhnekamskneftekhim (‘‘Nizhnekamskneftekhim’’). Consequently, we may be subject to pressures to enter into transactions that we might not otherwise contemplate with such suppliers and contractors. Although we believe that our relations with the Tatarstan government are currently good, the Tatarstan government has in the past and may in the future cause us to take actions that may not maximize shareholder value, such as maintaining employment levels, increasing expenditure on social assets, selling oil to certain customers, transferring exploration or production licenses to small Tatarstan oil companies (including companies not affiliated with Tatneft), acquiring specified companies or taking actions to raise funds for the benefit of Tatarstan.

Tatarstan legislation may be inconsistent with Russian legislation, and resolution of these inconsistencies is uncertain

During the period from 1991 until February 1994, when the treaty between Russia and Tatarstan was signed, Tatarstan issued privatization and other legislation that was inconsistent with Russian legislation. The treaty gives Tatarstan law precedence over Russian legislation on certain matters. Recently, Tatarstan adopted a number of legislative acts intended to bring Tatarstan law generally into conformity with Russian legislation. However, there is continuing uncertainty about the application of Russian and Tatarstan law in Tatarstan in circumstances where there was in the past or currently remains a conflict between Russian and Tatarstan law. For example, our privatization was conducted primarily in accordance with Tatarstan law, even though there was conflicting Russian legislation under which we conceivably should have been privatized. We are not aware of any challenge to our privatization, but if challenged, our privatization might not be deemed valid under Russian law. Moreover, federal legislation on the Golden Share is in several respects inconsistent with pre-existing Tatarstan legislation. The Tatarstan legislation attaches broader powers to the Golden Share than the federal legislation. See ''Item 7—Major Shareholders and Related Party Transactions—Major Shareholders.'' It is not clear whether a court would adhere to the federal or Tatarstan legislation if in the future the Tatarstan government would attempt to exercise the broader powers attaching to the Golden Share pursuant to the Tatarstan legislation. In addition, we cannot be certain that we will not become subject to inconsistent regulatory demands in the future.

Risks Relating to the Company

We have experienced liquidity problems in the past and could experience them in the future

As of December 31, 2004, our total indebtedness other than promissory notes, banking deposit certificates and banking customer deposits was RR27,619 million, of which approximately RR9,518 million was long-term indebtedness and RR18,101 million was short-term indebtedness. As of December 31, 2004, RR17,800 million of our indebtedness was denominated in U.S. dollars, incurred under loan facilities with various foreign banks and which includes the issuance of Eurobonds with a face value of U.S.$125 million by OAO Bank Zenit (''Bank Zenit''), which were fully repaid in June 2006. Of this amount, approximately 50% was long-term indebtedness and approximately 50% was short-term indebtedness (including current portion of long-term indebtedness). At December 31, 2004, we had outstanding

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RR2,998 million in promissory notes, RR6,444 million in bank promissory notes and RR24,597 million in banking customer deposits. A substantial portion of the revenues from our crude oil sales outside the CIS, our primary source of hard currency revenues, is pledged as collateral for our long-term hard currency indebtedness.

In mid-1998, we began to experience liquidity problems, which intensified in subsequent months, causing us to suspend certain payments of interest and principal to certain short-term hard currency creditors. This was primarily due to (i) the significant decrease in world crude oil prices which began in 1997 and continued throughout 1998 reducing our cash flow from exports; (ii) the turmoil in the Russian and international financial markets, most notably the financial crisis in Russia in 1998, which had a negative impact on the liquidity of our investments in Russian securities; and (iii) lending by us to Tatarstan, further reducing our available cash. Our suspension of payments to certain creditors resulted in export proceeds being temporarily retained by those creditors under security agreements in place, causing further cash flow difficulties.

In October 2000, we restructured RR13,635 million (U.S.$484.7 million) of our hard currency indebtedness, including the principal and capitalized deferred interest. All amounts due under the restructuring agreement were repaid by

March 2002.

In 2001 and 2002, we entered into secured loans arranged by BNP Paribas and Credit Suisse First Boston for an aggregate amount of U.S.$625 million. In April 2004, we repaid a syndicated loan of U.S.$100 million and borrowed a further U.S.$375 million in bridge loans from BNP Paribas and Credit Suisse First Boston, U.S.$187.5 million from each, for a period of six months, in connection with the proposed acquisition of the shares of Turkey's oil refining monopoly Tupras. See ‘‘Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions.’’ We repaid both of these bridge loans in 2004. Our outstanding loans are currently collateralized by aggregate oil exports of 200,000 tons per month (subject to increases depending on crude oil prices). We have also entered into a number of short-term loans collateralized by crude oil export contracts.

Although we believe that the loan agreements were executed on terms beneficial to us, our level of hard currency indebtedness, combined with the uncertainty of world oil prices and instability in the Russian and international financial markets, could have material adverse consequences for us, including:

- limiting our access to additional financing;
- limiting our ability to invest in business development due to the obligation to divert a substantial portion of our hard currency revenues to debt service; and
- increasing our vulnerability to economic downturns and changing market conditions.

The terms of the loan agreements also impose certain financial ratios and constrain our ability to pledge our crude oil sales, which may limit our access to additional financing.

Future delays in the timely completion of our financial statements or filing of our annual reports could lead to negative consequences for us, including sanctions by the New York Stock Exchange or the London Stock Exchange, or cause us to be in default under our loan agreements

The delays in the completion of the audits of our 2003 and 2004 financial statements prepared under U.S. GAAP and the consequent delay in the filing of this annual report have caused us to be in breach of the listing requirements of the New York Stock Exchange, Inc. (the ‘‘NYSE’’). Pending the filing of this annual report, the NYSE has permitted our ADSs to continue to be traded on the exchange. Nonetheless, should such delays occur again in the future we may be subject to a number of possible consequences, including the possible commencement of suspension or delisting procedures by the NYSE. In addition, the commencement of suspension or delisting procedures by the NYSE may also lead the United Kingdom Listing Authority to review our listing on the London Stock Exchange Limited (the ‘‘LSE’’) and to take possible action, which could, among other possible sanctions, include suspension or delisting. If a suspension or delisting were to occur, on either the NYSE or the LSE, there would be significantly less liquidity in our ADSs, which could result in a decline in the market price of our ADSs. See ‘‘—Our independent registered public accounting firm reported material weaknesses in our internal controls and we may not be able to remedy these material weaknesses or prevent future weaknesses’’ under this Item.

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In addition, delays in the completion of our audited 2003 and 2004 financial statements prepared under U.S. GAAP, and our interim consolidated financial statements for the six months ended June 30, 2005, caused us not to comply with one of the covenants contained in our loan agreement with BNP Paribas for U.S.$300 million and in our loan agreement with Credit Suisse First Boston for U.S.$200 million. See ‘‘Item 5—Operating and Financial Review and

Prospects—Liquidity and Capital Resources—Debt—Long-term foreign currency denominated debt.'' BNP Paribas notified us in April 2005 that it considered an event of default to have occurred under the loan agreement our failure to provide our audited 2003 U.S. GAAP financial statements and our interim U.S. GAAP consolidated financial statements for the six months ended June 30, 2004. However, we have provided BNP Paribas and Credit Suisse First Boston with our audited 2003 U.S. GAAP financial statements and we believe that by filing this annual report we have cured any event of default under our loan agreements. As such, we do not believe that BNP Paribas or Credit Suisse First Boston plan to attempt to accelerate payment of these loans or to enforce the related security. Nonetheless, should such delays occur again in the future we may be considered to be in default under certain of our loan agreements. Inability to obtain waivers for any such defaults could lead to acceleration of the payment of such loans, enforcement of the related security or, more generally, impairment of our ability to raise additional capital. See ''—Our independent registered public accounting firm reported material weaknesses in our internal controls and we may not be able to remedy these material weaknesses or prevent future weaknesses'' under this Item.

We sell a significant portion of our crude oil and refined products in the Russian market, where prices have historically been lower than in the international markets. These sales may adversely affect our revenues

In 2004, we sold approximately 25% of our crude oil volumes (including purchased crude oil) and 55% of our refined products volumes (including purchased refined products) within Russia, accounting for approximately 16% of our total revenues from sales of crude oil and 47% of our total revenues from sales of refined products, respectively. Russian crude oil prices remain below international spot market price levels due to, inter alia, significantly lower transport costs, large regional surpluses in Russia and increasing domestic supplies. Domestic Russian prices for refined products also remain below international spot market prices for refined products.

We are dependent on Transneft, a state-owned company that controls the monopoly pipeline system, for the transport of nearly all of our crude oil, and our ability to export crude oil is limited by the system for allocating access to Transneft's pipelines

Over 90% of the crude oil produced in Russia, and most of our crude oil, is transported through the Transneft system of trunk pipelines. OAO Transneft (''Transneft'') is a state-owned oil pipeline monopoly. The Transneft pipeline system is subject to breakdowns and leakage. By using multiple pipelines, however, Transneft has generally avoided serious disruptions in the transport of crude oil, and to date, we have not suffered significant losses arising from the failure of the pipeline system. A significant disruption in the pipeline system would, however, have a material adverse effect on our results of operations and financial condition.

Russian government authorities regulate access to Transneft's pipeline network. Pipeline capacity, including export pipeline capacity, is allocated quarterly to oil producers, generally in proportion to the amount of oil produced and delivered to Transneft's pipeline network in the prior quarter, planned oil production in the forthcoming quarter, and total pipeline capacity. Generally, a Russian oil company is given an allocation for export to non-CIS countries equal to approximately one-third of its total crude oil so produced and delivered to Transneft. Limitations on access to the export pipelines constrain the ability of producers to export crude oil, and limited port, shipping and railway facilities represent further constraints on the export of crude oil. Though these constraints have subsided in recent years, they have in the past, and may continue in the future, to have a significant impact on our cash flows and results of operations, since export prices are generally higher than domestic prices. Furthermore, failure to pay expenses or taxes to the Russian government could result in the termination or temporary suspension of our access to the export pipelines, which would materially adversely affect our results of operations and financial condition.

In 2001, a Russian court ruled that Transneft stop accepting shipments of crude oil by one of our competitors in response to a lawsuit filed by one of that oil company's shareholders. In 2002, Russian

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courts on several occasions granted similar requests in lawsuits against other Russian companies. Such rulings were overturned quickly. However, we cannot be certain that similar lawsuits will not be filed against us in the future or that any such lawsuits will be resolved in our favor. Any interruption in access to Transneft's pipeline network resulting from any such lawsuits could have a material adverse effect on our results of operations and financial condition.

A significant proportion of our crude oil production and reserves consists of high sulfur content oil, for which we receive a lower price and which has lower marketability than lower-sulfur content crude oil

As of January 1, 2005, most of our proved oil reserves had a high sulfur content, defined as greater than 1.8% sulfur content by mass.

A significant proportion of our crude oil production (approximately 42.8% in 2005, 43.1% in 2004, 42.5% in 2003 and 41.1% in 2002) consists of this high sulfur content oil, and we expect this proportion to continue to increase in the future. Our high sulfur content crude oil, which has an average sulfur content of approximately 3.5% by mass, typically commands a lower price than low sulfur content crude oil. Currently, however, virtually all of our high sulfur content crude oil is blended with low sulfur content crude oil produced by us and by other companies when it is transported through the Transneft pipeline system. The blended crude oil sells for a single uniform price. Although we pay Transneft a premium of U.S.$2.5 per ton (exclusive of value added tax (''VAT'')) of such blended and transported crude oil, we currently benefit overall from Transneft's practice of blending deliveries, as we generally receive a higher price for our blended crude oil than we would if either (i) the higher sulfur content crude oil were transported and sold separately or (ii) Transneft charged a premium for transporting high sulfur content crude that more closely matched the differential in world market price between high sulfur content crude oil and the blended crude oil that Transneft currently carries. There is currently no equalization scheme, often referred to as a ''quality bank,'' for differences in crude oil quality supplied to the Transneft pipeline system. In the past, Transneft and members of the Russian Government have raised, inter alia, the possibility that the oil companies whose high sulfur content oil is blended with low sulfur content oil when transported in the Transneft pipelines should pay compensation to oil companies transporting low sulfur content oil through Transneft pipelines. If these proposals are adopted, the current system will be changed to our significant detriment and our business and results of operations would be adversely affected. See ''Item 4—Information on the Company—Exploration and Production.''

We do not have arrangements with any refineries with respect to our shipments of high sulfur content crude oil, and the refineries could cease accepting such crude oil from us at any time. Moreover, there are a limited number of refineries in Europe that have the technical capabilities necessary to refine high sulfur content crude oil. We have taken steps to diversify our outlets for high sulfur content crude oil and believe that sufficient refining facilities for this oil will be available to us on acceptable terms in the future. We have made and will continue to make significant investments in the construction of the new Nizhnekamsk refining and petrochemical complex in order to ensure our continued access to facilities for refining high sulfur content crude oil. No assurance can be given, however, that we will succeed in following this strategy or that adequate refining facilities will continue to be available to us.

We must pay transportation expenses and tariffs to Transneft in order to maintain pipeline access, and these expenses and tariffs may be raised in the future, which could increase our costs

We must pay transportation expenses to Transneft in order to maintain our access to export pipelines and seaports. Our failure to pay these expenses could result in the termination or temporary suspension of our access to these export pipelines and seaports, which would adversely affect our results of operations and financial condition. For example, in

October 1998, as a result of our significant liquidity problems, we interrupted payments of transportation expenses to Transneft. Consequently, our export capacity was suspended until we resumed such payments. Further, if the tariffs that we pay for the transportation by pipeline of our crude oil were raised, our costs would increase, which could adversely affect our revenues, cash flows and results of operations.

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We have historically had commercial relations with certain countries, including Libya, Iraq, Syria, Iran and Sudan, that are currently or have been until recently the subject of economic sanctions imposed by the United States and international organizations. Violations of existing international or U.S. sanctions could subject us to penalties that would have a material adverse affect on our results of operations

International and U.S. sanctions have been imposed on companies engaging in certain types of transactions with specified countries or companies in those countries. The Tatarstan government and we have held discussions regarding possible transactions involving such countries, including Libya, Iraq, Syria, Iran and Sudan.

After the Libyan government opened its territory for international experts in September 2003, the U.N. lifted sanctions against Libya, and most U.S. trade sanctions were suspended in April 2004 and removed in September 2004. In October 2005, we, among nineteen other international oil companies, received a permit to explore and develop oil fields located in the central part of Libya.

U.N. and U.S. sanctions against Iraq have been lifted subsequent to the military action in Iraq in 2003. Prior to lifting of the sanctions we exported Iraqi oil under the U.N. oil-for-food program, participated in a consortium that includes Rosneft, a major Russian oil company indirectly owned by the Russian Federation (‘‘Rosneft’’), to develop Iraqi oil fields, drilled a number of oil wells in Iraq under U.N.-approved contracts and opened a representative office in Iraq. We believe that none of our activities in Iraq was prohibited by U.S. or international sanctions. We do not currently engage in any significant activities in Iraq.

We have opened a representative office in Iran and in February 2005 the government of Tatarstan and the government of Iran concluded an agreement pursuant to which we are expecting to register a joint venture with an Iranian entity in order to participate in various projects in Iran, including tenders for the development of oil fields. The terms of our participation in this venture have not yet been finalized. In 2002, we conducted work under a contract for demercaptanization (a process in which mercaptans—sulfur compounds—are removed from hydrocarbons) of refined products and oxidized gas in Iran and are currently performing contracts for testing microbiological bed stimulation technology in Iran. In addition, we have signed a contract to implement well casing technology in Iran and submitted proposals to participate in tenders to provide engineering services and to obtain production licenses for a group of Iranian oil fields. In March 2005, we concluded an agreement with the government of Syria and the Syrian Oil Company according to which we are to explore and to produce oil in eastern Syria. In the past, we and/or our affiliates discussed proposals for business projects in Sudan. We are currently not engaged, and are not contemplating to be engaged in the future, in any activities in Sudan.

In the future, we may enter into permitted transactions with other countries against which sanctions have been applied. If we violate existing U.S. or international sanctions, penalties could include a prohibition or limitation on our ability to obtain goods and services on the international market or to access the U.S. or international capital markets. However, we believe that we are not currently, and have not in the past been, involved in any transactions with Libya, Iraq, Syria, Iran and Sudan that could result in sanctions against us, and we intend to comply with international sanctions law in the future.

The Russian and Tatarstan governments can mandate deliveries of crude oil and refined products at less than market prices, adversely affecting our revenue and relationships with other customers

The Russian and Tatarstan governments may direct us to deliver crude oil or refined products to certain government-designated customers, which generally take precedence over market sales. Government-directed deliveries may take several forms. We may be directed to make export sales, to make deliveries to government agencies, the military, agricultural producers or remote regions, or to specific consumers or refineries, such as Nizhnekamskneftekhim, or to domestic refineries in general. Government-directed deliveries may disrupt our relations with our customers, lead to delays in payments for crude oil and refined products or result in sales of our crude oil or refined products at below market prices.

Any failure to make government-directed deliveries may affect our ability to export our crude oil. For example, in November 1998 the Russian government threatened to revoke the export rights of four

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Russian oil companies, including Tatneft, for failing to provide domestic refineries with steady supplies of oil. After receiving confirmation from us that we had been providing more than 50% of our crude oil to refineries located in the Russian Federation, the Russian government elected not to interrupt our exports. Any limitation of export rights could materially adversely affect our results of operations and financial condition.

We are dependent on oil refineries outside of Tatarstan

While we produce the majority of our oil in Tatarstan, we have limited ability to process crude oil in this area. Acting at the urging of Tatarstan President Shaimiev, in 1999 we formed a joint venture company, OAO Nizhnekamsk Oil Refinery, with Nizhnekamskneftekhim and OAO Tataro-American Investments and Finance (‘‘TAIF’’), which was at the time a related party of the Group, to expand, upgrade, and operate the refinery in Nizhnekamsk—the only oil refinery in Tatarstan. From December 2001, OAO Nizhnekamsk Oil Refinery leased a TAIF-owned crude distilling unit (the ‘‘CDU’’). The CDU was installed at the Nizhnekamsk oil refinery in 2002 and is a vital asset for its operations. The upgrade included improvements to the CDU and construction of a base refining complex consisting of six additional refining units with a higher added value production. Following the completion of the upgrade, the partners were expected to contribute their assets, including the refining units, the construction of which they had financed, to the charter capital of OAO Nizhnekamsk Oil Refinery, receiving a stake in the company in proportion to the value of their contribution. Since 1999, our most significant capital expenditures were for the upgrade of the Nizhnekamsk oil refinery. Our total investment in the refinery through September 1, 2005 amounted to approximately RR8,450 million. In 2004, we delivered 5.84 million tons of crude oil to the Nizhnekamsk oil refinery, representing approximately 63% of all our domestic crude oil deliveries.

Following the completion of the Phase I base complex in December 2002, we were not able to agree with TAIF on the value of the CDU. In 2003, TAIF brought a case before the arbitrazh court of the Tatarstan Republic claiming the return of the CDU leased to OAO Nizhnekamsk Oil Refinery because of alleged breaches by OAO Nizhnekamsk Oil Refinery of several provisions of the lease agreement. On October 6, 2003 the arbitrazh court of the Tatarstan Republic ruled in favor of TAIF and this decision was upheld by the instance of appeals of the arbitrazh court of the Tatarstan Republic on January 13, 2004. As a consequence, OAO Nizhnekamsk Oil Refinery returned the CDU to

TAIF. In addition, in early September 2005, we sold to TAIF our share in the production assets of OAO Nizhnekamsk Oil Refinery, including the refining units, for approximately U.S.$315 million. While these production assets have not been physically removed from the Nizhnekamsk oil refinery, TAIF established a new legal entity to which it transferred these assets. Following this sale, OAO Nizhnekamsk Oil Refinery was left without production assets, and is now in the process of liquidation. While we are now building a new oil refining and petrochemical complex in Nizhnekamsk, until its completion, we have limited ability to process crude oil in Tatarstan, and are thus dependent on oil refineries outside of Tatarstan. Should these oil refineries be unable to refine our crude oil, this would have a material effect on our operations.

The Russian tax system imposes substantial burdens on us and is subject to frequent change and significant uncertainty

We are subject to a broad range of taxes imposed at the federal, regional and local levels, including but not limited to excise taxes and export duties, income tax, value added tax, the unified natural resources production tax, property tax, social tax and pension contributions. We were subject to an effective income tax rate (current and deferred income tax expense/benefit as a percentage of income before income taxes and minority interest) of 30% and a total tax burden of 34% (income taxes and taxes other than income taxes as a percentage of sales and other operating revenue) in 2004.

Laws related to these taxes, such as the Russian Federation Tax Code (the ‘‘Tax Code’’), have been in force for a short period relative to tax laws in more developed market economies, and the government’s implementation of these tax laws is often unclear or inconsistent. Accordingly, few precedents with regard to the interpretation of these laws have been established. Often, differing opinions regarding legal interpretation exist both between companies subject to such taxes and the government and within government ministries and organizations, such as the Federal Tax Service of the Russian Federation (the ‘‘Federal Tax Service’’), and its various inspectorates, creating uncertainties and areas of conflict.

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Generally, tax declarations remain open and subject to inspection by tax and/or customs authorities for a period of three years following the tax year. The fact that a year has been reviewed by tax authorities does not close that year, or any tax declaration applicable to that year, from further review by an upper level of the tax authorities during the three-year period. Several Russian companies have recently been subjected to additional claims for taxes in prior years, including YUKOS, Vimpelcom and TNK-BP. In addition, on July 14, 2005, the Russian constitutional court issued a decision that allows the statute of limitations for tax liabilities to be extended beyond the three-year statutory term if a court determines that a taxpayer has obstructed or hindered a tax inspection. Because none of the relevant terms is defined, tax authorities may have broad discretion to argue that a taxpayer has ‘‘obstructed’’ or ‘‘hindered’’ an inspection and, ultimately, seek penalties beyond the three-year term. These facts create tax risks in Russia substantially greater than typically found in countries with more developed tax systems. In April 2005, we received a claim for back taxes from the federal tax authorities, based on their review of our tax filings for the years 2001, 2002 and 2003, in the amount of RR1,380 million. This amount includes both alleged non-payment and under-payment of taxes as well as fines and penalties. The amount of the tax claim was accrued in our financial statements as of December 31, 2003. While we could have challenged this claim, the issue of any such claim would have been uncertain, given the results of recent Russian companies’ tax claims. In addition, the amounts claimed were significantly smaller than similar claims recently received by other Russian companies. Consequently, we paid in May 2005 the entire amounts claimed.

The taxation system in Russia is subject to inconsistent enforcement at the federal, regional and local levels, which complicates our tax planning and related business decisions. For example, tax laws are unclear with respect to the deductibility of certain expenses. This uncertainty exposes us to the possible imposition of significant fines and penalties and to enforcement measures despite our efforts at compliance, and could result in a greater than expected tax burden.

Financial statements of Russian companies are not consolidated for tax purposes. Therefore, each of our Russian entities pays its own Russian taxes and may not offset its profit or loss against the loss or profit, respectively, of another of our entities. Because Russian legislation contains no consolidation provisions, dividends within the entities comprising our group are subject to Russian taxes at each level (if dividends are paid by a Russian company to another Russian company, the tax base would be determined as the difference between dividends to be paid and dividends received). Currently, dividends payable to a Russian entity are taxed at 9%, and the payer is required to withhold the tax when paying the dividend.

The Russian government has recently revised the Russian tax system. The new tax system is intended to reduce the number of taxes and the overall tax burden on businesses and to simplify the tax laws. However, the revised tax system relies heavily on the judgments of local tax officials and fails to address many of the existing problems. Even in the event of further reforms to tax legislation, they may not result in a reduction of the tax burden on Russian companies and the establishment of a more efficient tax system. Conversely, they may introduce additional tax collection measures. For example, in May 2004, a law was approved that increased the base tax rate for the unified natural resources production tax from RR347 to RR419 per ton of crude oil starting from January 1, 2005. Effective June 1, 2006, crude oil export duty rates were adjusted upwards to U.S.$199.8 per ton of crude oil from U.S.$186.4 per ton of crude oil as of April 1, 2006. Accordingly, we may have to pay significantly higher taxes, which could have a material adverse effect on our business.

We maintain insurance against some, but not all, potential risks and losses affecting our operations. We cannot assure you that our insurance will be adequate to cover all of our losses or liabilities. Also, we cannot predict the continued availability of insurance at an acceptable cost

Oil drilling and production activities are subject to numerous risks, including the risk that no commercially productive oil reserves will be found. The cost of drilling and completing wells is often uncertain. Oil drilling and production activities may be shortened, delayed or canceled as a result of a variety of factors, many of which are beyond our control. These factors include:

- unexpected drilling conditions;
- pressure or irregularities in formations;

- equipment failures or accidents;
- shortages in experienced labor or delays in the delivery of equipment;
- blowouts (i.e., uncontrolled releases of fluids, solids or gases) and surface cratering;
- pipe or cement failures;
- casing collapse; and
- embedded oil field drilling and service tools.

We only have a certain and potentially insufficient level of insurance coverage for expenses and losses that may arise in connection with property damage, work-related accidents and occupational disease, natural disasters and environmental contamination. We have no insurance coverage for loss of profits or other losses caused by the death or incapacitation of our senior managers. Accordingly, losses or liabilities arising from such events could increase our costs and have an adverse effect on our operations and financial condition.

Our main oil fields are considered ‘‘mature’’ and require increased capital expenditures to maintain production levels. Inability to finance these and other expenditures could have a material adverse effect on our financial condition and the results of our operations

One of our key strategies has been to focus on rehabilitating existing wells to stabilize and optimize production. We anticipate that substantial expenditures will be required to maintain reservoir pressure in our key fields and otherwise to optimize production. Our business also requires other significant capital expenditures, including in exploration and development, production, transport, refining, and to meet our obligations under environmental laws and regulations. We expect to finance a substantial part of these capital expenditures out of cash flows from our operating activities. If international oil prices fall, however, we will have to finance our planned capital expenditures increasingly through bank borrowings and offerings of debt or equity securities in the international capital markets. If necessary, these financings may be secured by our exports of crude oil. During 2005 and 2004, up to 30% of our approximately 1.0 million tons per month and 1.1 million tons per month, respectively, of non-CIS crude oil exports, have been pledged as security for existing borrowings. No assurance can be given that we will be able to raise the financings required for our planned capital expenditures, on a secured basis or otherwise, on acceptable terms or at all. If we are unable to raise the necessary financing, we will have to reduce our planned capital expenditures. Any such reduction could adversely affect our ability to expand our business, and if the reductions are severe enough, could adversely affect our ability to maintain our operations at current levels.

Our exploration, development and production licenses may be suspended, amended or revoked prior to their scheduled expiration

The licensing regime in Russia for the exploration, development and production of oil and natural gas is governed primarily by the Federal Law on Use of Subsoil of February 21, 1992, as amended (the ‘‘Subsoil Law’’) and regulations issued thereunder. Most of our licenses provide that fines may be imposed, or the licenses may be suspended, restricted or terminated if we fail to comply with license requirements, including the conditions that we make timely payments of levies and taxes for the use of the subsoil, if we systematically fail to provide information, if we go bankrupt or if we fail to fulfill any capital expenditure and/or production obligations or to meet certain environmental requirements.

Article 10 of the Subsoil Law also provides that a license to use a field must be extended by the relevant authorities at the initiative of the license holder if the extension is necessary to finish production in the field, provided that the licensee has not violated the terms of the license. We believe that our existing production licenses will be extended at or prior to their scheduled expiration and we will apply for extensions of our existing production licenses when appropriate.

We may not be able to, or may voluntarily decide not to, comply with the license conditions for some or all of our license areas. If the Russian government determines that we have failed to fulfill the specific terms of any of our licenses or if we operate in the license areas in a manner that violates Russian or local law, government regulators may impose fines on us or suspend or terminate our licenses, or we may not

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be able to extend our licenses. Any of these events could have a material adverse effect on our operations and the value of our assets, or cause the price of our ADSs to decline. See ''Item 4—Information on the Company—Exploration and Production.''

Our inability to replace current production with new reserves will result in reduced production and will have a material adverse impact on our financial condition and results of our operations

Since 1996, our oil production has generally remained stable. Increasing our crude oil production by developing our non-producing and undeveloped reserves will require significant capital expenditure. Though we believe that our current production levels are stable and sustainable as a result of our current development program, our exploration and production programs may not result in the replacement of current production with new reserves, such programs may not result in new, commercially viable operations and we may not be able to extend the life of our existing reserves. See ''Item 4—Information on the Company—Exploration and Production.''

We depend on our senior managers and other key personnel, the loss of any of whom could have an adverse impact on our business

We depend on the continued services and performance of our senior management and other key personnel. If we lose the services of our senior managers or if any of our other executive officers or key employees should cease to take an active role in managing our affairs, we may not be able to operate our business as effectively as we anticipate and our operating results may suffer. In particular, we are heavily dependent upon our General Director, Shafagat F. Takhautdinov, and certain other key managers. We cannot assure you that their services, or those of other key managers, will continue to be available to us, and the loss of any one of these could materially adversely affect our business.

Failure to carry out our corporate reorganization program in its entirety or for it to have the desired effects may adversely affect our expected financial and operational results

We have adopted a corporate reorganization program as part of our strategy for reducing costs and improving production efficiency. This program faces numerous difficulties, including local opposition to the transfer of social assets, such as schools and medical facilities, from our ownership or management to local jurisdictions. These have prevented or delayed and may well continue to prevent or delay the implementation of certain aspects of the corporate reorganization program. See ''Item 4—Information on the Company—Corporate Reorganization.''

Our independent registered public accounting firm reported material weaknesses in our internal controls and we may not be able to remedy these material weaknesses or prevent future weaknesses

In connection with their audits of our consolidated financial statements for the years ended December 31, 2003 and 2004, Ernst & Young, our independent auditor, reported weaknesses in our internal controls, as had PricewaterhouseCoopers, our independent auditor in respect of prior periods. Specifically, our independent auditor found that our system of internal control lacks adequate processes and controls relating to the timely and accurate capture and recording of transactions in accordance with U.S. GAAP that would reduce to a relatively low level the risk that errors in amounts that would be material in relation to those financial statements may occur and may not be detected within a timely period by management in the normal course of business. In particular, our independent auditor found that, with respect to the preparation of our U.S. GAAP consolidated financial statements for the year ended December 31, 2004:

- Our personnel directly involved in the financial reporting under U.S. GAAP consist of seven employees. Given our size, the complexity of our business transactions, the number of locations involved and the increasing requirements from the regulatory bodies (including those of Sarbanes-Oxley Act of 2002), our independent auditor believes that the size of our financial reporting department is inadequate to meet the applicable U.S. GAAP and the SEC reporting requirements. There is a risk therefore that financial information may be materially misstated, since in the process of financial statement closing the results of various transactions may not be correctly summarized, reviewed, consolidated, edited and included into a variety of regulatory and financial reports.

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- We do not have either integrated information systems or general ledgers which support dual Russian statutory and U.S. GAAP accounting. U.S. GAAP accounts are prepared with the use of spreadsheets, using Russian statutory accounting data as the initial inputs. Additionally, U.S. GAAP consolidation for the Group is performed using a complex spreadsheet. The lack of integrated information systems and the high volume of manual computations significantly increase the risk of unintentional material errors and create difficulties for us in preparing accurate and timely financial statements. Furthermore, our independent auditors note that we do not have computerized fixed assets registers for U.S. GAAP reporting purposes in respect of building and construction, and machinery and equipment. As a result, approximately RR27,229 million, or 15% of our consolidated fixed assets balance as at December 31, 2004, and approximately RR1,966 million, or 21% of our depreciation expense for 2004, were calculated with the use of spreadsheets, which, due to the human effort required, are prone to error.
- There is no process in place to ensure that the personnel charged with financial statement preparation are timely and fully informed by senior management about the substance of business transactions in order to determine their appropriate recognition in the consolidated financial statements prepared in accordance with U.S. GAAP.
- Our Executive Board controls the operations of OAO Tatneft, our parent company, only within the limits established by Russian legislation and our charter documents. We have a complex organization structure which includes more than one hundred subsidiaries and the structure changes from year to year. There is no written and clear policy establishing the role of senior executives of the Group in the internal control and oversight of the operations of the subsidiaries. Accordingly, there is a risk that certain significant business transactions that occur in the subsidiaries may not be properly authorized or approved by our senior executives, and these transactions may not be accurately disclosed or reported in the financial statements.
- There is no effective process in place to ensure that all entities (including those deemed immaterial) where we exercise control or significant influence are consolidated or equity accounted for in the U.S. GAAP financial statements, including consideration of variable interest entities, of which we may be the primary beneficiary or over which we may exert significant influence.
- There is no effective process in place to ensure that all related parties, as defined by U.S. GAAP and the SEC, are identified and the nature of relationships and respective transactions are reflected in the consolidated financial statements. In addition, the process that was in place during 2004 is not sufficient to allow us an opportunity to determine the identity of all counter-parties with which we enter into significant transactions.
- Given the seriousness of the material weaknesses discussed above, our independent auditor has recommended that the Audit Committee continues to be involved in the oversight of the financial reporting process, and in monitoring management's risk assessment processes (including the risks of fraud). Our independent auditor has also recommended that the Audit Committee provides guidance to our management in developing and implementing a plan to

overcome the above material weaknesses in an acceptable and timely manner. Our independent auditor has further recommended that the Audit Committee establishes a policy for reporting to our Board of Directors to allow important information to be brought to the attention of senior management on a regular basis.

In addition, an independent legal investigation into certain transactions, undertaken at the request of our Audit Committee in connection with the audit of our U.S. GAAP financial statements for the year ended December 31, 2003, indicated the following weaknesses in our internal controls: a lack of written policies and procedures at the group level; certain transactions not properly communicated to accounting and finance; incorrect recording of transactions, including failure to properly record substantial amounts of money being loaned; and procuring stock for a possible stock-based compensation plan without a complete formulation of the plan resulting in a failure to properly record treasury stock. The investigation found that our control environment (including our maintenance of books and records and internal controls) was inadequate under the applicable requirements of the Exchange Act.

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One of the components of internal control is the control environment. The control environment reflects the tone of the organization, which influences the control consciousness of its personnel. The key factors affecting the control environment include among other things, participation of the Board of Directors, management's philosophy and clearly defined operating style, organizational structure, assignment of authority and responsibility and policies and procedures. Our independent auditor found that the lack of clearly defined and articulated policies and procedures, combined with a management tone, which does not stress the importance of controls within the organization, increases the risk of error or misstatement in reported financial results. In a weak control environment such as ours, there is usually a greater likelihood that the specific risks created by one identified deficiency will not be overcome by strengths in other areas or by the basic attitude of the organization toward controls.

For further discussion of the independent legal investigation, its conclusions and the steps that we are taking to remedy our control deficiencies, see ''Item 15—Controls and Procedures.'' Notwithstanding the steps we are taking to address these issues, we may not be successful in remedying these material weaknesses or preventing future material weaknesses. If we are unable to remedy these material weaknesses, there is a risk that we may not be able to prevent or detect a material misstatement of our annual or interim U.S. GAAP consolidated financial statements. In addition, any failure to implement new or improved internal controls, or resolve difficulties encountered in their implementation, could harm our operating results or cause us to fail to meet our reporting obligations. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our shares and ADSs.

We expect the oil industry in Russia to become increasingly competitive

We expect that the ongoing restructuring of the oil and natural gas industry in Russia will lead to increased competition for new exploration and production licenses, access to capital resources, transportation infrastructure, sales and other aspects of the production and transportation process. Recently, the Russian oil industry has experienced significant consolidation, including the privatization sale of Slavneft, a large Russian oil company, to a consortium of shareholders who also control Tyumen Oil Company (''TNK'') and Sibneft, Russia's third and fifth largest oil companies, respectively; establishment of a strategic joint venture between BP and TNK on the basis of their respective Russian assets; the sale of Yuganskneftegaz, the most significant subsidiary of YUKOS, to Rosneft; and the acquisition of Sibneft, the fifth largest oil producer in Russia, by the state-owned Gazprom. These and other companies may have better access to financial and other resources than we do, and this may give them a competitive advantage. In addition, our domestic competitors may be strengthened through strategic acquisitions of additional assets, including in Tatarstan. Russneft, the tenth largest oil producer in Russia, has recently acquired significant production and refinery facilities in Russia and announced its plans to acquire additional facilities in the near future. See ''Item 4—Information on the Company—Competition.''

Excessive appreciation of the ruble against the U.S. dollar would adversely affect our margins and cash flows

After a protracted period of weakness, the ruble has appreciated against the U.S. dollar in recent years, including by 13.6% in 2004 and 3.9% in 2005 in real terms. Because our revenues are substantially linked to the U.S. dollar and our costs (other than a large portion of debt-service costs) are denominated primarily in rubles, the real appreciation of the ruble has already had and may continue to have an adverse effect on our business, results of operations, financial condition and cash flows by causing our costs to increase relative to our revenue.

Risks Relating to the Oil Industry

A substantial or extended decline in prices for crude oil and refined products could adversely affect our business, results of operations, financial condition, liquidity and our ability to finance planned capital expenditures

Our revenues, profitability and future rate of growth depend substantially upon prevailing prices of crude oil and refined products. Historically, prices for oil have fluctuated widely in respect to changes in many factors. Factors that can cause this fluctuation include:

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- global and regional supply and demand, and expectations regarding future supply and demand, for crude oil and refined products;
- market uncertainty;
- weather conditions;
- domestic and foreign governmental regulations;
- prices and availability of alternative fuels;
- prices and availability of new technologies;
- the ability of the members of the Organization of Petroleum Exporting Countries (the ''OPEC''), and other crude oil producing nations, to set and maintain specified levels of production and prices;
- political and economic developments in oil producing regions, particularly the Middle East;
- Russian and foreign governmental regulations and actions, including export restrictions and taxes; and
- global and regional economic conditions.

The decline in world oil prices from October 1997 to December 1998 by more than 54% to less than U.S.$10 per barrel was one of the primary reasons for our significant liquidity problems in the second half of 1998. See ''—Risks Relating to the Company—We have experienced liquidity problems in the past and could experience them in the future'' under this Item. While oil prices remain volatile, average price levels since 1998 have been consistently above the low levels reached in 1998. According to the International Energy Agency, the average prices of Brent crude, an international benchmark oil price, for the three years ended December 31, 2004, 2003 and 2002, were approximately U.S.$38.22, U.S.$28.83, and U.S.$25.02 per barrel, respectively. The average price of Brent crude increased to U.S.$54.38 per barrel in 2005 and the price of Brent crude was U.S.$69.39 per barrel at June 1, 2006. Crude oil prices increased in 2005, 2004 and 2003, following a slight increase in 2002 and after declining significantly in 2001, as a result of export restrictions imposed by OPEC and certain other crude oil producing nations, including Russia, in 2003, improving global economic conditions and heightened tensions in the Middle East and war in Iraq. However, there can be no assurance that oil prices will not decline again. Because our crude oil export sales are the primary source of our hard currency revenues, including revenues needed to repay lines of credit from foreign lenders, and an important source of our earnings and cash flows, any decline in international crude oil or refined product prices is likely to have a material adverse effect on our financial position and results of operations.

Lower prices may also reduce the amount of oil that we can produce economically or reduce the economic viability of projects planned or in development. We may reduce our planned capital expenditures if international crude oil or refined product prices fall below the price assumptions used in our internal estimates.

We do not currently engage in any hedging transactions or other derivatives trading to reduce the impact of fluctuations of crude oil prices on our company.

The crude oil and natural gas reserves data in the Reserves Reports are only estimates and are inherently uncertain, and our actual production, revenues and expenditures with respect to our reserves may differ materially from these estimates

The crude oil reserves data set forth in this annual report and the crude oil and natural gas reserves data set forth in the Reserves Reports, incorporated by reference into this annual report from our reports on Forms 6-K furnished to the SEC on July 23, 2004 and March 20, 2006, respectively, are estimates based primarily on internal engineering analyses that were audited by Miller and Lents, independent petroleum engineering consultants as of January 1, 2005 and 2004, respectively. The most recent reserves estimates were calculated using oil and natural gas prices for us in effect on January 1, 2005. Any significant price changes could have a material effect on the quantity and present values of our proved reserves.

Petroleum engineering is a subjective process of estimating underground accumulations of oil and natural gas that cannot be measured in an exact manner. Estimates of the value and quantity of

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economically recoverable oil and natural gas reserves, rates of production, future net revenues and cash flows and the timing of development expenditures necessarily depend upon a number of variable factors and assumptions, including the following:

- historical production from the area compared with production from other comparable producing areas;
- interpretation of geological and geophysical data;
- the assumed effects of regulations adopted by governmental agencies;
- assumptions concerning future percentages of international sales;
- assumptions concerning future oil and natural gas prices;
- capital expenditures; and
- assumptions concerning future operating costs, tax on the extraction of commercial minerals and excise taxes, development costs and workover and remedial costs.

Because all reserves estimates are subjective, each of the following items may differ materially from those assumed in estimating reserves as set forth in the Reserves Reports:

- the quantities and qualities of oil and natural gas that are ultimately recovered;
- the production and operating costs incurred;
- the amount and timing of future development expenditures; and
- future oil and natural gas sales prices.

Many of the factors, assumptions and variables involved in estimating reserves are beyond our control and assumptions and variables on which the Reserves Reports are based may prove to be incorrect over time. This is especially true in Russia, where there has been political and economic uncertainty in the recent past. Results of drilling, testing and production after the date of the estimates may require substantial upward or downward revisions in our reserves data. Furthermore, different reservoir engineers may make different estimates of reserves and cash flows based on the same available data. Actual production, revenues and expenditures with respect to reserves will vary from estimates and the variances may be material. Any downward adjustment could lead to lower future production and thus adversely affect our financial condition, future prospects and market value. See ‘‘Item 4—Information on the Company—Exploration and Production.’’

We may incur material costs to comply with, or as a result of, health, safety and environmental laws and regulations

We incur, and expect to continue to incur, substantial capital and operating costs in order to comply with increasingly complex laws and regulations covering the protection of the environment and human health and safety.

The level of pollution and potential clean-up is impossible to assess without an environmental audit (which we have not undertaken) and consistent interpretation and enforcement of environmental laws by the federal, regional and local authorities (which has not occurred). In connection with our applications for licenses to explore and develop oil resources, we are generally required to make significant commitments concerning levels of pollutants that we release and remediation in the event of environmental contamination.

New laws and regulations, the imposition of tougher requirements in licenses, increasingly strict enforcement of, or new interpretations of, existing laws, regulations and licenses, or the discovery of previously unknown contamination may require further expenditures to:

- modify operations;
- install pollution control equipment;
- perform site clean-ups;

- curtail or cease certain operations; or
- pay fees or fines or make other payments for pollution, discharges or other breaches of environmental requirements.

Furthermore, the implementation of the Kyoto Protocol to the United Nations Framework Convention on Climate Change from February 2005 (the ‘‘Kyoto Protocol’’) may impose new and/or additional rules or more stringent environmental norms. Such requirements may require additional capital expenditures or modifications in our operating practices.

Under existing legislation, we believe that there are no significant environmental liabilities, beyond the amounts that we have already incurred in order to comply with the environmental requirements, that will have a material adverse effect on our operating results or our financial position.

Although the costs of the measures taken to comply with the environmental regulations have not had a material adverse effect on our financial condition or results of operations to date, in the future the costs of such measures and liabilities related to environmental damage caused by us may increase. Furthermore, we do not have any insurance for environmental damage caused by our activities.

Risks Relating to Investment in our ADSs

You may be unable to repatriate your earnings from our ADSs

Russian currency control legislation pertaining to payment of dividends currently requires dividends on ordinary shares to be paid in rubles. Under this legislation, ruble dividends may be converted into U.S. dollars by the depositary for distribution to owners of ADSs without restriction. In addition, ADSs may be sold by non-residents of Russia for U.S. dollars outside Russia without regard to Russian currency control laws as long as the buyer is not a Russian resident for currency control purposes.

The ability of the depositary and other persons to convert rubles into U.S. dollars (or another hard currency) is also subject to the availability of U.S. dollars (or another hard currency) in Russia's currency markets. Although there is an existing market within Russia for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and no viable market in which to hedge ruble and ruble-denominated investments. See ''Item 10—Additional Information—Exchange Controls.''

Our ability to pay dividends is constrained by Russian accounting practices and our loan agreements with creditors

We are permitted to pay dividends on our Ordinary Shares out of net profits, and dividends on Preferred Shares out of net profits and special funds designated for such purposes, in each case calculated in accordance with RAR, which differ in significant respects from U.S. GAAP. Any amounts available for distribution as dividends on our shares as determined under RAR may be significantly lower than the amounts that would have been determined under U.S. GAAP. In addition, our loan agreements with some of our hard currency lenders contain restrictions on the payment of dividends. See ''Item 8—Financial Information—Dividends and Dividend Policy.''

The market price of our shares and ADSs could be adversely affected by potential future sales

The trading price of our shares and ADSs could be adversely affected as a result of sales of substantial numbers of our shares in the public market, or by the perception that this could occur. These factors could also make it more difficult to raise capital through equity or equity-linked offerings.

As of May 15, 2006, the Tatarstan government, through its wholly-owned entity Svyazinvestneftekhim and its subsidiary Investneftekhim, held approximately 33.59% of our capital stock and 35.87% of our Ordinary Shares. Svyazinvestneftekhim is free to dispose the Ordinary Shares it holds at any time. Significant dispositions of these shares could adversely affect the price of our ADSs.

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The rights of non-Russian residents to own or vote our shares or ADSs may be subject to restrictions

According to the Law on the Securities Market and the regulations of the Russian Federal Commission on the Securities Market, the predecessor of the FSFM, the deposit of shares of a Russian company into an American Depositary Receipt (''ADR'') program requires the permission of the FSFM. Such permission may be denied, among other reasons, if more than 35% of the class of shares eligible for deposit into the ADR program will circulate outside Russia, including in the form of ADSs, or if the ADR program contemplates the voting of the shares underlying the ADSs other than in accordance with the instructions of the ADS holders. Our ADR program has no express limitations on the deposit of our Ordinary Shares into the program, and it contemplates that, in the absence of instructions from ADS holders, the depositary will give a proxy to vote the shares underlying such ADRs to our representative. There is uncertainty as to whether the FSFM regulation applies to ADR programs into which additional shares have been deposited and/or continue to be deposited in excess of 35% of the Ordinary Shares at the time of enactment of the regulation, or only to ADR programs established after the time of its enactment. Articles appearing in the press have noted that in January 2003, The Bank of New York ceased deposits of shares of another Russian company into its ADR program after the aggregate number of shares deposited into the program exceeded the amount permitted by the FSFM for this company. We have never applied to the FSFM or its predecessor entities for permission for our ADR program. The number of the Ordinary Shares deposited in our ADR program constitutes approximately 24.5% of our Ordinary Shares, and we may be required to limit the amount of the Ordinary Shares deposited in our ADR program to 35% of our Ordinary Shares. Accordingly, we can give no assurance that The Bank of New York, acting as one of the depositaries for our ADR program, will allow additional deposits of the Ordinary Shares if they exceed the 35% limitation. Furthermore, the FSFM regulation does not specify the consequences of violating the regulation. An assertion that the FSFM regulation and/or the limitation on shares deposited in the program apply to our ADR program could have a material adverse effect on the market price of our Ordinary Shares or ADSs.

Voting rights with respect to the shares represented by our ADSs are limited by the terms of the deposit agreement for our ADSs and relevant requirements of Russian law, which may prevent or delay the ability of ADS holders to exercise their rights

ADS holders may exercise voting rights with respect to the Ordinary Shares represented by ADSs only in accordance with the provisions of the deposit agreement relating to the ADSs and relevant requirements of Russian law. However, there are practical limitations with respect to their ability to exercise their voting rights due to the additional procedural steps involved in communicating with them. For example, the Joint-Stock Companies Law and the Charter require us to notify shareholders at least 20 days in advance of any general meeting, 30 days in advance if the agenda of such meeting includes an item on the Company's reorganization and at least 50 days in advance of an extraordinary meeting relating to election of directors. Holders of our Ordinary Shares receive notice directly from us and are able to exercise their voting rights by either attending the meeting in person or voting by proxy.

By comparison, an ADS holder will not receive notice directly from us. Rather, in accordance with the deposit agreement, we will provide the notice to the depositary. The depositary has undertaken in turn, as soon as practicable thereafter, to mail to ADS holders the notice of such meeting, voting instruction forms and a statement as to the manner in which instructions may be given by holders. To exercise his or her voting right, the ADS holder must then instruct the depositary how to vote its shares. Because of this extra procedural step involving the depositary, the process for exercising voting rights may take longer for ADS holders than for holders of Ordinary Shares. ADSs for which the depositary does not receive timely voting instructions will not be voted. In addition, although securities regulations expressly permit the depositary to split the votes with respect to the shares underlying the ADSs in accordance with instructions from ADS holders, this regulation remains untested, and the depositary may choose to refrain from voting at all unless it receives instructions from all ADS holders to vote the shares in the same manner. ADS holders may thus have significant difficulty in exercising voting rights with respect to the shares underlying the

ADSs.

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Because the depositary may be considered the beneficial holder of the shares underlying the ADSs, these shares may be arrested or seized in legal proceedings in Russia against the depositary, adversely affecting the holders of our ADSs

Russian regulations governing nominee holders, including global custodians and ADS depositaries in their custodial capacity, are underdeveloped and subject to varying interpretations. For example, it is unclear whether global custodians and ADS depositaries that are acting outside of Russia for non-Russian clients and investors but who are, on behalf of their clients and investors, holding in Russia through a Russian licensed custodian, securities issued by Russian companies, including our Ordinary Shares underlying our ADSs, are required to obtain a license from the FSFM to hold Russian securities on behalf of these clients and investors. If they do not obtain this license, their ‘‘nominee holder’’ status in Russia might not be recognized and therefore they may be viewed under Russian law as the beneficial owner. Because Russian law may not recognize ADS holders as beneficial owners of the underlying shares, it is possible that an ADS holder could lose all its rights to those shares if the depositary’s assets in Russia are seized or arrested. In that case, an ADS holder would lose all the money invested in our ADSs.

Russian law may treat the depositary as the beneficial owner of the shares underlying the ADSs. This is different from the way other jurisdictions treat ADSs. In most states of the United States, for example, although shares may be held in the depositary’s name or to its order, making it a ‘‘legal’’ owner of the shares, the ADS holders are the ‘‘beneficial,’’ or real owners. In those jurisdictions, an action against the depositary, the legal owner, would not result in the beneficial owners losing their shares. Russian law may not make the same distinction between legal and beneficial ownership, and a court may only recognize the rights of the depositary in whose name the shares are held, not the rights of ADS holders, to the underlying shares. Thus, in proceedings brought against a depositary, whether or not related to shares underlying ADSs, Russian courts may treat those underlying shares as the assets of the depositary, subject to seizure or arrest. We do not know yet whether the shares underlying the ADSs may be seized or arrested in Russian legal proceedings against a depositary. In the past, a lawsuit was filed against a depositary bank seeking the seizure of various Russian companies’ shares represented by ADSs issued by that depositary. In the event that this type of suit were to be successful in the future, and if the shares underlying our ADSs were to be seized or arrested, the ADS holders involved would lose their rights to such underlying shares.

Given that under Russian law the depositary may also be viewed as the owner of the shares underlying the ADSs, the depositary may need to comply with various Russian legal requirements regarding aggregate share ownership in a Russian company. For example, under Russian law, a person must receive the prior approval of the Federal Antimonopoly Service, a successor to the Russian Ministry for Antimonopoly Policy and Support of Entrepreneurship, before holding more than 20% of a company the size of Tatneft. As of March 31, 2006, Bank of New York held approximately 24.5% of our Ordinary Shares.

You may have limited recourse against us and our officers and directors because we conduct our operations outside the United States and all of our officers and directors reside outside the United States

Our presence outside the United States may limit your legal recourse against us. We do not have any presence in the United States and are incorporated under the laws of the Russian Federation. All of our directors and executive officers reside outside the United States. All or a substantial portion of our assets and the assets of our officers and directors are located outside the United States. As a result, you may not be able to effect service of process within the

United States upon us or on our officers and directors. Similarly, you may not be able to obtain or enforce U.S. court judgments against us, our officers or directors, including actions based on the civil liability provisions of the federal securities laws of the United States. In addition, it may be difficult for you to enforce liabilities predicated upon U.S. securities laws in original actions brought in courts in jurisdictions outside the United States.

There is no treaty between the United States and the Russian Federation providing for reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters. Similarly, you may not be able to obtain or enforce foreign judgments against us on the same basis. These limitations may deprive you of effective legal recourse for claims related to your investment in our ADSs.

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The deposit agreement provides for controversies, claims and causes of action brought thereunder by any party thereto against us to be settled by arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association, provided that any controversy, claim or cause of action relating to or based upon the provisions of the federal securities laws of the United States or the rules or regulations promulgated thereunder may, but need not, be submitted to arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However, it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors, Russian courts' inability to enforce such orders, and corruption.

You may not be able to benefit from the United States-Russia double tax treaty

The Russian tax rules applicable to U.S. holders of our ADSs are characterized by significant uncertainties and by an absence of interpretive guidance. Russian tax authorities have not provided any guidance regarding the treatment of ADS arrangements, and there can be no certainty as to how the Russian tax authorities will ultimately treat those arrangements. In particular, it is unclear whether Russian tax authorities will treat U.S. holders as the beneficial owners of the underlying shares and dividends and other proceeds relating to the underlying shares and, therefore, persons entitled to the underlying shares, for the purposes of the United States-Russia double tax treaty. If the Russian tax authorities do not treat U.S. holders as the beneficial owners of such dividends and proceeds, then the U.S. holders would not be able to benefit from the provisions of the United States-Russia double tax treaty. In this event, dividends paid to U.S. holders generally will be subject to Russian withholding tax at a rate of 15% for holders that are legal entities and 30% for individual holders rather than the reduced rate of 5% for corporate legal entities owning at least 10% or more of our outstanding voting shares and the rate of 10% in other cases under the United States-Russia double tax treaty. See ''Item 10—Additional Information—Taxation.''

Other Risks

Terrorist activity and global instability could have an adverse effect on our business and share price

On September 11, 2001, terrorist attacks were carried out against multiple targets in the United States causing the loss of many lives and extensive property damage. These events and their aftermath have had a significant effect on international financial and commodities markets. Any future acts of terrorism of such magnitude could have an adverse effect on the international financial and commodities markets and the global economy.

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ITEM 4—INFORMATION ON THE COMPANY

BUSINESS OVERVIEW

Tatneft is one of the largest producers of crude oil in Russia. Substantially all of our production and other operations are located in Tatarstan, a republic of Russia situated between the Volga River and the Ural Mountains and located approximately 750 kilometers southeast of Moscow. We currently hold most of the exploration and production licenses and produce over 80% of the crude oil produced in Tatarstan. As of January 1, 2004, our total proved reserves of crude oil were approximately 836.6 million tons (5,959 mmbbl) and as of January 1, 2005, our total proved reserves of crude oil were approximately 814.4 million tons (5,801.1 mmbbl). We revised our estimate of the net oil reserves as of January 1, 2005, as set out in the Revised Reserves Report. See ''Exhibit 15.1—Report of Reserve Consultants, Miller and Lents, Ltd., dated March 20, 2006'' and ''—Exploration and Production.'' In addition to crude oil production, in recent years we have diversified our operations by building up our refining capabilities, developing a network of retail service stations, creating a petrochemicals holding division centered around one of Russia's largest tire producers Nizhnekamskshina and providing banking services through Bank Zenit and AB Bank Devon-Credit (''Bank Devon-Credit''). In April 2005, our wholly-owned subsidiary, Tatneft Oil AG, sold its 26.75% stake in Bank Zenit to three companies acting for the benefit of certain beneficiaries of Urals Energy NV (''Urals Energy''). This transaction had the effect of reducing our ownership interest in Bank Zenit from 52.70% to 25.95%. In May 2006 we acquired 48.92% of newly issued shares in Bank Zenit, thus increasing our stake to 39.73%. In December 2005, we sold all of our shares, 92%, in Bank Devon-Credit to Bank Zenit. See Appendix A to this report. Our sales and other operating revenues were RR206,782 million, RR155,818 million and RR146,328 million for the years ended December 31, 2004, 2003 and 2002, respectively. We employed approximately 80,560 persons as of December 31, 2005.

HISTORY AND DEVELOPMENT

Tatneft is an open joint-stock company organized under the laws of Russia and Tatarstan. Our principal business is to explore for, develop, produce and market crude oil. Our registered office is located at 75 Lenin Street, Almetyevsk, Tatarstan 423450, Russian Federation (telephone: 7-8553-250-700). Our main offices and virtually all of our administrative staff are located in Almetyevsk, a city located approximately 950 kilometers southeast of Moscow and 250 kilometers southeast of Kazan, the capital of Tatarstan. Our agent for service of process in the United States in connection with any suit or proceeding arising out of, or relating to, our Ordinary Shares, ADSs or the deposit agreement pursuant to which they were issued is Puglisi & Associates, located at 850 Library Avenue, Suite 204, P.O. Box 885, Newark, Delaware 19715, United States of America.

Tatneft is the legal successor to the Soviet-era production association ''PA Tatneft,'' which was formed in 1950, along with several other oil production-related state enterprises in Tatarstan. As part of the process of privatization of state-owned enterprises following the dissolution of the Soviet Union, substantially all of the assets of these enterprises were transferred to us, and we became an open joint-stock company in January 1994. For the history of our privatization, see ''Item 7—Major Shareholders and Related Party Transactions—Major Shareholders—Shareholding Structure.''

The first oil was discovered in Tatarstan in 1943, and Romashkinskoye oil field, the largest oil field in Tatarstan, was discovered in 1948. PA Tatneft received the right to develop the Romashkinskoye field in 1950 when PA Tatneft was formed. It was soon thereafter given the right to develop what is now Tatneft's second largest oil field, the

Novo-Yelkhovskoye field. Tatneft still produces most of its crude oil from these two fields. PA Tatneft subsequently also acquired licenses to numerous smaller fields in Tatarstan. See ‘‘—Exploration and Production’’ under this Item.

Tatneft’s core exploration and production activities are currently organized along geographic lines, although a number of exploration and production support functions have been centralized. Our core exploration and production activities are carried out by 11 units known as the Oil and Gas Production Departments, or by their Russian acronym ‘‘NGDUs.’’ Two of these units are expected to be merged into two other existing units in 2006. Each NGDU is responsible for the exploration and production of crude

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oil on specified sections of oil fields. Each NGDU historically combined exploration and production activities (production wells, oil preparation and storage units, maintenance units, automation shops and research units) with exploration and production support capabilities (transport and construction) and certain ‘‘social’’ activities (housing and agriculture). As part of a reorganization program, our exploration and production support capabilities and certain social assets have been transferred into separate service companies (in the areas of drilling, well rehabilitation, production services, construction and assembly) and other companies (e.g., road construction and maintenance companies and collective farms). Certain other social assets are being transferred to local authorities (e.g., housing) in order to allow Tatneft to focus on its core exploration and production functions. We intend to retain control over the new exploration and production service companies but may not retain control over the other companies. See ‘‘—Corporate Reorganization’’ under this Item for more information.

Our other business segments are refining and marketing (including our interests in the Nizhnekamsk oil refinery (until September 2005) and the Kichuyi oil refinery, our gas production, transportation and refining division Tatneftegaspererabotka, interests in oil trading companies and gas stations), petrochemicals (including our interests in one of the largest Russian tire producers, Nizhnekamskshina, and its technologically-integrated enterprises and management company OOO Tatneft-Neftekhim (‘‘Tatneft-Neftekhim’’)) and banking operations (including, until December 2005, majority stakes in Bank Devon-Credit, an Almetyevsk-based retail and commercial bank that serves southeastern Tatarstan, and, until April 2005, Bank Zenit, the sixteenth largest Russian bank by net profit, the twentieth by net assets and the twenty-fourth by capital as of April 1, 2006, as calculated under RAR, according to Kommersant: Money magazine, a leading Russian business weekly). For a further discussion of our banking operations see Appendix A to this annual report.

We have a number of oil production joint ventures. These include ZAO TATEX (‘‘TATEX’’), which installs Tatneft’s unique vapor recovery system in its holding tanks and produces small amounts of crude oil from one field using horizontal drilling techniques; ZAO Tatoilgas (‘‘Tatoilgas’’), which specializes in the recovery of oil from sludge and operates several small oil fields in Tatarstan; and ZAO Kalmtatneft (‘‘Kalmtatneft’’), a small oil company engaged in crude oil exploration and production activities in the Republic of Kalmykia, Russia, which we and the regional oil company Kalmneft established in May 2000, and in which we own 50%. In addition, we have entered into a joint operations agreement with ZAO Ritek-Vnedreniye (‘‘Ritek-Vnedreniye’’), pursuant to which Ritek-Vnedreniye operates the third block of the Pavlovskoye area of the Romashkinskoye oil field. We are entitled to 60% of the economic benefit from Ritek-Vnedreniye’s production from this area.

In 2001, we increased our shareholdings in Nizhnekamskshina from 34.6% to 51.7%, in Bank Devon-Credit from approximately 27% to approximately 51%, in ZAO IFK Solid (‘‘IFK Solid’’), a Russian broker-dealer, from approximately 55% to approximately 59.7% and in OAO Bank Ak Bars (‘‘Bank Ak Bars’’), the largest private bank registered in the Russian Federation and located in the Republic of Tatarstan in terms of assets and number of retail customers, from approximately 10% to approximately 13%. In the second quarter of 2001, we acquired approximately 40% of the shares of the Minnibaevsk Gas Refinery, which we had held as collateral for a loan to the government of Tatarstan. We also acquired an approximately 27% interest in OAO Health Recovery Complex Zelenaya Rostsha, a company operating a resort and recovery center on the shores of the Black Sea, and established ZAO Yarpolymermash-Tatneft (''Yarpolymermash-Tatneft''), formed on the basis of the assets of the Yaroslavl Polymer Machine Plant, to produce equipment for processing materials for tire production. In the course of 2001, our major divestitures included the sale of our 5.5% stake in OAO Norsi Oil, the operator of the Norsi oil refinery in Nizhny Novgorod. In December 2001, our joint venture OAO Nizhnekamsk Oil Refinery entered into an agreement with TAIF for the lease of the CDU, a vital asset for the Nizhnekamsk oil refinery operations.

In 2002, a reverse stock split carried out by the Minnibaevsk Gas Refinery resulted in our ownership of 100% of its outstanding shares, the minority shareholders having been cashed out. Subsequently, we transferred the assets of Minnibaevsk Gas Refinery into our newly-formed unincorporated gas production, transportation and refining division Tatneftegaspererabotka. We also increased our stake in Bank Devon-Credit to approximately 92.2% and in Bank Ak Bars to approximately 17.9% and divested our approximately 12.8% interest in OAO Tatfondbank.

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In 2003, we increased our stake in Nizhnekamskshina from 51.7% to 76.01% following a new share issuance by Nizhnekamskshina. We also raised our ownership interest in Bank Ak Bars from approximately 17.9% to approximately 21.77% and in ZAO Chulpan (''Chulpan''), an insurance company, from 79.6% to 95.8%, divested our interests in 21 agricultural companies and sold our 75.01% stake in OAO Tatincom-T (''Tatincom-T''), a regional cellular telecommunications company. In the same period we allowed our stake in Tatnefteotdacha, a joint venture that specializes in recovering hard-to-extract oil and increasing oil production efficiency, to decline from 14.5% to 3.5% following an additional share issuance in which we did not participate. In the beginning of 2003, we also increased our ownership in OAO Finansovaya Lizingovaya Kompania, a leasing company, from 12% to 21%. In October of 2003, we sold our interest in this company for RR676 million, resulting in a loss of RR99 million. In 2003, TAIF brought a case before the arbitrazh court of the Tatarstan Republic claiming the return of the CDU leased to OAO Nizhnekamsk Oil Refinery because of alleged breaches by OAO Nizhnekamsk Oil Refinery of several provisions of the lease agreement. On October 6, 2003 the arbitrazh court of the Tatarstan Republic ruled in favor of TAIF. In December 2003, together with the government of Tatarstan, OAO Tatneftekhiminvest-Holding, a holding company of the government of Tatarstan, Nizhnekamskneftekhim, LG International Corp. and LG Engineering and Construction Corp., we signed a letter of intent contemplating future joint work on the construction of an oil refining and petrochemical complex in Tatarstan. We subsequently formed OAO TKNK (''TKNK'') in order to carry out feasibility studies and arrange for financing of the construction of the oil refining and petrochemical complex. We held a 45.5% interest in TKNK, Nizhnekamskneftekhim held a 36.4% interest, Svyazinvestneftekhim held a 9.1% interest and LG International Corp. held a 9.1% interest.

In 2004, we acquired 33.3% of OAO Kalmneftegaz (''Kalmneftegaz''), which holds four licenses to explore and develop four oil fields in Kalmykia and two licenses for geological survey in Kalmykia. We also acquired 51% of ZAO Abdulinskneftegaz, which holds one geological survey license for oil fields in the Orenburg region. Over the course of 2004, we have acquired and established a number of oil production subsidiaries, such as OOO Tatneft-Abdulino (''Tatneft-Abdulino''), OOO Tatneft Severny (''Tatneft Severny'') and ZAO Tatneft-Samara (''Tatneft-Samara''). We own 75.1% in each of Tatneft-Abdulino and Tatneft Severny, which hold one and two subsoil licenses, respectively, for the exploration of hydrocarbon materials in deposits in the Orenburg region. Tatneft-Abdulino and Tatneft Severny each also received an additional license for the exploration of hydrocarbon materials in deposits in the Orenburg region in a license tender held on March 29, 2005. We also hold a 74.9% interest in Tatneft-Samara, which holds three subsoil licenses for the exploration of hydrocarbon deposits in the Samara region and recently received an additional two licenses for the exploration and production of hydrocarbon materials in deposits in the Samara region in a license tender held on February 22, 2005.

In January 2004, the instance of appeals of the arbitrazh court of the Tatarstan Republic upheld the decision of the arbitrazh court of the Tatarstan Republic to return to TAIF the CDU leased by OAO Nizhnekamsk Oil Refinery. As a consequence, OAO Nizhnekamsk Oil Refinery returned the CDU to TAIF. In September 2004, TKNK entered into a non-binding engineering, procurement and construction works arrangement with LG International Corp. and LG Engineering and Construction Corp. that sets forth the basic terms by which the LG entities are to carry out engineering, procurement and construction work on an oil refinery and petrochemical complex in Nizhnekamsk. TKNK and the LG entities entered into a further non-binding engineering, procurement and construction work arrangement in December 2004 that provided for the construction of certain refining equipment in Nizhnekamsk. In May 2004, Tatneft provided TKNK with a U.S.$4.3 million loan for financing feasibility studies and services as part of developing the oil refining and petrochemical complex. In addition, Tatneft has invested RR40 million in the first phase of the construction of the oil refining plant.

During 2004, we raised our ownership interest in Bank Zenit from 50% plus one share to 52.7%. We also raised our ownership interest in Bank Ak Bars from 21.77% to 29.46%. Our participation in Chulpan decreased in 2004 from 95.8% to 45.5%, as a result of two share issuances undertaken by Chulpan, in which we did not participate. In accordance with our expansion strategy, we concluded in 2004 an agency agreement with Integrated Petroleum Services Co. to market Tatneft's technologies and services in Oman.

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We also continued our program of transferring our social assets to public ownership. We transferred to public ownership assets with a net book value of RR455 million, RR2,162 million and RR1,293 million in the years ended December 31, 2004, 2003 and 2002, respectively.

We have not been the subject of any public takeover offers by third parties in the past three years.

Developments in 2005 and 2006

Our capital expenditures for 2005 (exclusive of acquisitions) were approximately RR18,000 million, which were financed through operating cash flows and debt. Our most significant current capital commitment for 2005 was made on production development, drilling development and other equipment to maintain current crude oil production. We have also made significant investments in the Nizhnekamsk oil refinery.

Production

Over the course of 2005 we have acquired and established a number of oil production subsidiaries and joint-ventures, including ZAO Severgeologia (''Severgeologia'') and ZAO Severgazneftеprom (''Severgazneftеprom''), with a share ownership of 50% of each of these two entities. Severgeologia and Severgazneftеprom each hold two geological survey licenses for oil fields in Nenetsk Autonomous District. We, along with Rosneft, which owns the remaining portion in these entities, have developed a geological exploration program for 2005 to 2007. While at this stage we cannot predict the level of capital investment that may be required of us in connection with Severgeologia and Severgazneftеprom, preliminary studies suggest that the total necessary investment for the exploration and production will amount to RR1.4 billion. In 2005, we also acquired 70% of OAO Ilekneft (''Ilekneft''), which holds one production license and two combined exploration and production licenses in the Orenburg region.

Oil Refining and Petrochemical Plants

In early September 2005, we sold to TAIF our share in the production assets of OAO Nizhnekamsk Oil Refinery, including the refining units, for approximately U.S.$315 million. While these production assets have not been physically removed from the Nizhnekamsk oil refinery, TAIF established a new legal entity to which it transferred these assets. Following this sale, OAO Nizhnekamsk Oil Refinery was left without production assets, and is now in the process of liquidation. See ''Item 3—Key Information—Risk Factors—Risks Relating to the Company—We are dependent on oil refineries outside of Tatarstan.'' In October 2005, we entered into a long-term supply contract with TAIF in order to supply up to 650,000 tons per month of crude oil to TAIF at market price to be refined by the Nizhnekamsk oil refinery.

In accordance with the decision of the Security Counsel of the Republic of Tatarstan and subsequent decisions of our Board of Directors, in September 2005, together with Svyazinvestneftekhim, we founded ZAO Nizhnekamsk Oil Refinery to build an oil refining and petrochemical complex in Nizhnekamsk. We directly own 40% of the new company and Svyazinvestneftekhim owns 9%. The remaining 51% is indirectly held by International Petro-Chemical Growth Fund Limited (''IPCG Fund''), an open-ended investment company incorporated in Jersey, Channel Islands. The new complex will comprise an oil refinery with a refining capacity of 7 million tons of oil per year, construction of which is expected to be completed in 2008, a deep refining unit with a fuel oil capacity of 3.5 million of tons, construction of which is expected be completed in 2009, and a petrochemical plant producing products based on aromatics that is projected to be opened in 2010. The initial construction works (including the preparation of the site, etc.) commenced in September 2005. The total projected cost of this new refinery and petrochemical complex is approximately U.S.$3.2 billion. As of December 31, 2005, our investments in ZAO Nizhnekamsk Oil Refinery amounted to approximately RR240 million, and our projected investments for 2006 are approximately RR6.5 billion. These funds have been and will continue to be lent to ZAO Nizhnekamsk Oil Refinery and used by the latter to finance initial construction phase as well as to cover certain administrative and operational expenses. We expect ZAO Nizhnekamsk Oil Refinery to repay these loans to us once the project finance funding for the project has been obtained by ZAO Nizhnekamsk Oil Refinery from outside financiers. The project financing is expected to be opened in 2007. In May 2006, we retained BNP Paribas to advise us on the possible structure of the financing of the new refinery

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complex. In connection with this project, we applied for financial support for the construction and upgrade of existing infrastructure relating to the new Nizhnekamsk refinery (such as pipelines and railways) to the Ministry of Economic Development and Trade of the Russian Federation, which oversees the Investment Fund of The Russian Federation. On June 14, 2006 the State Investment Commission made a preliminary recommendation to the Government of the Russian Federation to approve financial support in the amount of RR16.5 billion. The final decision is expected to be made by the Government of the Russian Federation in July 2006.

In June 2005, all work on the TKNK project was suspended as the joint venture parties could not reach an agreement with respect to its financing and as we designed the project to build a new refinery complex in Nizhnekamsk.

Operations Outside Tatarstan

In May 2005, we registered a joint venture with Omani company Hamed International Marketing and Services Co. LLC to promote our products and services in Oman and other countries in the region. In 2005, we held discussions with the state-owned Petroleum Development Company of Oman regarding local well-casing technology for problem wells. In 2005, we also signed an agreement with an Omani firm for the development of special-sized well casings.

In October 2005, we, among nineteen other international oil companies, received a permit to explore and develop petroleum in the Gedames basin located in the central part of Libya, which is the site where Africa's largest known crude-oil reserves are located. In December 2005, we entered into an exploration and production sharing agreement with the National Oil Corporation of Libya (''NOCL'') to that effect. We currently expect that exploration works at this project will take three to four years, and we anticipate that our initial exploration and development expenses in this project will be approximately U.S.$23 million through 2008. At this stage we cannot predict the level of reserves on these fields and the level of capital investment that may be required from us in connection with the development of any reserves that may be discovered. In accordance with the applicable Libyan laws and regulations, development and production activities will be carried out through a joint venture. Although the joint venture agreement has not been signed yet, the form of such agreement was approved in a schedule to the exploration and production sharing agreement signed with NOCL in 2005 as described above.

In March 2005, we concluded an agreement with the government of Syria and the Syrian Oil Company according to which we are to explore for oil in eastern Syria and to develop a field on the basis of a 25-year production sharing agreement. We are required to spend at least U.S.$7 million on exploration activities over three years, but we may extend this for two additional two-year periods, provided that we make additional minimum expenditures of U.S.$6.3 million and U.S.$12.8 million, respectively. We currently conduct no exploration or production activities in Syria as no agreement has been reached on the financing of the joint venture for the development of the field.

We have opened a representative office in Iran, and in February 2005 the government of Tatarstan and the government of Iran concluded an agreement pursuant to which we are expecting to register a joint venture with an Iranian entity in order to participate in various projects in Iran, including tenders for the development of oil fields. Our participation in this venture and the terms of any such participation have not yet been finalized. Our final decision as to our participation in Iranian projects will take into account the possible international sanctions imposed on Iran.

Banking Operations

In April 2005, our wholly-owned subsidiary Tatneft Oil AG sold its 26.75% stake in Bank Zenit to three companies acting for the benefit of certain beneficiaries of Urals Energy. This transaction had the effect of reducing our ownership interest in Bank Zenit to 25.95%. In May 2006, we acquired 48.92% of newly issued shares in Bank Zenit, as a result of which our total shareholding in Bank Zenit currently is 39.73%.

In 2005, we increased our shareholding in Bank Ak Bars to 29.98% and in 2006 we further increased it to 32.27%.

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In December 2005, we sold all of our shares in Bank Devon-Credit, representing 92% of the total outstanding shares of Bank Devon-Credit, to Bank Zenit. Prior to this sale, Bank Zenit owned 3.2% of the shares of Bank Devon-Credit.

As a result of the sale of a significant part of our participation in Bank Zenit and of all our participation in Bank Devon-Credit, we no longer consider our banking activities to be significant to our operations. For more comprehensive information about our sale of the shares of Bank Zenit and Bank Devon-Credit, see Note 22 to our audited consolidated financial statements included in this annual report.

Other Developments

On December 23, 2005, our subsidiary Tatneft Oil AG acquired participation shares with the total value of U.S.$394.4 million in an open-ended investment company IPCG Fund, incorporated in Jersey, Channel Islands, by contributing 116 million ordinary shares of Tatneft, treasury shares of the Group, and U.S.$1 million in cash into the fund. IPCG Fund invests its assets primarily in equity and debt of companies operating in, or whose activities are connected to, the Russian Federation in general, and in or to the Republic of Tatarstan, in particular, with a priority for entities operating in the oil and chemicals industry and, to a lesser extent, the banking sector. IPCG Fund's investment objective is to achieve medium and long-term capital appreciation of its investments. IPCG Fund is managed by MARS Capital Management Limited, a company regulated by Jersey Financial Services Commission. IPCG Fund is an indirect shareholder of ZAO Nizhnekamsk Oil Refinery and is expected to participate in the financing of the new refinery and petrochemical complex, including through participation of additional investors in the fund.

In late December 2005, we sold all of our shares in IFK Solid, representing 59.7% of the total outstanding shares of IFK Solid. This company was not considered as material to our financial condition or results of operations.

In August 2005, our wholly-owned subsidiary Tatneft Oil AG acquired from a third party two land plots in the city of Kazan, Tatarstan, of a total size of approximately 2 million square meters for U.S.$46.6 million. The acquisition was made on market terms for investment purposes.

In March-April 2006, we acquired 100% of the shares of OAO LDS-1000, the owner of the ice hockey arena in the city of Kazan, for RR2.1 billion.

In March 2006, we entered into a general cooperation agreement with OAO Avtovaz (''Avtovaz''), a large Russian car manufacturer. Pursuant to this agreement, we will supply Avtovaz with petrochemical complex products, including synthetic motor oils and high quality gasoline and tires manufactured by Nizhnekamskshina. This agreement will remain in force for three years and it will be automatically extended for each subsequent year, unless the parties agree to its termination.

In July 2005, we entered into a six-month crude oil sales contract with Ukrtatoil Limited to supply 3.5 million tons in total at market price.

ORGANIZATIONAL STRUCTURE

General

Our operations are currently divided into the following main segments:

- exploration and production;
- refining and marketing;
- petrochemicals; and
- banking.

Our exploration and production segment is the largest segment, and comprises the majority of our structural subdivisions. It consists of 11 NGDUs (two of these units are expected to be merged into two

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other existing units in 2006); a natural gas production, transportation and refining subdivision; three well repair and reservoir oil yield improvement subdivisions; a chemical production subdivision (Neftekhimservis); two pumping equipment repair centers; a research and development institute; and subdivisions responsible for geological exploration, communications and information support, drilling fluid delivery, security and logistics, operations outside Tatarstan and other matters. This segment also includes service subsidiaries over which we continue to retain control.

Our refining and marketing segment consisted of our interests in OAO Nizhnekamsk Oil Refinery (until September 2005) and the Kichuyi oil refinery and a minority stake in ZAO Ukrtatnafta (''Ukrtatnafta''); OOO Tatneft-Centernefteproduct and OOO Tatneft - Moskvanefteproduct, management companies for Tatneft-branded gas station network; and certain other oil trading and ancillary companies.

Our petrochemicals segment has been consolidated into a management company, Tatneft-Neftekhim, which manages Nizhnekamskshina and the companies technologically integrated with it, including OAO Nizhnekamsk Industrial Carbon Plant (''Nizhnekamsk Industrial Carbon Plant''), Yarpolymermash-Tatneft and Nizhnekamsk Mechanical Plant. OOO Tatneft-Neftekhimsnab and OOO Trading House Kama are responsible, respectively, for procuring supplies and marketing products produced by the companies of this segment.

Bank Zenit (until April 2005) and Bank Devon-Credit (until December 2005) constituted our banking segment. We also hold stakes in a number of other financial services companies.

We have non-core assets, such as social and cultural facilities, road construction companies, transportation companies, telecommunications companies and other ancillary enterprises, most of which we plan to sell in the course of our continuing reorganization.

Joint Ventures, Subsidiaries and Associated Companies

We have a number of oil production joint ventures. These include TATEX, in which we own 50% and which is accounted for under the equity method in our consolidated financial statements, Kalmtatneft, in which we own 50% and which is accounted for under the equity method in our consolidated financial statements, and Tatoilgas, in which we currently own 50% but maintain management control and which is fully consolidated. We are also party to a joint operations agreement with Ritek-Vnedreniye pursuant to which Ritek-Vnedreniye operates an oil field that is licensed to us, and we provide various services to Ritek-Vnedreniye in connection with its operations. We are entitled to 60% of the economic benefit from Ritek-Vnedreniye's operations of this field.

Currently, oil production by the joint ventures is limited. We believe that the primary benefits of the joint ventures are their contribution to us of new technologies and techniques that increase productivity and well recoverability and the introduction of new approaches to improve our organization and efficiency.

With the exception of Tatneft Oil AG and its subsidiaries, including our Western European marketing agent Tatneft Europe AG (''Tatneft Europe''), which are incorporated in Switzerland, all of our significant joint ventures, subsidiaries and associates are incorporated in the Russian Federation.

The joint ventures are:

- TATEX. TATEX is a joint venture with the U.S. company Texneft (a subsidiary of Devon Energy Corp.) in which we each held a 50% interest as of December 31, 2004. TATEX has installed oil vapor recovery systems on all of Tatneft's oil holding tanks to capture natural gas; TATEX subsequently sells this natural gas. TATEX has also obtained rights to the Onbiyskoye oil field, previously developed by Tatneft, where TATEX produces oil. In 2005, TATEX produced approximately 492,100 tons (3.50 mmbbl) of oil, 492,633 tons (3.50 mmbbl) of oil in 2004 and 486,141 tons (3.46 mmbbl) of oil in 2003.
- Tatoilgas. At December 31, 2004, we owned 50% of the voting shares of Tatoilgas, a joint venture with the German firm Mineralol-Rohstoff-Handel, GmbH. Tatoilgas recovers oil from sludge and holds production licenses for two small oil fields in Tatarstan. In 2005, Tatoilgas produced approximately 267,691 tons (1.91 mmbbl) of oil, and 257,198 tons (1.83 mmbbl) of oil in 2004. Tatoilgas is consolidated in our consolidated financial statements.

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- Kalmtatneft. We own 50% of Kalmtatneft, which holds four licenses to explore and develop four oil fields in Kalmykia.

We control a number of subsidiary companies and have minority stakes in a number of other companies, including those described below. Except for Nizhnekamskshina and Bank Zenit (until April 2005), we do not believe that any of these companies is material to our financial condition or results of operations.

- Nizhnekamskshina. We purchased approximately 34.6% of Nizhnekamskshina in 2000 from the Tatarstan government as part of our strategy to become a vertically integrated oil company. In 2001, we increased our stake to 51.7% and Nizhnekamskshina was consolidated in our consolidated financial statements from September 30, 2001. In 2003 we increased our stake to 76.01% following an additional share issuance by Nizhnekamskshina. Nizhnekamskshina is one of the largest tire manufacturing plants in Russia, and supplies products to both domestic and foreign markets. The Tatarstan government holds a Golden Share in Nizhnekamskshina that permits it to veto certain board and shareholder decisions and to appoint representatives to Nizhnekamskshina's management bodies.
- Bank Zenit. Until April 2005, we owned 52.7% of Bank Zenit, a Russian commercial bank founded in December 1994 and based in Moscow, having increased our holdings from 50% plus one share in 2004. Bank Zenit has branches in Rostov-on-Don, Nizhny Novgorod, Almetyevsk, Gorno-Altaisk, St. Petersburg, Kemerovo and Kursk, a representative office in Kazan and additional offices in Kazan and Nizhnekamsk. In April 2005, our wholly-owned subsidiary Tatneft Oil AG sold its 26.75% stake in Bank Zenit to three companies acting for the benefit of certain beneficiaries of Urals Energy. This transaction had the effect of reducing our ownership interest in Bank Zenit to 25.95%. In May 2006, we acquired 48.92% of newly-issued shares in Bank Zenit, increasing our current shareholding to 39.73%. See ''Appendix A—Tatneft's Banking Operations.''
- IFK Solid. As of December 31, 2004, we owned approximately 59.7% of IFK Solid. IFK Solid is a market maker in our shares in the Russian equity markets and also acted as a financial advisor and agent to us for transactions in the Russian equity markets and in connection with our stock option plan. See ''Item 9—The Offer and Listing—Markets—Activities of the Company and its Affiliates in the Market'' and ''Item 6—Directors, Senior Management and Employees—Compensation.'' In late December 2005, we sold the totality of our stake in IFK Solid.
- Bank Ak Bars. We currently own approximately 32.27% of Bank Ak Bars.

- Bank Devon-Credit. As of December 31, 2004, we owned approximately 92% of Bank Devon-Credit, a Russian commercial and retail bank. Bank Devon-Credit serves Tatneft and much of the local population in Almetyevsk and the southeast of Tatarstan through a network of 13 branch offices. We sold the totality of our stake in Bank Devon-Credit in December 2005 to Bank Zenit.
- Tatneft, Solid & Co. Tatneft is both a general partner and a limited partner in Tatneft, Solid & Co., a limited partnership set up to purchase our Ordinary Shares. See ‘‘Item 9—The Offer and Listing—Markets—The Ordinary Share Market.’’
- Chulpan. As of December 31, 2004, we owned approximately 45.5% of Chulpan, an Almetyevsk-based company that provides voluntary medical and property insurance services. Our participation in this company was diluted in 2005 as a result of two share issuances undertaken by Chulpan, in which we did not participate.
- Marketing Agents. We have formed a number of subsidiaries that act as sales agents dedicated to working with specific refineries and markets. One of these agents, Tatneft Europe, registered in Switzerland, is one of the major offtakers of our oil. Each of the sales agents is consolidated in our consolidated financial statements.
- OAO Tatneftegeofizika. We own 88.1% of a geophysical services company, OAO Tatneftegeofizika (‘‘Tatneftegeofizika’’), which provides services in the discovery and exploration

of oil and natural gas reserves in Tatarstan, Siberia and outside of Russia (including Egypt, India, Kazakhstan, Libya and Turkey). The Tatarstan government holds a Golden Share in Tatneftegeofizika that permits it to veto certain board and shareholder decisions and appoint representatives to the company’s management bodies.
- Nizhnekamsk Industrial Carbon Plant. We own 77.1% of Nizhnekamsk Industrial Carbon Plant. Nizhnekamskshina uses the carbon plant products as raw materials, and this acquisition is part of our efforts to create a vertically integrated group.
- OAO Nizhnekamsk Oil Refinery. We hold 63% of OAO Nizhnekamsk Oil Refinery, which operated the production facilities at the Nizhnekamsk oil refinery, previously owned by us and other shareholders. In early September 2005, we sold our share in the production assets of OAO Nizhnekamsk oil refinery. Following this sale, OAO Nizhnekamsk Oil Refinery was left without production capacity, and is now in process of liquidation. See ‘‘—Refining and Marketing—Refined Products’’ under this Item and ‘‘Item 3—Key Information—Risk Factors—Risks Relating to the Company—We are dependent on oil refineries outside of Tatarstan.’’
- Yarpolymermash-Tatneft. In 2001, we formed Yarpolymermash-Tatneft, of which we currently own 51%, based on the assets of the Yaroslavl Polymer Machine Plant, to manufacture equipment for processing materials for tire production.
- Ukrtatnafta. We own 8.6% of Ukrtatnafta. Ukrtatnafta holds a 100% interest in the Kremenchug refinery in Ukraine, one of the largest refineries for high sulfur content crude oil in the CIS. The Tatarstan government holds 28.8% of Ukrtatnafta. The Ukrainian government currently owns approximately 46% of Ukrtatnafta’s shares. There is currently a dispute between the Ukrainian government and certain holding companies of Ukrtatnafta over 18% of Ukrtatnafta’s shares.

STRATEGY

Our strategic objectives are to enhance our position as a leading crude oil producer in Russia and to become an internationally recognized oil company. We seek to fulfill these objectives by (i) creating a vertically integrated oil company, (ii) maintaining production from our existing crude oil reserves base in Tatarstan, (iii) expanding and diversifying our reserves base outside Tatarstan and (iv) improving our corporate governance, through the following strategic initiatives:

Shaping and improving our structure as a vertically integrated oil company. We intend to increase our refining capacity and to expand our petrochemicals activities and retail gasoline operations in order to become a vertically integrated oil company. The government of Tatarstan, our major shareholder, is actively encouraging this approach. We believe that increasing our presence in these market sectors is the most effective strategy for mitigating the potential risks presented by possible fluctuations in global crude oil prices and demand.

We intend to continue to develop our relationships with refineries that have installed, or plan to install, the equipment necessary to convert heavy fraction high sulfur content crude oil, which constitutes a large proportion of our production, into higher-value products such as gasoline, jet fuel and diesel. As part of this strategy, in September 2005, together with Svyazinvestneftekhim, we founded ZAO Nizhnekamsk Oil Refinery to build an oil refining and petrochemical complex in Nizhnekamsk. We directly own 40% of the new company and Svyazinvestneftekhim owns 9%. The remaining 51% is indirectly held by IPCG Fund. The new complex will comprise an oil refinery with a refining capacity of 7 million tons of oil per year, construction of which is expected to be completed in 2008, a deep refining unit with a fuel oil capacity of 3.5 million of tons, construction of which is expected be completed in 2009, and a petrochemical plant producing products based on aromatics that is projected to be opened in 2010. The initial construction works (including the preparation of the site, etc.) commenced in September 2005. The total projected cost of this new refinery and petrochemical complex is approximately U.S.$3.2 billion. As of December 31, 2005, our investments in ZAO Nizhnekamsk Oil Refinery amounted to approximately RR240 million, and our projected investments for 2006 are approximately RR6.5 billion. These funds have been and will continue to be lent to ZAO Nizhnekamsk Oil Refinery and used by the latter to finance initial construction phase as well as to cover certain administrative and operational expenses. We

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expect ZAO Nizhnekamsk Oil Refinery to repay these loans to us once the project finance funding for the project has been obtained by ZAO Nizhnekamsk Oil Refinery from outside financiers. The project financing is expected to be opened in 2007. In May 2006, we retained BNP Paribas to advise us on the possible structure of the financing of the new refinery complex. In connection with this project, we applied for financial support for the construction and upgrade of existing infrastructure relating to the new Nizhnekamsk refinery (such as pipelines and railways) to the Ministry of Economic Development and Trade of the Russian Federation, which, oversees the Investment Fund of The Russian Federation. On June 14, 2006 the State Investment Commission made a preliminary recommendation to the Government of the Russian Federation to approve financial support in the amount of RR16.5 billion. The final decision is expected to be made by the Government of the Russian Federation in July 2006.

In addition to investing in our refining activities, we own a 76.01% stake in Nizhnekamskshina, one of the largest tire-producing factories in the Russian Federation, located in the city of Nizhnekamsk. We also own a 77.1% share of Nizhnekamsk Industrial Carbon Plant, a major supplier of technical carbon to tire manufacturers in Russia, including Nizhnekamskshina. We also formed Yarpolymermash-Tatneft, of which we own 51%, in 2001 based on the assets of Yaroslavl Polymer Machine Plant to construct equipment for processing materials for tire production. In 2000, we established control over a large producer of chemical reagents, OAO Tatneftekhimservice. We also constructed a plant in Nizhnekamsk for the production of synthetic lubricants for engines and machinery. To increase the efficiency of our petrochemicals operations, in 2002 we created the management company Tatneft-Neftekhim and transferred control over our shares in Nizhnekamskshina, Nizhnekamsk Industrial Carbon Plant, Yarpolymermash-Tatneft and other petrochemicals companies to it.

We are also currently expanding the Tatneft-controlled network of retail gasoline sales outlets both inside and outside Tatarstan, particularly in Moscow, St. Petersburg and the Moscow, Chuvashiya, Ulyanovsk, Arkhangelsk, Vladimir and Leningrad regions in Russia, as well as in Ukraine. We are conducting this expansion both directly and through our subsidiaries and affiliates. As of January 1, 2006, there were 553 Tatneft-controlled service stations throughout Russia and Ukraine, including 408 in Russia and 145 in Ukraine. Tatneft-controlled service stations sold 1 million tons of refined products in 2005. We are currently implementing a program to increase the number of our controlled service stations.

Maintain crude oil production from existing fields. In the mid-term, we plan to maintain production from our existing fields at approximately the current level, subject to the absence of significant adverse changes in taxation. We believe that this level of production will optimize the long-term value of the reserves base while generating cash flows to support our current operations. In addition, by maintaining production from our existing fields we may benefit from the introduction of a differentiated unified natural resources production tax that would apply a lower tax rate to oil companies with mature fields. See ''—Overview of the Russian Oil industry—Current System of Oil-Related Taxes and Payments—The Unified Natural Resources Production Tax'' under this Item. We expect to continue to implement our well rehabilitation program to increase the use of secondary and tertiary recovery methods in order to maintain production levels. Our ability to carry out these programs will be limited by the extent to which we are able to provide the necessary financing. We also are actively pursuing opportunities to use new technologies in order to maximize the recovery from our existing reserves base. See ''Item 4—Information on the Company—Exploration and Production.''

We are currently exploring bitumen reserves in Tatarstan, with a view to begin in 2007 the production of bitumen from these reserves. In order to drill these reserves, we are using Steam Assisted Gravity Drainage Solutions-based technology. We will proceed to the development of the bitumen production only if this production proves economically viable. In particular, the production of bitumen is currently subject to a significant tax burden. Taxation of bitumen production may be revised by the new tax law introducing a differentiated rate for the unified natural resources production tax and designed to stimulate development of new oil fields in certain regions. See ''Item 4—Information on the Company—Exploration and Production.''

Expansion of reserves base outside Tatarstan. We intend to expand and diversify our reserves base by gaining access to reserves outside Tatarstan, particularly in Kalmykia, the Ulyanovsk, Samara, Orenburg, Saratov and Murmansk regions, Astrakhan, and the Chuvash Republic. We intend selectively

to establish strategic alliances to develop and operate oil fields in order to facilitate this process. Outside the Russian Federation, we participate or intend to participate in projects in Oman, Libya, Iraq, Syria and Iran, subject to compliance with applicable international sanctions regimes.

Improving our corporate governance. We are seeking to improve our corporate governance in accordance with Russian and international standards, such as the Principles of Corporate Governance of the Organization for European Cooperation and Development and the model Code of Corporate Conduct approved by the Russian Government. Among the areas we are trying to improve are the transparency of financial activity, informational transparency, responsibility to shareholders and corporate social responsibility. Steps taken in recent years towards improving our corporate governance have included establishing the Audit Committee, Disclosure Committee and Corporate Governance Committee, progressive implementation of non-financial modules of the SAP R/3 corporate management system and divestiture of non-core assets.

However, Ernst & Young, our independent auditor, and PricewaterhouseCoopers, our independent auditor until 2003, have identified weaknesses in our control environment. For further information regarding weaknesses in our control environment, see ''Item 3—Key Information—Risk Factors—Risks Relating to the Company—Our independent registered pul accounting firm reported material weaknesses in our internal controls and we may not be able to remedy these material weaknesses or prevent future weaknesses'' and ''Item 15—Controls and Procedures.''

OVERVIEW OF THE RUSSIAN OIL INDUSTRY

The information presented herein is presented on the basis of official public documents, including, without limitation, the laws, regulations and rules cited therein, and has been presented on the authority of such documents unless otherwise indicated.

Background

Since the dissolution of the Soviet Union, the oil industry in Russia has undergone a major restructuring. Under the Soviet regime, the incentive system focused on the quantity of crude oil produced without regard to the quality of the oil. Furthermore, the domestic prices for oil and refined products were maintained by the state at artificially low levels, and the maximization of economic value played little or no part in the production decisions. As a result, producers had little incentive to produce crude oil from which a relatively high percentage of premium products could be refined, and over-production and under-maintenance of equipment were widely prevalent in the system.

The privatization of the Russian oil industry was launched by Presidential Decree No. 1403, issued on November 17, 1992, which established the federal framework for privatizing Russian oil companies and the basis for the transformation of state-owned exploration, production, refining and distribution enterprises into several major vertically integrated companies. Initially the major Russian oil companies essentially functioned as holding companies with shares in separate production, refining and distribution subsidiaries. The process of vertical integration of such companies was facilitated by a further Russian Presidential decree No. 327, issued on April 1, 1995, allowing the integration of subsidiaries into vertically integrated companies through share exchanges.

Other major Russian oil companies, such as Tatneft, also possess significant crude oil reserves and exploration and production capabilities, but do not currently possess significant independent refining capabilities. These entities were also formed through the transformation of separate state-owned exploration and production enterprises into new companies during the privatization process.

The Russian government's shares in several vertically-integrated oil companies were placed under fiduciary management with banks and other institutions in the ''loan-for-shares'' program held in late 1995 under which the institutions extended loans to the government in return for the right to manage the shares. When these loans were not repaid at maturity, the lending institutions generally acquired the right to sell the stakes they had managed to settle the loans, which has resulted in the sale of the managed shares of Surgutneftegaz, Sidanco, Sibneft and YUKOS.

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The Russian government continued to privatize Russian oil companies that remained under its control. Privatization of an 85% government stake in ONAKO was completed in 2000. In May 2002, the government sold 36.82% of Eastern Oil Company through an auction to YUKOS and sold approximately 6% in LUKOIL in December 2002. In November 2002, the government of Belarus sold its 10.83% stake in Slavneft to a consortium of shareholders of TNK and Sibneft, and the Russian government sold its 74.95% in Slavneft at an auction held in December 2002 to the same consortium. The Russian government sold its remaining 7.6% stake in LUKOIL in a privatization auction to ConocoPhillips in September 2004.

The Russian oil industry has also recently undergone a wave of consolidation. In February 2003, Alfa Group and Access-Renova (together, TNK's, ONAKO's and Sidanko's majority shareholders) and BP announced plans to combine their oil and natural gas operations in Russia and Ukraine, and this transaction was completed in August 2003. The new holding company, TNK-BP, created on the basis of the combined assets of TNK, ONAKO, Sidanco and BP's Russian assets (excluding BP's assets in the Sakhalin Islands), is owned 50% each by BP and the combined Alfa-Access-Renova and is the third-largest oil company in Russia by reserves and production. Alfa-Access-Renova and BP subsequently reached an agreement to contribute TNK's 50% stake in Slavneft to TNK-BP, and announced the completion of this transaction in January 2004. In April 2003, YUKOS and Sibneft announced that their respective shareholders had reached an agreement in principle on effecting a merger and this transaction was completed with effect in October 2003. However, pursuant to claims for back taxes against YUKOS by the Russian government, the merger has since been reversed. In December 2004, the Russian government auctioned a 76.8% stake in Yuganskneftegaz, YUKOS' largest production subsidiary, in partial settlement of back tax claims against YUKOS, to Rosneft. In October 2005, Gazprom Finance B.V., a subsidiary of Gazprom, acquired approximately 76% of the shares of Sibneft, in line with Gazprom's new long-term strategy to become a diversified energy group represented in all energy sectors. Gazprom has publicly announced plans to proceed to further acquisitions of oil assets in Russia and abroad.

The various oil companies differ as to their size of operations, geographic focus and management philosophy. Moreover, the Russian government has applied different policies with respect to such companies at various times during the privatization process. Some companies seek foreign ventures beyond neighboring countries, while others concentrate primarily on opportunities in their historical region of operations or within the former Soviet Union. In addition, Russian oil companies may acquire additional assets through mergers or other forms of combination.

Production

Oil production in Russia declined between the late 1980s and 1997. The decrease in production was attributable to many factors, including overproduction of wells during the Soviet period, lack of funds for capital expenditures to maintain operations, inefficient secondary recovery methods, insufficient transportation capacity in the pipeline system, losses during transit and reduced demand attributable to the Russian economic recession. In 1997, production increased by approximately 1.3% to approximately 305 million tons (2,172.5 mmbbl) as compared to 1996. After a slight decrease by approximately 0.8% to 303.2 million tons (2,159.7 mmbbl) in 1998, Russian crude oil production began to increase starting 1999. This rise has resulted from several factors, including relatively high world and domestic oil prices, increased rehabilitation of non-operational wells and increased export opportunities.

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The table below sets forth data on Russian oil production for the years indicated:

Year	Russian production of crude oil		Change from prior year
	(millions of tons)	(mmbbl)	
1999	305.0	2,172.5	0.6%
2000	312.7	2,227.4	2.5%
2001	336.9	2,399.7	7.7%
2002	379.6	2,703.9	12.7%
2003	421.4	3,001.6	11.0%
2004	458.8	3,268.1	8.9%
2005	470.0	3,349.2	2.5%

Source: BP Statistical Review of World Energy.

In general, reforms in regulation are now prompting the Russian oil industry to adopt commercially-oriented production practices. These reforms included the liberalization of crude oil and refined product prices and the elimination of export quotas and licensing requirements in early 1995. However, domestic pricing remained until recently significantly below world levels, hampering the ability of companies to reinvest or modernize production practices, equipment and facilities. The following table shows approximate crude oil production levels of the largest Russian oil companies in 2005, 2004, 2003 and 2002:

Company	2005[2]	2004[2]	2003[2]	2002[2]
		(millions of tons)		
YUKOS[1]	24.4	85.7	80.7	69.9
LUKOIL	87.3	84.1	78.9	75.5
TNK-BP[4][5]	74.9	70.3	43.0	37.5[3]
Surgutneftegaz	63.5	59.6	54.0	49.2
Sibneft[5]	32.8	34.0	31.4	26.3
Tatneft	25.6[6]	25.4[6]	24.9[6]	24.9[6]
Sidanco	~~(7)~~	~~(7)~~	18.6	16.3
Slavneft	24.0	22.0	18.1	16.2
Rosneft[8]	73.9	21.6	17.8	16.1
Bashneft	11.9	12.0	12.0	12.0

Source: Interfax Petroleum Report, except for Tatneft.

(1) Includes production at Yuganskneftegaz through 2004.

(2) Totals exclude the share of production of affiliated joint ventures.

(3) Including the production of ONACO.

(4) Data for periods prior to 2004 is for TNK only.

(5) Excludes production attributable to Slavneft.

(6) Including annual production attributable to our joint venture Tatoilgas, which is consolidated into our consolidated financial statements, of approximately 267,691 tons, 257,198 tons, 265,301 tons and 291,000 tons in the years ended December 31, 2005, 2004, 2003 and 2002, respectively. Including also approximately 173,783 tons (1.2 mmbbl), 173,495 tons (1.2 mmbbl), 169,193 tons (1.2 mmbbl) and 172,000 tons (1.2 mmbbl) in the years ended December 31, 2005, 2004, 2003 and 2002 respectively, produced at the third-block of the Pavlovskoye area of the Romashkinskoye oil field operated by

Ritek-Vnedreniye under a joint operations agreement with us.
(7)Included within TNK-BP starting from 2004.
(8)Includes production at Yuganskneftegaz from 2005.

Crude Oil Prices

Domestic oil prices in Russia do not reflect world levels or international supply and demand fundamentals. Constraints on exports have kept domestic oil prices below export prices and hindered a significant real increase in the domestic price of crude oil. In addition, in June 1999, the Russian government signed an agreement with leading Russian industries to impose price controls on energy,

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metals and transportation, further restricting the increase in the domestic price of crude oil. In September 2005, pursuant to a request of the Russian government, the leading Russian oil companies agreed to freeze the prices on refined products until the end of 2005. In March 2006, this freeze was extended until summer 2006. However, at times, selling crude oil domestically has been more profitable than exporting it in light of transportation costs, the taxation regime and the margins available on refined products.

Prior to 1995, Russia carried out a policy of controlling domestic oil prices and exports in order to ensure a low-cost domestic supply of crude oil. Beginning in 1995, oil prices have been liberalized by elimination of these controls. Moreover, there has been substantial liberalization of the program of mandatory sales at fixed prices to governmental authorities.

In the second quarter of 1998, domestic crude oil prices, which had been previously unaffected by the decline in world market prices, decreased significantly. This reduced the profitability of domestic crude oil sales and had a negative impact on the operations of Russian oil companies. The increase in world and domestic oil prices in the second part of 1999 significantly helped Russian oil companies to increase profitability. World oil prices have increased significantly since January 1999, when the price was approximately U.S.$10.33 per barrel, resulting in windfall profits for Russia’s major oil producers. According to the International Energy Agency, the average prices of Brent crude, an international benchmark oil, for the four years ended December 31, 2005, 2004, 2003 and 2002, were approximately U.S.$54.38, U.S.$38.22, U.S.$28.83 and U.S.$25.02 per barrel, respectively. The price of Brent crude was U.S.$69.39 per barrel at June 1, 2006. Crude oil prices increased during 2004 over the level at the end of 2003 as a result of export restrictions imposed by OPEC and certain other crude oil producing nations, including Russia, increased demand and uncertainty with respect to the situation in Iraq and the Middle East more generally. International crude oil prices also increased in 2005 as compared to 2004 resulting from an increase in global demand and the lack of spare oil production capacities, including as a result of the Hurricanes Katrina and Rita.

Domestic prices have also risen from U.S.$30 to U.S.$35 per ton in January 1999 to an average of U.S.$91.60 per ton for 2001, declining in 2002 to an average of U.S.$83.70. Domestic prices were an average of RR2,439 per ton (U.S.$82.82 at the exchange rate prevalent on December 31, 2004) in 2004 and RR5,450 per ton (U.S.$192.51 at the exchange rate prevalent on December 31, 2005) in 2005.

Crude Oil Exports

Russian oil companies have significantly increased their crude oil exports since 1991 in light of the fall in domestic demand, a substantial gap between domestic and foreign prices and the elimination of export quotas and licensing requirements. The trunk pipelines for the transport of crude oil and refined products in Russia are controlled by Transneft and OAO Transnefteprodukt (''Transnefteprodukt''), both of which are state-controlled monopoly companies. The Russian government is expected to retain control over these entities for the foreseeable future. Since September 11, 2001, the pipeline capacity, including export pipeline capacity, and terminal access have been allocated among oil producers and their parent companies in proportion to the volumes of oil produced and delivered to the Transneft pipeline system (and not in proportion only to oil production levels, as was previously the case) in the prior quarter, planned oil production in the forthcoming quarter, and total pipeline capacity. As a consequence, most producers are able to export only between 30—35% of their oil production through the Transneft system. Limitations on access to the pipeline network act as a constraint on the ability of producers to export crude oil, and limited port, shipping and railway facilities further constrain exports of crude oil. Furthermore, Russian oil companies are required to pay taxes owed to the Russian government in order to maintain their access to export pipelines and terminals. See ''—Regulation of the Russian Oil Industry—Oil and Refined Products Transportation Regime'' under this Item. Although there are Russian government-sponsored and private programs to improve pipeline and port capacity, it does not appear likely that the situation will improve significantly in the medium term.

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In 2005, Russia exported approximately 204.1 million tons of crude oil to non-CIS countries, a 12% increase from 2004. In 2004 and 2003, Russian exports of crude oil to non-CIS countries amounted to approximately 200.9 million tons and 155.0 million tons, respectively. This represented a 30% increase from 2003, and a 12% increase from 2002. The following table shows approximate export volumes of crude oil for deliveries to non-CIS countries by certain Russian oil companies in 2005, 2004, 2003 and 2002:

Company	2005	2004	2003[2]	2002[2]
		(millions of tons)		
YUKOS[1]	1.6	34.0	29.6	25.6
LUKOIL	34.2	33.0	27.1	25.9
TNK—BP[3]	37.6	30.8	18.8	14.8
Surgutneftegaz	27.5	20.9	18.3	17.5
Sibneft	15.9	13.4	11.6	10.5
Tatneft	12.1	13.0	13.1	10.9
Sidanco	—[4]	—[4]	8.3	5.2
Slavneft	5.1	8.2	5.8	5.5
Rosneft[5]	34.2	6.8	6.4	6.1
Bashneft	4.3	3.9	3.9	4.1

Source: Interfax Petroleum Report, except for Tatneft.

(1)Includes production at Yuganskneftegaz through 2004.

(2)These totals exclude production of affiliated joint ventures and oil purchased from third parties.

(3)Data for periods prior to 2004 is for TNK only.

(4)Included within TNK-BP starting from 2004.

(5)Includes production at Yuganskneftegaz from 2005.

Refining

The current refining market in Russia is characterized by overcapacity. Refinery utilization since 1995 has remained at approximately 60%, which is relatively low by international measures. This rate has increased in recent years. Primary oil refining was 174.8 million tons in 2002, 190.0 million tons in 2003, 195.0 million tons in 2004 and 207.4 million tons in 2005. This generally increasing trend reflects the growth in exports of refined products, since domestic consumption remained relatively stable. Russian vertically-integrated oil companies are now typically seeking to increase the utilization of their refining capacities as Russian domestic prices for refined products have risen and the Russian Government has raised the export tariffs on crude oil to a point where domestic sales of refined products now present an economic alternative to oil exports.

Regulation of the Russian Oil Industry

General

Regulation of the oil industry in Russia is still evolving, with federal, regional and local authorities each promulgating rules.

At the federal level, the Ministry of Industry and Energy is the principal authority that sets governmental policy for the industry and coordinates the activities of oil companies. The Federal Tariff Service and the Ministry of Industry and Energy address issues in the oil industry related to access to Transneft's truck oil pipelines and tariffs. The Ministry of Natural Resources is the principal authority that sets government policy for the use of subsoil and licenses the use of subsoil resources, as described below. The Federal Service for the Supervision of the Use of Natural Resources, acting under the Ministry of Natural Resources, oversees compliance with the terms and conditions of licenses issued by the Ministry of Natural Resources and environmental legislation and oversees exploration and geological prospecting for the oil and gas industries. In certain circumstances (such as the use of subsoil resources on the continental shelf), licenses are granted by the government of the Russian Federation. Regional and local authorities enforce their taxation regimes, administer land-use regulations and oversee compliance with

environmental and worker safety rules. Local and regional authorities also exercise some control over the use of the national and local pipeline grid through their jurisdiction to regulate land use and environmental matters. The Federal Antimonopoly Service supervises competition in the Russian oil industry sector.

According to Russian and international press reports, the Ministry of Industry and Energy has prepared a draft law restricting foreign investments in certain ''strategic'' Russian industries. This draft law has not been submitted to, or approved by, the State Duma and therefore has not become public. The draft law reportedly provides that foreign investors may not own, directly or through a chain of affiliated companies, 50% or more of the share capital of a company involved in a ''strategic'' industry. In addition, a governmental approval will reportedly be required for acquisition by a foreign investor of more than 25% of a company involved in a ''strategic'' industry. On March 2, 2006, the Kommersant daily newspaper published a list of 39 ''strategic'' industries that might be influenced by the proposed law, which included production of natural resources. See ''Item 3—Key Information—Risk Factors—Risks Relating to the Russian Legal System and Russian Legislation—Possible restrictions of foreign investments in strategic industries may limit your ability to hold or sell our ADSs.''

Licensing

The licensing regime for use of subsoil for geological research, exploration and production of mineral resources is established primarily by Subsoil Law, and the regulations thereunder. Until January 2000, when important amendments to the Subsoil Law were introduced, exploration licenses were typically granted for up to five years, while production licenses were granted for up to twenty years and licenses for combined activities were granted for up to twenty-five years. Under the Subsoil Law, as currently in effect, the maximum term of an exploration license remains five years and a production license may be issued for the useful life of the mineral reserves field, calculated on the basis of a feasibility study for exploration and production that ensures rational use and protection of the subsoil. A license recipient is also usually granted rights to use the land surrounding the license area.

Important amendments to the Subsoil Law, passed in August 2004, significantly changed the procedure for awarding exploration and production licenses, in particular abolishing the joint grant of licenses by federal and regional authorities. Under the 2004 amendments, production licenses and combined exploration and production licenses are awarded by tender or auction conducted by the Federal Services for the Supervision of the Use of Natural Resources. While the auction or tender commission includes a representative of the relevant region, the separate approval of regional authorities is no longer required in order to issue subsoil licenses. The winning bidder in a tender is expected to submit the most technically competent, financially attractive and environmentally sound proposal that meets published tender terms and conditions. Licenses for geological exploration and production may also be issued without the holding of an auction or tender by the decision of the federal authorities to holders of exploration licenses that discover mineral resource deposits through exploration work conducted at their own expense.

Licenses may be transferred only under certain limited circumstances that are identified in the Subsoil Law, including the reorganization or merger of the license holder or in the event that an initial license holder transfers its license to a legal entity in which it has at least a 50% ownership interest, provided that the transferee possesses the equipment and authorizations necessary to conduct the exploration or production activity that is covered by the transferred license.

A license holder has the right to develop and sell oil extracted from the license area. The Russian Federation, however, retains ownership of all subsoil resources at all times, and the license holder only has rights to the crude oil when extracted.

Licenses generally require the license holder to make various commitments, including:

- extracting annually an agreed target amount of reserves;
- conducting agreed drilling and other exploratory and development activities;
- protecting the ecology in the fields from damage;
- providing geological information and data to the relevant authorities;

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- submitting on a regular basis formal progress reports to regional authorities; and
- paying certain royalty and other obligatory payments when due.

Article 10 of the Subsoil Law also provides that a license to use a field must be extended by the relevant authorities at the initiative of the license holder if the extension is necessary to finish production in the field, provided that the licensee has not violated the terms of the license. We believe that our existing production licenses will be extended at or prior to their scheduled expiration and we will apply for extensions of our existing production licenses when appropriate. However, in the event that the Russian government determines that we have not complied with the terms of one of our licenses, it may not extend the license upon the expiration of its current period. See ''Item 4—Information on the Company—Exploration and Production.''

The Federal Service for the Supervision of the Use of Natural Resources, or its regional division, oversees compliance with the terms of licenses. A licensee can be fined for failing to comply with a subsoil production license and a subsoil production license can be revoked, suspended or limited in certain circumstances, including:

- breach or violation by the licensee of material terms and conditions of the license;
- repeated violation by the licensee of the subsoil regulations;
- failure by the licensee to commence operations within a required period of time or to produce required volumes, both as specified in the license;
- the occurrence of an emergency situation;
- the emergence of a direct threat to the life or health of people working or residing in the area affected by the operations under the license;
- liquidation of the licensee; and
- non-submission of reporting data in accordance with the legislation.

In the case of expiration of the term of a license or early termination of subsoil use, all oil and natural gas facilities in the relevant licensing area, including underground facilities, must be removed or properly abandoned. In accordance with removal and abandonment regulations, all mining facilities, including oil and natural gas wells, must be maintained at a level that is safe for the population, the environment, buildings and other facilities. Abandonment procedures must also secure the conservation of the relevant oil and natural gas field, mining facilities and wells. Our estimates of future abandonment costs consider present regulatory or license requirements and are based upon our management's experience of the costs and requirements of such activities. Most of these costs are not expected to be incurred until several years, or decades, in the future and will be funded from our general resources at the time of removal. For a further discussion of our treatment of our asset removal obligations, see Note 11 to our audited consolidated financial statements included in this annual report.

Certain activities relating to the oil and gas industry require specific licenses. These include the construction, operation, repair, manufacture and installation of oil and natural gas producing equipment and refining facilities, the storage of oil and natural gas and their respective products, the processing and transportation of hydrocarbons and hydrocarbon products and the construction and manufacturing of buildings and other structures connected with oil and natural gas activities. The Ministry of Industry and Energy and the Federal Service for Environmental, Technology and Nuclear Supervision, the designated government agency, are authorized to issue these specific licenses.

Land Use Permits

In addition to a subsoil production license, permission to use surface land within the specified licensed area is necessary. A majority of land plots in the Russian Federation are owned by federal, regional or municipal authorities that can sell, lease or grant other use rights to the land to third parties through public auctions or tenders or through private negotiations.

Land use permits are typically issued with respect to specified areas, upon the submission of standardized reports, technical studies, pre-feasibility studies, budgets and impact statements. A land use

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permit generally requires that the holder make lease payments and revert the land plot to a condition sufficient for future use, at the licensee's expense, upon the expiration of the permit.

System of Payments for the Use of Subsoil

Beginning January 1, 2002, the previously existing system of payments for the use of subsoil was modified by merging royalties, excise taxes and mineral restoration payments into a single tax called the unified natural resources production tax. Further, based on amendments to the Subsoil Law, the following types of payment obligations were established:

- one-time payments in cases specified in the license;
- regular payments for subsoil use, such as rent payments for the right to conduct prospecting/appraising and exploration work;
- payments to the state for geological subsoil information;
- fees for the right to participate in tenders and auctions; and
- fees for the issuance of licenses.

The rates at which payments are to be levied are usually established in a license by federal authorities within a range of minimum and maximum rates established by the Subsoil Law. These rates are not significant.

Production Sharing Agreements

Petroleum operations carried out under production sharing agreements (''PSAs'') are governed by separate laws. A PSA is a contract between the Russian Government or its authorized body, acting on behalf of the Russian Federation, and one or more investors whereby the investor agrees to bear the costs and risks of exploration and production of a mineral resource and the parties agree to share the output in predetermined proportions. PSAs aim to reduce an investor's risk by providing a stable legal and fiscal framework for long-term and large investments. Since the enactment of the Law on Production Sharing Agreements in 1995, a number of oil fields were approved by other federal laws as eligible for PSAs. However, to date, very few PSAs have been conducted with respect to these fields.

PSA laws provide that operations conducted under a PSA are to be governed by the PSA itself and are not to be affected by contrary provisions of any other legislation, including laws relating to subsoil licenses. Furthermore, PSAs entered into by the Russian government prior to the enactment of the PSA laws are recognized under a grandfather clause.

We do not participate in any PSA arrangements in Russia.

Oil and Refined Products Transportation Regime

From 1995, as part of its plan to deregulate prices and liberalize export controls, the Russian government established equal pipeline and terminal access procedures for all oil companies in proportion to the actual production volume of each company. This system allows Russian oil companies to export, on average, 30-35% of crude oil produced.

Over 90% of the oil produced in Russia is transported through Transneft, the state-owned monopoly owner and operator of Russia's trunk crude oil and export pipelines. Transportation of oil is based on contracts with Transneft and its subsidiaries, which set forth the basic obligations of the contracting parties, including the right of Transneft to blend or substitute a company's oil with oil of other producers. Transneft establishes and collects on prepayment terms a ruble tariff on domestic shipments and an additional hard currency tariff on exports. The Federal Tariff Service is authorized to periodically review and set the tariff rates applicable for each segment of the pipeline. The Druzhba pipeline, which is operated by Transneft in Russia and extends from central Russia (near to our production fields) to markets in the Czech Republic, Germany, Hungary, Poland and Slovakia, has throughput capacity of approximately

1.5 mmbbl of oil per day and currently accommodates over a third of total Russian exports.

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Currently, the allocation of pipeline and terminal access rights is overseen by the Ministry of Industry and Energy, which approves quarterly schedules that, among other things, detail the precise volumes of oil that each oil producer can pump through the Transneft system. These quarterly schedules provide certain stability in the export regime for Russian oil companies. Once the access rights are allocated, oil producers generally cannot increase their allotted capacity in the export pipeline system, although they do have limited flexibility in altering delivery routes. Oil producers are generally allowed to assign their access rights to third parties.

In 2001, the Russian government began reforming the system of pipeline allocation and terminal access rights. Since September 2001, pipeline and terminal access rights have been distributed among oil producers and their parent companies in proportion to the volumes of oil produced and delivered to the Transneft pipeline system in prior periods (not only in proportion to oil production volumes).

Generally, Transneft has no ability to transport individual batches of crude oil, which results in the blending of crude oil of differing qualities. Transneft does not currently operate a system whereby companies, including Tatneft, shipping heavy and sour (high sulfur content) crude compensate the shippers of higher-quality crude oil for deterioration in crude quality due to blending. Although the introduction of a blending compensation system, often referred to as a ‘‘quality bank,’’ is currently under discussion between Transneft and the Russian government, these proposals are generally met with aggressive resistance by producers, including Tatneft, with reserves of a lower quality and regional authorities where such reserves are located.

Refined products are transported by similar means as crude oil, including railways, sea transportation and specially designed pipelines for refined products. The majority of refined products, however, are transported by railways. The regime for the transportation of refined products is generally similar to the regime for the transportation of crude oil. In particular, the rules provide for equal access to refined products pipelines, which currently transport primarily gasoline and diesel fuel.

Imports and Exports

In the past, the Russian government imposed seasonal limitations on the export of certain refined products (such as diesel fuel, fuel oil, gasoline and jet fuel). No such restrictions are in effect at present. However, the Ministry of Energy, the predecessor of the Ministry of Industry and Energy, proposed seasonal regulation of export duties on refined products and the imposition of state non-tariff limitations on the domestic refined products market. Effective from May 6, 2006, pursuant to the amended Government Regulation No. 939 of December 9, 2000, refined products are subject to the following export customs duties rates: U.S.$137.9 per ton for light refined products and U.S.$120 per ton for dark refined products (as compared to U.S.$120.7 per ton and U.S.$65 per ton, respectively, prior to May 6, 2006).

To protect national economic interests, the Russian government implements tariff regulations through the use of export duties. The amounts of export duties vary depending on existing crude oil prices.

Environmental Protection

Petroleum operations are subject to extensive federal and regional environmental laws and regulations. These laws and regulations set various standards for health and environmental quality, provide for penalties and other liabilities for the violation of such standards, and establish, in certain circumstances, obligations to compensate for environmental damage and restore environmental conditions.

The Russian Federal Law on Environmental Protection dated January 10, 2002 (the ''Environmental Protection Law'') established a ''pay-to-pollute'' regime administered by the Federal Service for Ecological, Technological and Nuclear Supervision and other federal and regional authorities. Fees are assessed both for pollution within the limits agreed of emissions and effluents and for pollution in excess of these limits. There are additional fines for certain other breaches of environmental regulations. The Environmental Protection Law does not stipulate precise requirements for the clean-up of pollution, although it does contain an obligation to provide full compensation for all environmental losses caused

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by pollution. The rates of the ''pay-to-pollute'' regime are determined by the Government Decree No. 344 ''On Rates of Payments for Pollutant Emissions Into the Air by Stationary and Mobile Sources, Pollutant Disposals Into Surface and Underground Waters, Disposal of Production and Consumption Waste'' dated June 12, 2003.

Natural resources development matters are subject to periodic environmental evaluation. While these evaluations have in the past generally not resulted in substantial limitations on natural resources exploration and development activities, they are expected to become increasingly strict in the future. Furthermore, the implementation of the Kyoto Protocol may impose new and/or additional rules or more stringent environmental norms. Such requirements may require additional capital expenditures or modifications in operating practices. The impact on us will depend on, among other factors, the base level against which permissible levels of emissions are to be measured and the allocation of quotas for such emissions, which is currently uncertain.

Current System of Oil-Related Taxes and Payments

In general, the Russian oil industry is subject to the same burdensome tax regime as other industries. In addition, the oil companies are subject to industry-specific taxes. As noted above under ''—Regulation of the Russian Oil Industry—Oil and Refined Products Transportation Regime,'' the Russian government may impose restrictions on the export of crude oil and oil products by companies that have arrears to tax authorities at any level of government.

The Unified Natural Resources Production Tax

Federal Law No. 126-FZ of August 8, 2001, which amended the Tax Code and became effective on January 1, 2002 (the ''Natural Resources Tax Law''), amended the previously existing regime of mineral resource restoration payments, royalties and excise taxes on the production of oil and gas condensate and replaced all such taxes with the unified natural resources production tax, a tax on the extraction of commercial minerals.

For the year ended December 31, 2004, the base tax rate for the unified natural resources production tax was set at RR347 per ton of crude oil produced, and was increased to RR419 per ton of crude oil produced effective from January 1, 2005, and is adjusted monthly depending on the market price of Urals blend and the ruble exchange rate. The tax becomes zero if the Urals blend price falls to or below U.S.$9.00 per barrel (U.S.$8.00 per barrel prior to January 1, 2005). For the year ended December 31, 2003, the average effective rate for the unified natural resources production tax, based on the Urals blend market price and ruble exchange rates, was RR801 per ton of crude oil produced. At December 31, 2004, the effective rate for the unified natural resources production tax was RR1,037.67 per ton and RR2,061.48 per ton at December 31, 2005. Pursuant to the Tax Code, from January 1, 2007, the unified natural resources production tax rate is set by law at 16.5% of the value of extracted crude oil, calculated either by reference to actual sale prices of natural resources or the deemed value of natural resources (determined by the oil producer based on its tax declaration) net of VAT less export duties, transportation expenses and certain other distribution expenses.

On June 7, 2006 a draft law was passed in the first reading (from three mandatory readings) by the State Duma introducing a differentiated rate for the unified natural resources production tax, with the effect that oil companies with more mature fields would pay a lower rate than those with better quality reserve deposits. The introduction of a differentiated unified natural resources production tax may benefit us because the majority of our fields are considered mature. Under the draft law, the tax rate for the production of oil would be set at RR419 per ton starting January 1, 2007 through December 31, 2016. This tax rate would be applied with a coefficient based on the levels of the international oil prices and the levels of maturity of the oil fields. Such formula would benefit producers of oil fields having a maturity level superior to 80%, with a 30% decrease in tax expenses compared to the current expenses for oil fields having a maturity level of 100%. In addition, the aforementioned law is designed to stimulate development of new oil fields in the region referred to as Eastern-Siberian Oil and Gas Province (which include Yakutia, the Irkutsk region and Krasnoyarskyi Krai). Under the draft law, the tax rate would be set at 0% up to a total of 25 million tons of oil produced in the oil fields in the Eastern-Siberian Oil and

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Gas Province. Development of such fields would have a 10-year term for production and exploration licenses and a 15-year term for licenses for production and geological survey. However, as there can be no assurances that the draft law will be enacted as passed in the first reading, at this stage we cannot speculate as to the impact that a differentiated tax rate would have on our operations.

Oil-related Export Duties

In early 1999, the Russian government reintroduced export customs duties on crude oil and oil products. Following increases in world oil prices, the export customs duties have been steadily increasing. In September 2001 the Law on Customs Tariff (the ''Law on Customs Tariff'') was amended to establish the rates of export customs duties for crude oil based on the average price of Urals blend for the two preceding months.

The rates of customs duties established by the Russian government in accordance with the framework set out in the amended Law on Customs Tariff are as follows:

Average Price for Urals Crude Oil Blend(1)	Export customs duties
Up to U.S.$109.50 per ton (U.S.$15.37 per barrel)	0%
U.S.$109.50 to U.S.$146 per ton (U.S.$15.37 to U.S.$20.50 per barrel).	35% of the difference between the actual price (per ton) and U.S.$109.50

U.S.$146 to U.S.$182.50 per ton (U.S.$20.50 to U.S.$25.62 per barrel)	U.S.$12.78 plus 45%(2) of the difference between the actual price (per ton) and U.S.$146
Greater than U.S.$182.50 per ton (U.S.$25.62 per barrel).	U.S.$29.2 plus 65%(3) of the difference between the actual price (per ton) and U.S.$182.50

(1)The Urals crude oil blend price is calculated as the price for Urals blend on world markets (Mediterranean and Rotterdam) for the two months immediately preceding the current two-month period.
(2)This rate was 35% prior to June 2004.
(3)This rate was 40% prior to June 2004.

The current customs export duty established by the Russian government (effective from June 1, 2006) is U.S.$199.8 per ton (U.S.$28.05 per barrel).

Oil-related Payments for the Right to Explore and Appraise Oil Fields and Prospect for Natural Resources

Historically, Russian oil companies made payments for the right to explore and appraise oil fields, as well as payments for the right to prospect for natural resources as a percentage of the value of exploration and appraisal works (1-2%) and the value of prospecting works (3-5%).

Starting from 2002, the Natural Resources Tax Law introduced a new approach to the calculation of these payments. This law linked the payments to the size of the license area provided to the user of the subsoil. The minimum and the maximum rates of quarterly payments are set by Federal Law No. 57-FZ of May 29, 2002: (i) the rate for the right to explore and appraise oil fields is from RR120 (RR50 for offshore areas) per square kilometer to RR360 (RR150 for offshore areas) per square kilometer; and (ii) the rate for the right to prospect for natural resources from RR5,000 (RR4,000 for offshore areas) per square kilometer to RR20,000 (RR16,000 for offshore areas) per square kilometer as set by the regional authorities. Exact rates for specific areas are to be set by regional authorities for onshore areas and the Ministry of Natural Resources for offshore areas. Where these specific rates have not been set, the above maximum rates shall apply.

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Current Excise Tax on Oil Products

Historically gasoline, diesel fuel and motor oils were subject to a fuel sales tax at 25% of their value. Excise tax was payable only with respect to gasoline. Effective January 1, 2001, this fuel sales tax has been abolished, and excise tax became applicable to all of the above products. The current excise tax rates on oil products are as follows:

Oil Product	Rate per ton (RR)
Gasoline with octane numbers not exceeding ‘‘80’’ (low octane gasoline)	2,460
Gasoline with octane numbers exceeding ‘‘80’’ (high octane gasoline)	3,360
Diesel fuel	1,000

Motor oil	2,732

EXPLORATION AND PRODUCTION

Reserves and Fields

General

Unless otherwise noted, all presentations of reserves in the following section are with respect to net reserves. Net reserves exclude quantities due to others when produced.

Our oil and gas fields are located principally in Tatarstan. We obtain licenses from the governmental authorities to explore and produce oil and gas from these fields. Most of our existing production licenses expire from 2013 to 2019, and the license for our largest field, Romashkinskoye, expires in 2013. The economic lives of our licensed fields extend significantly beyond the license expiration dates. Under Russian law, we are entitled to renew our licenses to the end of the economic lives of the fields, provided certain conditions are met. Article 10 of the Subsoil Law provides that a license to use a field ‘‘shall be’’ extended at its scheduled termination at the initiative of the subsoil user if necessary to finish production in the field, provided that there are no violations of the conditions of the license. The legislative history of Article 10 indicates that the term ‘‘shall’’ replaced the term ‘‘may’’ in August 2004, clarifying that the subsoil user has an absolute right to extend the license term so long as it has not violated the conditions of the license. We have recently received a letter dated April 4, 2006, from the Tatarstan branch of the Federal Services for the Supervision of the Use of Natural Resources under the Ministry of Natural Resources of the Russian Federation, confirming that, to date, it has not identified any violations of the terms of our licenses that could prevent their extension and that, based on approved development plans and in accordance with the Subsoil Law, our licenses will be extended at our request. Our right to extend our licenses is, however, dependent on our continuing to comply with the terms of our licenses, and we have the ability and intent to do so. We plan to request the extension of our licenses. Our current production plans are based on the assumption, which we consider to be reasonably certain, that we will be able to extend all of our existing licenses. These plans have been designed on the basis that we will be producing crude oil through the economic lives of our fields and not with a view to exploiting our reserves to maximum effect only through the license expiration dates.

Miller and Lents, our independent oil and gas consultants, have confirmed our view that it is ‘‘reasonably certain’’ that we will be allowed to produce oil from our reserves after the expiration of our existing production licenses and until the end of the economic lives of the fields. ‘‘Reasonable certainty’’ is the applicable standard for defining proved reserves under the SEC’s Regulation S-X, Rule 4-10. Accordingly, we have included in proved reserves in this annual report on Form 20-F all reserves that otherwise meet the standards for being characterized as ‘‘proved’’ and that we estimate we can produce through the economic lives of our licensed fields.

We revised our estimate of the net oil reserves as of January 1, 2005, as set out in the Revised Reserves Report. The revised report reflected a change in our oil price to U.S.$17.47 per barrel (rather than the price of U.S.$21.53 per barrel that had previously been used) and a change in the ownership interest in our Stepnoozerskoye and Yelginskoye fields. As a result, the estimate of our total proved

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reserves, previously 5,962.6 mmbbl, was revised to 5,801.1 mmbbl through the economic lives of our licensed fields, and the estimate of our total proved reserves through the current license expiration was revised from 1,499.1 mmbbl to 1,476.1 mmbbl, as presented in the Revised Reserves Report. See ‘‘Exhibit 15.1—Report of Reserve Consultants, Miller and Lents, Ltd., dated March 20, 2006.’’

The SEC staff have indicated that proved reserves generally should be limited to those that can be produced through the license expiration date unless there is a long and clear track record which supports the conclusion that the extension of the license will be granted as a matter of course. We believe that the extension of our licenses is a matter of course as fully described above. To assist the reader in understanding the proved oil reserves that will be produced during the existing license periods and those that will be produced during the period of the expected license extension, we have presented reserves information in this annual report on Form 20-F for each of these two periods.

Classification of reserves in Russia currently differs from classifications established in other countries, including the United States. In November 2005, the Russian Ministry of Natural Resources approved a new classification of reserves that should bring the Russian classification into line with international standards, in particular with the classification of petroleum reserves and resources established by the United Nations (WPC/SPE/AAPG). The new classification is expected to come into effect on January 1, 2009.

For a discussion of the accounting treatment of depletion, depreciation and amortization of our oil producing assets, see ‘‘Item 5—Operating and Financial Review and Prospects—Critical Accounting Policies and Estimates’’ and Note 3 and Note 11 to our audited consolidated financial statements included in this annual report.

Reserves and Reserves by Fields

The following tables present our net proved reserves at January 1, 2005, 2004, 2003 and 2002.

	Proved Reserves Through the Economic Lives of Our Licensed Fields As of January 1,[1]							
	2005		2004		2003		2002	
Reserve Category	Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
	(millions of units)							
Proved Developed Reserves	776.3	5,529.8	783.7	5,582.4	774.8	5,518.6	706.8	5,034.8
Proved Undeveloped Reserves	38.1	271.2	52.8	376.6	63.6	453.4	58.9	419.9
Total Proved Reserves	814.4	5,801.1	836.6	5,959.0	838.4	5,972.0	765.7	5,454.7

	Proved Reserves Through Current License Expirations As of January 1,[1]							
	2005		2004		2003		2002	
Reserve Category	Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
	(millions of units)							
Proved Developed Reserves	200.8	1,430.5	279.0	1,978.6	308.0	2,194.1	328.3	2,338.8
Proved Undeveloped Reserves	6.4	45.6	19.2	137.0	23.5	167.5	24.3	173.1
Total Proved Reserves	207.2	1,476.1	298.2	2,115.6	331.5	2,361.6	352.6	2,511.9

(1)Columns may not total due to rounding.

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The following tables present, by major field, our net proved reserves through the economic lives of our licensed fields, at January 1, 2005, 2004, 2003 and 2002.

	Proved Reserves Through the Economic Lives of our Licensed Fields[(1)(2)]							
	2005		2004		2003		2002	
Field	Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
	(millions of units)							
Romashkinskoye	444.7	3,167.5	471.0	3,354.9	455.4	3,243.6	432.1	3,078.6
Novo-Yelkhovskoye	79.5	566.0	72.3	514.8	69.5	494.7	67.3	479.1
Bavlinskoye	48.7	346.7	52.5	374.1	51.5	366.6	44.9	319.9
Sabanchinskoye	15.3	109.2	15.2	108.9	15.6	110.8	15.4	109.8
Others	226.3	1,611.8	225.5	1,606.3	246.6	1,756.2	206.0	1,467.3
Total	814.4	5,801.1	836.6	5,959.0	838.4	5,972.0	765.7	5,454.7

	Proved Developed Reserves Through the Economic Lives of our Licensed Fields[(1)(2)]							
	2005		2004		2003		2002	
Field	Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
	(millions of units)							
Romashkinskoye	439.6	3,131.4	465.1	3,312.7	446.2	3,178.4	426.7	3,039.3
Novo-Yelkhovskoye	78.7	560.8	71.7	510.6	68.8	490.3	66.6	474.1
Bavlinskoye	40.1	285.8	39.1	278.2	35.1	250.1	28.5	202.8
Sabanchinskoye	14.5	103.4	14.3	102.1	14.6	104.0	14.2	101.0
Others	203.4	1,448.5	193.6	1,378.9	210.0	1,495.8	171.0	1,217.6
Total	776.3	5,529.8	783.7	5,582.4	774.8	5,518.6	707.0	5,034.8

	Proved Undeveloped Reserves Through the Economic Lives of our Licensed Fields[(1)(2)]							
	2005		2004		2003		2002	
Field	Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
	(millions of units)							
Romashkinskoye	5.1	36.1	5.9	42.2	9.2	65.2	5.5	39.3
Novo-Yelkhovskoye	0.7	5.1	0.6	4.2	0.6	4.4	0.7	5.0
Bavlinskoye	8.6	60.9	13.5	95.9	16.4	116.5	16.4	117.1
Sabanchinskoye	0.8	5.9	0.95	6.8	1.0	6.8	1.2	8.8
Others	22.9	163.3	31.9	227.4	36.6	260.4	35.1	249.7
Total	38.1	271.2	52.8	376.6	63.6	453.4	58.9	419.9

(1)Columns may not total due to rounding.

(2)For convenience, throughout this annual report certain amounts of crude oil have been translated from tons to barrels. These translations were made at the rate of 7.123 barrels per ton of crude oil, reflecting the weighted average density of our crude oil reserves. Translations in these tables may differ, however, as the crude oil reserves in the reservoirs within specific fields may have a different weighted density than that of our total average crude oil reserves.

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The following tables present, by major field, our net proved reserves for the periods through the current license expiration dates, at January 1, 2005, 2004, 2003 and 2002.

	Proved Reserves Through the Current License Expirations(1)(2)							
	2005		2004		2003		2002	
Field	Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
	(millions of units)							
Romashkinskoye	117.4	835.9	161.6	1,149.1	169.3	1,205.7	183.1	1,304.0
Novo-Yelkhovskoye	18.1	129.0	27.9	196.7	30.5	217.0	34.8	248.2
Bavlinskoye	8.1	57.5	18.8	130.5	18.6	132.7	19.4	138.5
Sabanchinskoye	5.2	36.9	5.9	41.6	6.4	45.8	7.0	49.7
Others	58.5	416.7	84.0	597.7	106.8	760.4	108.3	771.4
Total	207.2	1,476.1	298.2	2,115.6	331.5	2,361.6	352.6	2,511.9

	Proved Developed Reserves Through the Current License Expirations(1)(2)							
	2005		2004		2003		2002	
Field	Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
	(millions of units)							
Romashkinskoye	116.1	826.7	159.6	1,131.3	165.4	1,178.3	180.3	1,284.6
Novo-Yelkhovskoye	17.8	127.0	27.3	193.9	30.0	213.8	34.3	244.3
Bavlinskoye	6.6	46.9	13.8	97.6	13.0	92.4	13.1	93.0
Sabanchinskoye	4.9	35.2	5.5	38.5	6.1	43.1	6.4	45.8
Others	55.4	394.8	72.9	517.3	93.6	666.5	94.2	671.0
Total	200.8	1,430.5	279.0	1,978.6	308.0	2,194.1	328.3	2,338.8

	Proved Undeveloped Reserves Through the Current License Expirations(1)(2)							
	2005		2004		2003		2002	
Field	Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
	(millions of units)							
Romashkinskoye	1.3	9.3	2.5	17.9	3.8	27.4	2.7	19.4
Novo-Yelkhovskoye	0.3	2.0	0.4	2.7	0.4	3.2	0.5	3.9
Bavlinskoye	1.5	10.5	4.6	32.8	5.7	40.3	6.4	45.5
Sabanchinskoye	0.2	1.7	0.4	3.1	0.4	2.7	0.5	3.9
Others	3.1	22.0	11.3	80.4	13.2	93.9	14.1	100.4
Total	6.4	45.6	19.2	137.0	23.5	167.5	24.3	173.1

(1)Columns may not total due to rounding.
(2)For convenience, throughout this annual report certain amounts of crude oil have been translated from tons to barrels. These translations were made at the rate of 7.123 barrels per ton of crude oil, reflecting the weighted average density of our crude oil reserves. Translations in these tables may differ, however, as the crude oil reserves in the reservoirs within specific fields may have a different weighted density than that of our total average crude oil reserves.

In the discussion that follows we focus on our proved reserves that we estimate we can produce through the economic lives of our licensed fields. According to appraisals of our reserves performed by the engineering firm Miller and Lents, as of January 1, 2005, our reserves had decreased by 0.2% in 2003 and by 2.7% in 2004, bringing the total volume of proved developed and undeveloped reserves to 836.6 million tons (5,959.0 mmbbl) and 814.4 million tons (5,801.1 mmbbl) as of January 1, 2004 and 2005, respectively. We had 783.7 million tons (5,582.4 mmbbl) and 776.3 million tons (5,529.8 mmbbl) of proved developed reserves at January 1, 2004 and 2005, respectively, of which proved developed producing reserves accounted for approximately 493.5 million tons (3,515.3 mmbbl) or 59% of the total proved reserves and 484.9 million tons (3,453.9 mmbbl) or 59.5% of the total proved reserves, respectively. The slight decline in our reserves during 2003 is primarily attributable to fluctuations in price and cost levels that impact the economic viability of recovering oil from certain of our fields. Our reserves decreased in

2004 as compared to 2003 as a result of the revision of the estimates of our net oil reserves as of January 1, 2005 as set out in the Revised Reserves Report. See ‘‘Item 3—Key Information—Risk Factors—Risks Relating to the Oil Industry—Tl crude oil and natural gas reserves data in the Reserves Reports are only estimates and are inherently uncertain, and our actual production, revenues and expenditures with respect to our reserves may differ materially from these estimates’’ and ‘‘Exhibit 15.1—Report of Reserve Consultants, Miller and Lents, Ltd., dated March 20, 2006.’’ Most of our reserves consist of crude oil with a high sulfur content (over 1.8% sulfur by mass), and the average sulfur content of the high sulfur content crude oil that we produce is approximately 3.5% by mass. This high sulfur content crude oil typically commands a lower price in the market, although the impact of this is mitigated by Transneft’s practice of blending high and low-sulfur crude oil. See ‘‘—Transportation’’ under this Item. In 2005 and 2004, approximately 42.8% and 43.1%, respectively, of our total oil production volume was high sulfur content crude oil. See ‘‘—High Sulfur Content Crude Oil’’ under this Item for additional information.

Our crude oil reserves currently have a water cut of approximately 83% when produced, meaning that 83% of the fluid produced is water. The crude oil and extracted water are separated in field separation facilities. The crude oil is then transferred into the Transneft pipeline system for further distribution and the remaining water is re-injected into our wells to maintain reservoir pressure.

We are expanding our reserves outside Tatarstan into other regions of Russia, including Kalmykia, the Samara region and the Orenburg region. We currently hold licenses for exploration in the Ulyanovsk region, the Chuvash Republic, the Samara region and the Nenetsk Autonomous District and a joint exploration and production license for the Matrosovskoye oil field, located in both Tatarstan and the Orenburg region. In December 2002, the area of the initial subsoil license for the Matrosovskoye oil field was expanded due to the inclusion of a deposit in the Orenburg region, which was previously explored under a separate subsoil license. See ‘‘Item 5—Operating and Financial Review and Prospects—Licenses.’’

We also have plans to acquire exploration, development or production rights in Oman, Libya, Iraq, Syria and Iran. In May 2005 we registered a joint venture with Omani company Hamed International Marketing and Services Co. LLC to promote our products and services in Oman and other countries in the region. In October 2005, we, among nineteen other international oil companies, won on a tender a permit to explore and develop petroleum in the Gedames basin located in the central part of Libya, which is the site where Africa's largest known crude-oil reserves are located. U.N. and U.S. sanctions against Iraq have been lifted subsequent to the military action in Iraq in 2003. Prior to the lifting of the sanctions we exported Iraqi oil under the U.N. oil-for-food program, participated in a consortium that included Rosneft to develop Iraqi oil fields, drilled a number of oil wells in Iraq under U.N.-approved contracts and opened a representative office in Iraq. We do not currently engage in any significant activities in Iraq. In November 2003, the Syrian government selected us to explore and develop a production block in eastern Syria, and in March 2005 we concluded an agreement with the government of Syria and the Syrian Oil Company according to which we are to explore for oil in this area and to produce oil on the basis of a 25-year production sharing agreement. We are also planning to participate in future tenders for the development of oil fields in Syria. We do not yet conduct any exploration or production activities in Syria as no agreement has been reached on the financing of the joint venture for the development of the field. We have opened a representative office in Iran and in February 2005 the government of Tatarstan and the government of Iran concluded an agreement pursuant to which we are expecting to register a joint venture with an Iranian entity in order to participate in various projects in Iran, including tenders for the development of oil fields. The terms of our participation in this venture have not yet been finalized. Our final decision as to our participation in Iranian projects will take into account the possible international sanctions imposed on Iran. We believe that our operations in Iran and Syria have been conducted in full compliance with applicable Russian, U.S. and international law.

Since January 1, 2002, we have funded our exploration operations, including exploratory drilling, from internal funds. Prior to 2002, we funded these activities primarily through funds that we received from the Tatarstan Mineral Restoration Fund (the ‘‘Restoration Fund’’). We were required to contribute to the Restoration Fund an amount equal to 8.0% of our total expected sales proceeds (net of VAT and excise tax) for all crude oil that we extracted, and received back from the Tatarstan government each year

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a portion of our required contribution. The decision to remit any funds to us and the amount of any funds so remitted was at the discretion of the Tatarstan government. In 2001, we received back approximately RR563.5 million, or 9.6% of our contribution. We could carry-forward to subsequent years any amounts received but not used in the year of receipt. These funds had to be used to conduct exploration activities in Tatarstan relating to increasing recoverability of oil from existing deposits, certain purchases of new equipment, and certain research and development activities. The Tatarstan government had to approve the use of these funds. Due to a change in Russian legislation, since January 1, 2002 we no longer make contributions to the Restoration Fund. Moreover, we do not expect to receive any additional funds in connection with our contributions to the Restoration Fund made in prior periods. We are also seeking opportunities to acquire new fields that we consider economically viable. From time to time, we acquire small fields in Tatarstan.

High Sulfur Content Crude Oil

High sulfur content crude oil, defined as crude oil containing more than 1.8% of sulfur by mass, represents most of our total proved reserves. Our high sulfur content crude oil contains on average 3.5% sulfur by mass. We believe that high sulfur content crude oil as a proportion of our production will increase in the future due to the maturation of our low sulfur content crude oil fields and the resulting decrease in production volumes. The amount of high sulfur content crude oil as a percentage of our crude oil production steadily increased from 1986 (20.2%) to 1992 (28.1%). In 1993 and 1994, high sulfur content crude oil represented a smaller portion of our crude oil production (26.1% in 1993 and 22.9% in 1994), as we experienced difficulties in exporting high sulfur content crude oil to the Kremenchug refinery in Ukraine due to the temporary disruption of trading relations between Russia and other CIS countries. Our production of high sulfur content crude oil increased to approximately 41.1% of our total oil production in 2002, 42.5% in 2003, 43.1% in 2004 and 42.8% in 2005 as a result of renewed shipments to Kremenchug starting in 1995, the establishment of new arrangements with refineries, in Nizhnekamsk and elsewhere, that are capable of refining high sulfur content crude oil, and our ability to transport our high sulfur content crude oil through the national pipeline system. The new oil refining and petrochemical complex in Nizhnekamsk will allow us to refine up to 7 million tons of high sulfur content crude oil per year.

Production

Overview

In the years ended December 31, 2005 and 2004, we produced approximately 25.6 million tons (182.4 mmbbl) and 25.4 million tons (181.6 mmbbl) of crude oil, respectively, not including our share of production by TATEX, a joint venture that is accounted for by the equity method. This represented approximately 5.7% and 5.5% of the total crude oil production in Russia in 2005 and 2004, making Tatneft the sixth largest crude oil producer in Russia. The table below sets forth our production levels for the years ended December 31, 2005, 2004, 2003 and 2002:

Year Ended December 31,							
2005(1)(2)		2004(1)(2)		2003(1)(2)		2002(1)(2)	
Tons	Barrels	Tons	Barrels	Tons	Barrels	Tons	Barrels
(in millions)							
25.6	182.4	25.4	181.6	24.9	177.3	24.9	177.3

(1) Includes annual production attributable to our joint venture Tatoilgas, which is consolidated with our results, of approximately 267,691 tons (1.9 mmbbl), 257,198 tons (1.8 mmbbl), 265,301 tons (1.9 mmbbl) and 291,000 tons (2.1 mmbbl) in the years ended December 31, 2005, 2004, 2003 and 2002, respectively.

(2) Includes approximately 173,783 tons (1.2 mmbbl), 173,495 tons (1.2 mmbbl), 169,193 tons (1.2 mmbbl) and 172,000 tons (1.2 mmbbl) in the years ended December 31, 2005, 2004, 2003 and 2002 respectively, produced at the third-block of the Pavlovskoye area of the Romashkinskoye oil field operated by Ritek-Vnedreniye under a joint operations agreement with us.

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Our largest oil field is the Romashkinskoye field, from which we produced approximately 15.0 million tons (106.8 mmbbl) of crude oil in 2005, 14.8 million tons (105.4 mmbbl) in 2004 and 14.5 million tons (103.5 mmbbl) in 2003. We produced approximately the same quantities of crude oil from this field in prior years, our production amounting to 14.4 million tons (102.6 mmbbl) in 2002. The field was discovered in 1948 and reached peak production levels in 1970. The field is one of the largest in Russia in terms of reserves and physical size, covering an area of approximately 520,309 hectares (approximately 2,000 square miles).

Our second largest oil field is the Novo-Yelkhovskoye field, from which we produced approximately 2.5 million tons (17.6 mmbbl) of crude oil in 2005, 2.4 million tons (17.1 mmbbl) in 2004 and 2.4 million tons (17.1 mmbbl) in each of 2003 and 2002. The field was discovered in 1956, began producing in 1958, and reached peak production levels in 1976. The field covers an area of approximately 124,543 hectares (approximately 479 square miles).

Our third largest oil field is the Bavlinskoye field, which was first discovered in 1946 and began production in the same year. The field reached peak production levels in 1957. Production from the field was approximately 0.9 million tons (6.6 mmbbl) of crude oil in 2005, approximately 0.9 million tons (6.1 mmbbl) in 2004 and 0.8 million tons (5.8 mmbbl) in 2003. We produced approximately 779,600 tons (5.7 mmbbl) in 2002 from this field. The field covers an area of 46,989 hectares (approximately 181 square miles).

We reached our peak production levels of approximately 100 million tons (712.0 mmbbl) of crude oil per year in the mid-1970s. Our production declined from 1980 to 1993 due to the maturation of production from the Romashkinskoye and Novo-Yelkhovskoye fields. The reduction in output was compounded by the Russian economic recession of the early 1990s following the dissolution of the Soviet Union, which led to a downturn in demand for crude oil in Russia and a lack of capital investment. Since 1994, our production, combined with that of our joint ventures, has stabilized at approximately 24 to 25 million tons per year. We achieved this stabilization of production by utilizing a broad range of advanced oil extraction techniques, including hydrodynamic, geophysical, chemical, thermal, gas and microbiological technologies. Other factors contributing to the stabilization of production volumes since 1994 have included:

- a more favorable Tatarstan tax regime through the end of 2000, providing increased economic incentives to bring a number of non-operational wells into production;
- the impact of our well rehabilitation program; and
- employment of secondary and tertiary recovery techniques to increase well productivity.

Tax benefits

In 1999 and 2000, we benefited from certain tax reductions and exemptions granted by Tatarstan with respect to some of the revenues derived from low-productivity wells. Other Tatarstan laws provided additional benefits, including a return of certain amounts of that portion of the royalties for the use of the subsoil that was payable to Tatarstan, and an exemption from property taxes on related wells and fixed assets, including, from January 1, 1998, amounts that had previously been payable to local authorities.

Tatarstan had in the past granted to us tax benefits with respect to some of the revenues derived from wells on newly exploited oil fields and from crude oil produced using secondary and tertiary crude oil recovery techniques, including an exemption from payments to the Restoration Fund in respect of such crude oil. Certain other Tatarstan tax benefits also aided us in the past in maintaining production volumes, including the return to us of up to 80% of the amount otherwise allocable to the Restoration Fund in 1995 and 1996, approximately 42% to 49% from 1997 through 1999, approximately 13.5% in 2000 and approximately 9.6% in 2001. As a result of reconciling the Russian and Tatarstan tax regimes, we no longer enjoy any specific tax benefits in Tatarstan. In 2002, the Tatarstan government set for us the minimum rates permitted by Russian legislation for payments for the right to explore and appraise oil fields and prospect for natural resources. However, effective from January 1, 2003, the Tatarstan government raised the rates to the maximum level permitted by the legislation. In 2005 and 2004, the rates for the right to explore and appraise oil fields in Tatarstan, Ulyanovsk and Orenburg regions were RR360 per square kilometer (compared to RR360 per square kilometer in 2003 and RR120 per square kilometer

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in 2002) and RR20,000 per square kilometer for the right to prospect natural resources (compared to RR20,000 and RR5,000 per square kilometer in 2003 and 2002, respectively).

Prior to January 1, 2002, we benefited from tax reductions granted by Russian Government Regulation No. 1213 of November 1, 1999. This regulation allowed the Ministry of Natural Resources to exempt oil companies from payments for oil production and from royalties for the use of subsoil owed to the federal government with respect to oil produced from rehabilitated and previously inactive wells as of January 1, 1999.

On June 7, 2006 a draft law was passed in the first reading by the State Duma introducing a differentiated rate for the unified natural resources production tax. For further information, see ''—Overview of the Russian Oil Industry—Current System of Oil-Related Taxes and Payments—The Unified Natural Resources Production Tax'' under this Item.

Well rehabilitation

Well rehabilitation primarily involves replacing or reconditioning pumps, replacing corroded pipes, and clearing well bores in order to bring wells back into production. At December 31, 2005 and 2004, approximately 12% and 23% of our production wells were non-operational, respectively, compared to approximately 20% as of December 31, 2003.

Secondary and tertiary recovery

As most of our oil fields, including Romashkinskoye, our largest, are in a mature stage of development, we have designed and successfully implemented a range of measures aimed at maintaining and even increasing production volumes from these mature fields. We plan to continue our well stimulation program, subject to providing necessary financing. We produced approximately 11.2 million tons (79.8 mmbbl), or 44.4% of our total crude oil produced in 2005, using secondary and tertiary recovery techniques, approximately 11.3 million tons (80.5 mmbbl), or 45.1% of our total crude oil produced in 2004, and 11.2 million tons (79.6 mmbbl), or 45.3% of our total crude oil produced in 2003, using these techniques. We intend to continue to use these and other enhanced recovery techniques to optimize our production of crude oil and expect that crude oil produced using these methods will increase as a percentage of our total production. These advanced techniques include flow rate and water injection pattern management, horizontal drilling, hydraulic rupture of formations and chemical, microbiological and thermal recovery techniques. We continue to explore technologies that will enhance these methods.

Production Costs

Our overall crude oil production costs have generally increased in recent years. In 2004, such costs increased by 10.8% due to the increase in taxes; however, at the same time our operating costs decreased by 3.2%. Our direct operating costs for crude oil extraction (the ''lifting expenses'') per barrel increased in 2004 to U.S.$2.48 due to the real appreciation of the Russian ruble against the U.S. dollar as compared to 2003. These costs remained virtually unchanged in 2003 (U.S.$2.46 compared to U.S.$2.47 in 2002), with the positive effects from our cost reduction program offset by the real appreciation of the ruble against the U.S. dollar. Direct operating costs do not include accretion of liability in accordance with SFAS 143, ''Accounting for Asset Retirement Obligations'' (''SFAS 143''). At the same time, the growth in transportation expenses, increase in taxes other than income taxes and higher depreciation, depletion and amortization expenses resulted in an overall 23% increase in per barrel production costs from U.S.$11.92 in 2003 to U.S.$15.55 in 2004, as compared to a 25% increase in 2003. We expect that the production costs in 2005 will be at the same level as in 2004.

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The table below illustrates the dynamics of our production costs and average production costs per ton (excluding the unified natural resources production tax) over the periods indicated:

	Year ended December 31,		
	2004	2003	2002
Revenue (RR millions)	124,076	93,155	84,394
Production costs (RR millions)	26,500	26,562	24,521
Production (thousands of tons)	25,606	24,935	24,890
Average sales price (RR/ton)	4,891	3,736	3,391
Average production cost (RR/ton)	1,045	1,065	985

Wells

We had 42,675 wells as of December 31, 2005, including 18,867 active production wells and 8,602 active injection wells. As of December 31, 2004, we possessed a total of 42,635 wells. Of these, 18,659 were active production wells and 8,504 were active injection wells. Tatneft possessed a total of 42,322 wells as of December 31, 2003, of which 19,209 were active production wells and 8,431 were active injection wells. Production wells are used to extract oil, while injection wells are used to pump water or other agents into the reservoir in order to maintain pressure and to enhance crude oil recovery.

The table below sets forth information on our wells in the years ended December 31, 2005, 2004, 2003 and 2002:

	Year ended December 31,			
	2005	2004	2003	2002
Production wells	21,460	24,154	24,095	23,887
in operation	18,867	18,659	19,209	19,832
not in operation(1)	2,593	5,495	4,886	4,055
Injection wells	9,393	9,220	9,017	8,831
in operation	8,602	8,504	8,431	8,259
not in operation(2)	791	716	586	572
Total production and injection wells	30,853	33,374	33,112	32,718
Others(3)	11,822	9,261	9,210	9,205
Total	42,675	42,635	42,322	41,923

(1) Includes wells that are temporarily inactive, wells due to be rehabilitated or stimulated and wells that are used for testing purposes only.

(2) Includes wells due to be rehabilitated.

(3) Examples of other wells include irreparable wells that have been abandoned or dismantled and special purpose wells.

The table below sets out the drilling activity of Tatneft and our joint ventures in the years ended December 31, 2005, 2004, 2003 and 2002:

Type of Drilling	Year ended December 31, 2005	2004	2003	2002
	(thousand meters)			
Production	502.5	521.9	646.0	699.1
Exploration	52.9	50.1	51.4	57.7

Tatneft drilled 354 new production wells in 2005, 350 new production wells in 2004, 414 new production wells in 2003 and 417 new production wells in 2002. Our joint ventures drilled 36, 33, 40 and 42 new production wells in 2005, 2004, 2003 and 2002, respectively. We generally drill more wells in the second half of the year than in the first half of the year, as weather conditions and poor roads make it difficult to drill during the spring. Most exploration activities conducted in the years ended December 31, 2004, 2003 and 2002 took place in the southern and eastern parts of Tatarstan. In addition,

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our oil services subsidiaries drilled 196.9 thousand meters, 160.5 thousand meters and 176.7 thousand meters for third parties, primarily small independent oil companies operating in Tatarstan in 2004, 2003 and 2002, respectively.

In the years ended December 31, 2005, 2004 and 2003, approximately 667, 598 and 816 production wells were taken out of operation (representing approximately 3.1%, 2.8% and 3.4% of the total production wells), respectively. We rehabilitated 1,134 production wells in 2005, 3,545 production wells in 2004 and 2,570 production wells in 2003, accounting for 5.3%, 18.9% and 13.4% of the active producing wells as of December 31, 2005, 2004 and 2003, respectively. In the year ended December 31, 2002, approximately 531 wells were taken out of operation. We rehabilitated 2,745 wells in 2002, accounting for approximately 13.6% of the active producing wells as of December 31, 2002.

We improved production at 1,250 production wells (representing 6.5% of the active production wells) and at 1,497 production wells (accounting for approximately 7.5% of active production wells) as of December 31, 2003 and 2002, respectively. In 2004, we improved production at approximately the same number of wells as in 2004.

TRANSPORTATION

We transport most of our crude oil through the pipeline system operated by Transneft, Russia's monopoly pipeline operator. The Ministry of Industry and Energy allocates usage of the pipeline network for export deliveries to oil producers on a quarterly basis.

Currently, the pipeline capacity, including non-CIS export pipeline capacity, and terminal access are allocated among oil producers on a quarterly basis in proportion to the volume of oil produced and delivered to the Transneft pipeline system in the prior quarter, planned oil production in the forthcoming quarter, and total pipeline capacity. Our non-CIS export pipeline allocation is equivalent to approximately one-third of the oil we produce and deliver to Transneft. Failure to pay taxes to the Russian government could result in the termination or temporary suspension of our access to the export pipelines. We do not believe that our share of pipeline export capacity will be materially adjusted in the near future. See ''Item 3—Key Information—Risk Factors—Risks Relating to the Company.''

Transneft sets the tariff rates for using its pipelines subject to the oversight of the Federal Tariffs Service, a successor to the Federal Energy Commission, which also regulates the activities of natural monopolies in petroleum and energy transmission networks. Pipeline transportation costs have risen substantially over the past several years. The overall price to transport crude oil depends on the number of Transneft ‘‘districts’’ through which the oil is transported. Currently, the pipeline tariff (determined using the Central Bank’s ruble/U.S. dollar exchange rate at May 4, 2006 and exclusive of VAT) for us to transport crude oil to Butinge is approximately U.S.$14.40 per ton; to Moscow approximately U.S.$7.18 per ton; to the Kremenchug refinery approximately U.S.$10.18 per ton; to Primorsk approximately U.S.$14.59 per ton; to Novorossisk approximately U.S.$13.71 per ton; and to Germany approximately U.S.$10.94 per ton. In addition, Transneft charges a premium of U.S.$2.5 per ton (exclusive of VAT) to deliver high sulfur content crude oil when it is mixed with other, low sulfur content crude oil. See ‘‘—Exploration and Production—Reserves and Fields—High Sulfur Content Crude Oil’’ under this Item for additional information on high sulfur content crude oil.

Transportation costs for the shipment of our crude oil are covered out of the price of crude oil exported to both CIS and non-CIS countries. We pay these rates in advance. Domestic prices do not include transportation costs, because we charge domestic buyers separately for the cost of transportation. We pay transportation costs with respect to tolling arrangements, as crude oil delivered under such contracts remains our property.

In addition to transportation of crude oil via Transneft, we transport a portion of our refined products through the Transnefteprodukt pipeline. Transnefteprodukt is also a state-controlled entity, specializing in the transportation of refined products. The Transnefteprodukt system is less extensive than the Transneft system. The Federal Tariffs Service also has responsibility for setting the tariff rates for Transnefteprodukt.

In 2002, we started shipping crude oil and refined products by railroad from the Nizhnekamsk oil refinery’s oil-loading platform and in 2003 from Tikhoretskaya oil-loading platform. Our total rail

shipments were 2.1 million tons (15.2 mmbbl) of refined products and 0.03 million tons (0.2 mmbbl) of crude oil in 2005, 4.3 million tons (30.4 mmbbl) of refined products and 1.3 million tons (9.4 mmbbl) of crude oil in 2004, 3.2 million tons (22.8 mmbbl) of refined products and 2.3 million tons (16.4 mmbbl) of crude oil in 2003 and approximately 4.6 million tons (32.6 mmbbl) of refined products and 48,400 tons (0.3 mmbbl) of crude oil in 2002.

Since November 2002, we have accumulated a fleet of railroad cars capable of carrying oil and oil products and formed a subsidiary, OOO Tatneft-Trans, to operate these and leased rail cars and to coordinate transportation of our products via rail-road. As of December 31, 2005, we operated 1,168 rail cars, including 950 rail cars that we owned, 1,162 rail cars, including 950 rail cars that we owned as of December 31, 2004, and 1,166 rail cars, including 950 rail cars that we owned as of December 31, 2003.

REFINING AND MARKETING

Crude Oil

We have three markets for the crude oil that we produce ourselves or purchase from other producers: (i) the domestic Russian market; (ii) the market for exports to the CIS; and (iii) the market for exports to non-CIS countries. In recent years, we have shifted the focus of our domestic Russian market activities to selling refined products instead of selling primarily crude oil. Since we own and lease limited refining capacity, we generally either sell crude oil directly or through intermediaries and then purchase refined products produced from our oil for further resale, or transfer oil to refineries for refining under processing arrangements and receive in return refined products for sale into the market. We currently no longer have processing arrangements. See ‘‘—Refined Products’’ under this Item.

The table below sets forth certain data with respect to the sales volumes of crude oil that we produced and purchased from other producers for the years ended December 31, 2004, 2003 and 2002:

	Year Ended December 31,								
	2004			2003			2002		
	Tons	Barrels	%	Tons	Barrels	%	Tons	Barrels	%
	(in thousands of units, except percentages)								
Crude oil sales[1]									
Domestic	5,329	37,959	24.7	6,153	43,828	28.1	5,402	38,478	26.6
CIS	3,153	22,459	14.7	2,637	18,783	12.0	4,077	29,040	20.0
Non-CIS	13,035	92,848	60.6	13,124	93,482	59.9	10,861	77,363	53.4
Total	21,517	153,266	100.0	21,914	156,093	100.0	20,340	144,881	100.0

(1) Includes purchases of 3,673, 5,310 and 4,679 thousand tons in the years ended December 31, 2004, 2003 and 2002, respectively.

Our domestic sales volumes decreased in 2004 in comparison with 2003 primarily due to a decrease in our deliveries to the Moscow oil refinery. We increased slightly export sales in 2004 in comparison to 2003. Export sales were previously generally made at a higher price than were domestic sales, and we are required to export certain volumes of crude oil in connection with our obligations under some of our loan agreements. See ‘‘Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources—Debt.’’

Revenues from sales of crude oil accounted for approximately 59% of total sales revenues in 2004, compared to 58% in 2003.

Non-CIS Crude Oil Export Sales

We charge world market prices for crude oil exported to non-CIS countries, including the Baltic States. Although the average price for non-CIS exports is higher than CIS and domestic prices, we are prevented from exporting additional amounts of oil to non-CIS countries due to our limited access to the Transneft pipeline network. See ‘‘—Transportation’’ under this Item.

In 2005, 2004 and 2003, approximately 21.9%, 14.0% and 26.6% of our non-CIS deliveries, respectively, were supplied to customers located in Germany, Poland, the Czech Republic and Slovakia via the Druzhba pipeline. The remainder of our oil was exported via the ports of Novorossisk, Primorsk, Butinge, Odessa and Yuzhnyi primarily to customers located in Turkey, France and Germany, or via the Transneft pipeline system to the Baltic States.

We sell most of the oil that we export to international oil traders. Approximately 30%, or 0.3 million tons per month, of our export sales are made pursuant to long-term contracts securing our long-term loan agreements, and the remaining export volumes are sold on the basis of spot contracts. We generally conclude export sales for delivery at the relevant port (in the case of shipment by oil carrier) or for delivery at the Russian border (in the case of cross-border pipeline transport) and usually receive payment for exports to non-CIS countries within one to two months of delivery. The price of non-CIS exports generally must cover transportation costs that we pay to Transneft. See ''—Transportation'' under this Item. In 2004, our non-CIS export crude oil prices per ton increased to RR6,575 compared to an average in 2003 of RR5,296 due to the increase in demand.

We make our non-CIS export sales for hard currency. A substantial portion of our non-CIS foreign currency export volumes is pledged as security for our foreign currency loans. During 2005 and 2004, up to 30% of our approximately 1.0 million tons per month and 1.1 million tons per month, respectively, of non-CIS crude oil exports, have been pledged as security for existing borrowings. See ''Item 3—Key Information—Risk Factors—Risks Relating to the Company,'' ''—Relationship with Tatarstan'' under this Item and ''Item 5—Operating and Financial Review and Prospects—Liquidity and Capital Resources—Debt.''

We currently do not hedge our foreign currency exposure (except, to a certain extent, for Bank Zenit (until April 2005) in connection with its own operations), but may do so in the future to the extent that we are able to do so. See ''Item 10—Additional Information—Exchange Controls'' and ''Item 11—Quantitative and Qualitative Disclosures about Market Risk—Derivatives.''

CIS Crude Oil Export Sales

CIS exports comprise exports to member nations of the CIS other than Russia, and represent primarily exports to the Kremenchug refinery in Ukraine operated by Ukrtatnafta. CIS crude oil prices have historically been lower than the prices we are able to realize on our non-CIS exports but have historically been higher than domestic prices. We delivered approximately 4.4 million tons (31.5 mmbbl) of crude oil to the Kremenchug refinery, representing approximately 88% of our CIS oil sales in 2005, and 3.09 million tons (22.0 mmbbl) of crude oil, representing almost all of our CIS oil sales, in 2004. In 2003, we delivered approximately 2.56 million tons (18.5 mmbbl) of crude oil to the Kremenchug refinery, representing approximately 97% of our CIS crude oil sales. The price of CIS exports generally must cover transportation costs that we are required to pay to Transneft. See ''—Transportation'' under this Item. CIS average crude oil prices per ton increased to RR5,357 in 2004 from RR3,591 in 2003, a 49% increase, due to the increase in demand.

Domestic Crude Oil Sales and Deliveries

Domestic crude oil prices are normally lower than world market prices and are only relatively correlated with them. Domestic crude oil prices result from the supply and demand imbalance within the domestic market, which owing to the limitations on export is generally oversupplied. In 2004, our domestic prices per ton averaged RR3,702, compared to average price of RR1,844 per ton in 2003, representing a 101% increase, driven by an increase in demand of domestic refineries.

We conclude a significant portion of our domestic crude oil sales with a number of domestic oil dealers, who then sell oil to refineries. We have long-standing relationships with many of the domestic oil dealers, but do not currently maintain any material long-term contractual commitments. We also transferred oil until April 2004 under processing arrangements with third parties, under which we receive refined products for sale into the market.

Most of the crude oil sold to domestic oil dealers or transferred by us under processing arrangements was ultimately delivered to the Nizhnekamsk oil refinery (until September 2005) and the Moscow oil

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refinery (until April 2004). In 2005, 2004 and 2003, approximately 73%, 78% and 58%, respectively, of our total domestic crude oil shipment volumes were ultimately delivered to these two refineries, including approximately 54%, 63% and 50%, respectively, to the Nizhnekamsk oil refinery. Deliveries were also made to other refineries located throughout European Russia, including in Ufa, Ryazan and Nizhny Novgorod. In total, approximately 7.4 million tons, 9.2 million tons and 8.3 million tons were delivered to domestic refineries, representing approximately 27%, 38% and 34% of all our deliveries (excluding purchased oil) in 2005, 2004 and 2003, respectively. The decrease of deliveries to domestic refineries in 2005 is mainly due to the increase in deliveries to the Kremenchug refinery in Ukraine.

We also engage in swap transactions with other Russian oil companies whereby we undertake to deliver our oil to certain refineries in Russia or the CIS in exchange for delivery of oil of equivalent value to refineries in or adjacent to regions of Russia where we have retail operations. Such swap arrangements are beneficial to us and our counterparties insofar as they result in reduction of transportation costs and improved marketing efficiencies. The total volume of such swap transactions amounted to 1.2 million tons, 0.4 million tons and 2.1 million tons in 2005, 2004 and 2003, respectively. In 2002, swap transactions amounted to 2.7 million tons.

High Sulfur Content Crude Oil Sales

High sulfur content crude oil has a lower market value than crude oil with low sulfur content. The national pipeline operator, Transneft, charges a premium of U.S.$2.5 per ton (exclusive of VAT) for blending and transporting crude oil with a sulfur content of more than 1.8%, which includes our high sulfur content crude. The fee is payable in rubles, converted at the official ruble/U.S. dollar exchange rate as reported by the Central Bank in effect on the first day of each month. Transneft's current practice of blending our high sulfur content crude oil benefits us. See ''Item 3—Key Information—Risk Factors—Risks Relating to the Company—A significant proportion of our crude oil production and reserves consists of high sulfur content oil, for which we receive a lower price and which has lower marketability than lower-sulfur content crude oil.'' We blended and shipped virtually all of our high sulfur content crude oil production.

Refined Products

Tatneft did not receive or acquire any refining capacity in connection with the privatization of the Russian oil and natural gas sector. However, we have increasingly been developing our refining capabilities and reducing our reliance on purchases of refined products produced from our crude oil from third parties. The table below sets forth our refined product sales for the years ended December 31, 2004, 2003 and 2002:

	Year Ended December 31,								
	2004			2003			2002		
	Tons	Barrels	%	Tons	Barrels	%	Tons	Barrels	%
	(in thousands of units, except percentages)								
Refined product sales[1]									
Domestic	6,202	44,177	55.0	7,271	51,791	61.3	7,403	52,732	58.6
CIS	459	3,270	4.1	63	449	0.5	7	50	0.1
Non-CIS	4,609	32,830	10.9	4,523	32,217	38.2	5,216	37,153	41.3
Total	11,270	80,277	100.0	11,857	84,457	100.0	12,626	89,935	100.0

(1)Includes purchases of 4,177, 4,086 and 4,490 thousand tons in the years ended December 31, 2004, 2003 and 2002, respectively.

In August 1997, Tatarstan President Shaimiev announced plans to expand and upgrade the petrochemicals complex at Nizhnekamsk, owned by Nizhnekamskneftekhim, in order to enable Tatarstan to become independent from refineries located elsewhere. To this end, we entered into discussions with Nizhnekamskneftekhim and TAIF, both of which are related parties under the influence of the Tatarstan government. These discussions resulted in an agreement to form a joint venture company OAO Nizhnekamsk Oil Refinery to expand, upgrade and operate the Nizhnekamsk oil refinery. Our total

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investment in the refinery amounted to approximately RR8,450 million as of September 1, 2005. The Phase I Base Complex of the refinery was brought on stream in 2002, and we intended to further expand and upgrade this facility. However, OAO Nizhnekamsk Oil Refinery has been involved in a dispute with TAIF over the lease of the CDU owned by TAIF. This dispute resulted in the return by OAO Nizhnekamsk Oil Refinery of the CDU to TAIF, and in the sale of substantially all our production assets of OAO Nizhnekamsk Oil Refinery to TAIF. In October 2005, we entered into a long-term supply contract with TAIF in order to supply up to 650,000 tons per month of crude oil to TAIF at market price to be refined by the Nizhnekamsk oil refinery. For further discussion see ‘‘Item 3—Key Information—Risk Factors—Risks Relating to the Company—We are dependent on oil refineries outside of Tatarstan.’’ We have also formed TKNK, a joint venture with Nizhnekamskneftekhim, Svyazinvestneftekhim and LG International Corp. to carry out a feasibility study and construction of an oil refining and petrochemicals complex in Tatarstan. However, in June 2005, all work on the TKNK project was suspended as the joint venture parties could not reach an agreement with respect to its financing and as we designed the project to built a new refinery complex in Nizhnekamsk. See ‘‘—History and Development’’ under this Item.

In accordance with the decision of the Security Counsel of the Republic of Tatarstan and subsequent decisions of our Board of Directors, in September 2005, together with Svyazinvestneftekhim, we founded ZAO Nizhnekamsk Oil Refinery to build an oil refining and petrochemical complex in Nizhnekamsk. We directly own 40% of the new company and Svyazinvestneftekhim owns 9%. The remaining 51% is indirectly held by IPCG Fund. The new complex will comprise an oil refinery with a refining capacity of 7 million tons of oil per year, construction of which is expected to be completed in 2008, a deep refining unit with a fuel oil capacity of 3.5 million of tons, construction of which is expected be completed in 2009, and a petrochemical plant producing products based on aromatics that is projected to be opened in 2010. The initial construction works (including the preparation of the site, etc.) commenced in September 2005. We expect that completion of this new complex should decrease our dependence on refineries outside of Tatarstan and should enable us to produce more environmentally-friendly and more competitive oil products. See ‘‘—History and Development—Developments in 2005 and 2006’’ under this Item.

We own a small oil refinery in Kichuyi, Tatarstan, which began operating in 1995. This refinery is one of the most technologically modern oil refineries in Russia. It has an annual refining capacity of 400,000 tons (approximately 2.85 mmbbl) and produces gasoline and diesel fuel to serve primarily our fuel needs and those of local residents of the Almetyevsk region.

We also own the Minnibaevsk Gas Refinery in Tatarstan. Deliveries from the Minnibaevsk Gas Refinery totaled 0.9 million tons of gas products in each of 2003 and 2004, of which approximately 56% were delivered to Nizhnekamskneftekhim, 1% exported, and the balance sold to various domestic customers. In 2005, deliveries from the Minnibaevsk Gas Refinery totaled 0.8 million tons of gas products, of which approximately 11.5% were delivered to Nizhnekamskneftekhim, 19.48% were exported and the balance was sold to domestic customers.

We own an 8.6% interest in Ukrtatnafta, a company with a 100% ownership interest in the Kremenchug refinery in Ukraine, one of the largest refineries for high sulfur content crude oil in the CIS. The government of Tatarstan owns 28.8% of the outstanding share capital of Ukrtatnafta. The Ukrainian government currently owns, through NK Naftogas of Ukraine, approximately 46% of Ukrtatnafta's shares. There is currently a dispute between the Ukrainian government and certain holding companies of Ukrtatnafta over 18% of Ukrtatnafta's shares. The Ukrainian government announced its intention to privatize these shares in an auction. However, the terms of the auction are unclear. We may consider participating in the auction once its terms are officially announced. We may also become involved in additional alliances and equity participations with certain refineries to which we deliver crude oil or which we consider economically viable. See ''—Organizational Structure—Joint Ventures, Subsidiaries and Associated Companies'' under this Item.

As a result of measures that we have undertaken in recent years in the areas of sales and marketing of refined products, our sales structure has undergone significant changes. Further development of our retail network has resulted in increased sales of refined products in domestic markets. Due to the fact that we lease limited own refining capacity, we sell crude oil to intermediaries, who then refine oil in domestic

refineries, following which we purchase refined products processed from our oil. In 2004, we purchased refined products totaling approximately 4.2 million tons, of which we exported 1.8 million tons. We sold refined products totaling 11.3 million tons, 11.9 million tons and 12.6 million tons, and earned revenue of RR60,121 million, RR43,831 million and RR44,876 million from these sales for the years ended December 31, 2004, 2003 and 2002, respectively. The decreasing volume of these sales is attributable to a shift away from purchases and resales of refined products in favor of an increased emphasis on selling our own refined products.

Processing arrangements, primarily with the Nizhnekamsk oil refinery until September 2005, accounted for a significant portion of our crude oil product sales in 2004. Under such arrangements, a refinery processes crude oil for us in exchange for either a portion of crude oil, refined products, or a payment made by us. We retain ownership of the crude oil and of the related derivative products throughout the refining process.

We are also actively engaged in developing our retail sales network for refined products. As of January 1, 2006, there were 553 Tatneft-controlled service stations throughout Russia and Ukraine, including 408 in Russia and 145 in Ukraine. Tatneft-controlled service stations sold 1 million ton of refined products in 2005. We are currently implementing a program to increase the number of our controlled service stations.

PETROCHEMICALS

We did not receive or acquire any petrochemicals companies or operations in connection with the privatization of the Russian oil and gas sector. However, in an attempt to create a vertically integrated company, since 2000 we have been increasing our petrochemicals capabilities. In 2000, we purchased an approximately 34.6% stake in Nizhnekamskshina from the Tatarstan government, subsequently increasing our stake to 76.01% through additional purchases and participation in a new share issuance. Nizhnekamskshina has been consolidated in our consolidated financial statements from September 30, 2001.

Nizhnekamskshina is one of the largest tire manufacturers in Russia, accounting for approximately 28.4%, 29.0% and 27.7% of all tires produced in Russia in 2005, 2004 and 2003, respectively, and supplying its products to both domestic and foreign markets. Nizhnekamskshina consists of two divisions, a mass tire plant that produces tires for light-weight vehicles and a truck tires plant. Approximately 21.1%, 27.0% and 26.0% of the tires produced by Nizhnekamskshina in 2005, 2004 and 2003, respectively, were supplied to car manufacturers (25.9% in 2002); 58.8%, 53.0% and 53.6% were sold on the secondary market (60.3% in 2002); and 20.1%, 20.0% and 20.3% were exported (13.7% in 2002), including approximately 16.6%, 15.0% and 15.4% (10.3% in 2002) to customers in the CIS. We are in the process of renovating the manufacturing facilities at Nizhnekamskshina, and intend to attract investment and know-how from Western partners. To this end, in May 2002 Nizhnekamskshina entered into an agreement with Italian tire producer Pirelli to use Pirelli's know-how and equipment, and in July 2004 we started producing tires for light passenger vehicles using this technology in the production of up to two million tires annually under the Kama-Euro brand. From July to December 2004, we shipped 102,700 of these tires. In 2005, we produced 10.3 million tires, and we plan to produce 11.1 million tires in 2006.

We also acquired approximately 77.1% of Nizhnekamsk Industrial Carbon Plant in 2000 from the Tatarstan government. Nizhnekamskshina obtains raw materials from Nizhnekamsk Industrial Carbon Plant. Nizhnekamsk Industrial Carbon Plant also sells its products to other Russian tire manufacturers and exports its products to Poland, Bulgaria, India, China, Vietnam, Indonesia, Turkey and other countries. In addition, we formed and own 51% of Yarpolymermash-Tatneft, which is based on the assets of the Yaroslavl Polymer Machine Plant, in order to manufacture equipment for processing materials for tire production. In 2003, we commenced production at OOO Tatneft-Nizhnekamskneftekhimoil, a polyalphaolefin-based synthetic lubricants plant that is the only such enterprise in Russia. In the first half of 2004 the production of polyalphaolefin-based synthetic lubricants was conducted on a transitional basis. In December 2004, programs were approved to update the oils to international standards and on the production of new products. These programs require an investment of approximately RR79.9 million. Polyalphaolefin-based synthetic lubricants are also used at the plant for the production of high-quality greasing substances, such as engine, transmission, refrigerator and synthetic oils. The American Oil Institute has issued a license on the conformity of our engine oil ''Tatneft-Profy'' with the API standards.

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In 2002, we created Tatneft-Neftekhim, a management company for our petrochemicals operations, and transferred to it our holdings in Nizhnekamskshina, Nizhnekamsk Industrial Carbon Plant, Yarpolymermash-Tatneft, Tatneft-Nizhnekamskneftekhimoil, OOO Trading House Kama, a marketing subsidiary of Nizhnekamskshina, and other petrochemicals companies.

BANKING OPERATIONS

In 2004, we conducted our banking operations through, and consolidated the results of, Bank Zenit and Bank Devon-Credit and we owned shares in a number of banking and financial entities. We have recently decreased our activities in these market sectors following the sale in 2005 of our controlling share in most of our significant banking subsidiaries. As of December 31, 2004, our most significant banking subsidiaries were as follows:

- Bank Zenit. As of December 31, 2004, we owned 52.70% of Bank Zenit, a Russian commercial bank founded in December 1994 and based in Moscow. Bank Zenit has branches in Rostov-on-Don, Nizhny Novgorod, Almetyevsk, Gorno-Altaisk, St. Petersburg, Kemerovo and Kursk, a representative office in Kazan and additional offices in Kazan and Nizhnekamsk. We increased our stake from 50% plus one share to 52.70% in 2004, then reduced it to 26.95% in 2005 as a result of the sale by our wholly-owned subsidiary, Tatneft Oil AG, of its 26.75% stake in April 2005 to three companies acting on behalf of certain beneficiaries of Urals Energy. As of May 5, 2006, we owned 39.73% of Bank Zenit, as a result of the acquisition in May 2006 of its newly issued shares.

- Bank Devon-Credit. As of December 31, 2004, we owned approximately 92% of Bank Devon-Credit, a Russian commercial and retail bank. Bank Devon-Credit serves Tatneft and a significant portion of the local population in Almetyevsk and the southeast of Tatarstan through a network of 13 branch offices. In December 2005, we sold all our shares of Bank Devon-Credit to Bank Zenit.
- Bank Ak Bars. As of December 31, 2004 we owned approximately 29.46% of Bank Ak Bars, the largest private bank located in the Republic of Tatarstan in terms of assets and number of retail customers. In 2005 we increased our shareholding to 29.98% of the share capital of this bank and further increased it to 32.27% in 2006. Bank Ak Bars has held approximately 1% of Tatneft's Ordinary Shares since 2000.

As a result of the sale of a significant part of our participation in Bank Zenit and of all our participation in Bank Devon-Credit in 2005, we no longer consider our banking activities to be significant to our operations. For more comprehensive information about our sale of the shares of Bank Zenit and Bank Devon-Credit, see Note 22 to our audited consolidated financial statements included in this annual report. For a more detailed discussion of our banking operations in general see ''Appendix A—Tatneft's Banking Operations.''

COMPETITION

Oil and Refined Products

We currently hold most of the licenses for oil exploration and production within Tatarstan. We consider all other major Russian oil companies, including Rosneft (particularly following its acquisition of the former YUKOS subsidiary Yuganskneftegaz in December 2004), LUKOIL, Surgutneftegaz, TNK-BP and Gazprom Neft (formerly Sibneft, after its acquisition by Gazprom in October 2005), to be our principal competitors in our core business segments. We compete with these and other oil companies for customers both within Russia and internationally, primarily for sales of crude oil.

We believe that our drilling costs are less than those for oil companies operating in Siberia. Our oil reserves are generally closer to the surface than in Siberia, and are located in more geographically accessible terrain. While the main productive horizons in Siberia are found at a depth of approximately 2,300 to 2,400 meters, our main productive horizons lie at a depth of approximately 1,200 to 1,700 meters. We also believe our location gives us a transportation cost advantage over companies operating in Siberia, as we are located closer to major markets in Moscow and Eastern and Western Europe. In addition, while

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we have mature fields and while we produce high sulfur content crude oil, we believe that this has not to date contributed to a higher cost per barrel compared to the other Russian oil companies.

We expect to experience increasing levels of competition in the industry. A number of other Russian oil companies, as well as foreign oil companies, compete on bids for licenses and offer services in Russia, increasing the competition that we face. Foreign-owned companies in particular may have access to greater financial and other resources than we do, which may give them a competitive advantage. We also expect to experience increasing competition due to the limited quantities of unexploited and unallocated oil reserves remaining in Russia, and the effects of, and financial resources provided by, increased foreign investment into the Russian oil industry. Full implementation of the PSA laws could substantially increase levels of interest of foreign and domestic companies in oil production in Russia and further increase the level of competition we face even within Tatarstan. Strategic acquisitions of additional assets, such as mergers or other forms of combination, may also strengthen our domestic competitors. For example, in 2002, 2003 and 2004 the Russian oil industry experienced substantial consolidation, including the privatization sale of Slavneft, a large vertically-integrated oil company, to the shareholders of TNK and Sibneft, at the time Russia's third and fifth largest oil companies, respectively; the formation of TNK-BP, a joint venture between TNK and BP that combined the assets of TNK, Sidanko and ONACO oil companies and TNK's share in Slavneft with the Russian assets of BP (excluding investments in Sakhalin 5), and Yuganskneftegaz—the largest production subsidiary of YUKOS—was sold at auction by the Russian government in partial settlement of tax claims against YUKOS and subsequently acquired by Rosneft. In addition, in September 2004, the Russian government sold its remaining 7.6% stake in LUKOIL in a privatization auction to ConocoPhillips. In October 2005 Gazprom acquired approximately 76% of shares of Sibneft. These competitors may have better access to financial and other resources and greater political influence than we do.

Petrochemicals

In the petrochemicals sector we compete for the Russian and CIS tire markets primarily with other Russian tire manufacturers, such as the Yaroslavl, Omsk, Moscow, Kirov, Krasnoyarsk, Voronezh, Volzhsky, Barnaul, NIIShP, Ural and Petroshina tire companies, as well as Ukrainian tire plant Rosava. The Omsk, Yaroslavl, Volzhsky and Ural tire companies, accounting for approximately 46.4% of tires produced in Russia, are controlled by Sibur, a petrochemicals subsidiary of Gazprom, Russia's state-controlled largest company and natural gas transportation monopoly and the world's largest producer of natural gas. The Kirov, Krasnoyarsk and Voronezh tire companies, accounting for approximately 18.3% of tires produced in Russia in 2003, as well as Rosava, are controlled by AMTEL, a Russian petrochemicals holding. Several of our competitors have entered into joint ventures with major international tire manufacturers, and several international tire manufacturers, including Goodyear, Michelin, Continental, Pirelli and Nokian Tires, have announced plans or taken steps to enter the Russian tire manufacturing market. We expect to experience increasing levels of competition in the petrochemicals segment in the coming years. For example, Nokian Tires has announced its decision to build a new plant in Vsevolzhsk and within three years to produce 3.5 million tires per year (with a maximum production capacity of 8-9 million tires per year). In addition, in 2004, Michelin opened a plant that produces extra class radial tires and sport tires in Davidovo (in the Moscow region) and has announced plans to reach a production capacity of 2.1 million tires per year in 2005.

Banking

The Russian market for financial and banking services is also highly competitive. Although the Russian banking industry is dominated by a few Moscow-based banks, according to the Central Bank, 1,238 banks and other non-bank credit organizations were licensed to conduct banking transactions in Russia as of April 1, 2006. The total assets of banks in Russia were RR10.4 trillion and the twenty largest banks accounted for 62.6% of all banking sector assets (under RAR) in Russia. Due to the large number of banks in Russia and the varying focuses of many of those banks, Bank Zenit faces competition from different banks in each of the business sectors and various regions of Russia in which it operates. In the corporate banking sector, Bank Zenit's primary competitors are OAO Alfa Bank (''Alfa Bank''), MDM Bank (''MDM Bank'') and OAO Uralsib Bank. In the investment banking sector, Bank Zenit's primary

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competitors are Alfa Bank, MDM Bank and Investment Bank ''Trust.'' In the private banking sector, Bank Zenit's primary competitors are Financial Corporation NIKoil, Rosbank, Alfa Bank, ING Bank (Eurasia) ZAO and Raiffeisen Bank Austria LLC. Currently, we do not view Bank Zenit as having a competitive position in the Russian retail banking sector. Russian banks expect to face increased competition as a result of recent and proposed Russian banking reforms, which are likely to facilitate further entry of experienced international banks into the Russian market. In addition, many of our banking competitors possess greater resources, both in terms of assets and business volume, and have better access to funding, making them less vulnerable to economic downturns. For a more detailed discussion of our banking operations in general see ''Appendix A—Tatneft's Banking Operations.''

ENVIRONMENTAL MATTERS

We are currently subject to environmental legislation enacted by both Russia and Tatarstan. The Russian legislation provides grounds for requiring polluters to clean up environmental pollution. Environmental authorities may impose fines for breaches of environmental and sanitation standards as a payment for remediation of the damage caused to the environment. We actively pursue policies, however, that are designed to reduce pollution and its effects, particularly with respect to water, soil and air. Furthermore, the implementation of the Kyoto Protocol may impose new and/or additional rules or more stringent environmental norms. Such requirements may require additional capital expenditures or modifications in operating practices. The impact on us will depend on, among other factors, the base level against which permissible levels of emissions are to be measured and the allocation of quotas for such emissions, which is currently uncertain.

The Russian Government adopted a regulation on October 12, 2005 incorporating the Special Technical Regulation on Requirements to emissions of hazardous substances by automotive vehicles circulating on the territory of the Russian Federation. Pursuant to this regulation, all fuels (gasoline and oil fuels) must meet certain ecologic standards (Euro-2) from April 21, 2006, certain stricter ecologic standards (Euro-3) from January 2008, and certain even stricter ecologic standards (Euro-4) from 2010. We intend to base the infrastructure of the new refining complex in Nizhnekamsk on the latest technology in order to meet these ecological requirements. For further information on the new Nizhnekamsk facility, see ''—History and Development—Developments in 2005 and 2006'' under this Item.

All four of the main rivers located in the territory of our operations previously tested positive in excess of safe levels for chlorides (chemicals derived from the oil production process) and oil products, which characterizes the impact of oil producing industry on these rivers. Levels of chloride contamination in local rivers peaked in 1986, have recently dropped below the maximum allowable concentrations established by law and continue to decrease. We use the system of circulating and repeated water supply in oil production where water is used in maintaining the steam pressure after the oil treatment.

We have responded to problems of pipeline corrosion by implementing a technology, which we have developed, for coating pipes on the inside with corrosion-resistant material (polyethylene). Almost all of our wastewater carrying pipelines have now been replaced with such polyethylene-coated pipes and we continue to replace our oil-gathering networks. Where the use of polyethylene-coated pipes is technically impossible, we use pipes with an internal polymer coating. Along with other corrosion control methods, we have successfully used corrosion inhibitors and electro-chemical protection of oil producing equipment. We develop and implement measures for diagnostics of the technical state of oil-producing pipes on an annual basis. We also organized a permanent monitoring of corrosion of oil-producing equipment for assessment of maintaining resources for safe use and prevention of environmental risks.

To protect underground drinking water sources we have engaged in a well rehabilitation program involving liquidation of old wells, drilling of stand-by wells, construction of more environmentally safe well constructions and hydroisolation of storage pits during well drilling and repair work.

We have developed a complex of measures to ensure ecologically safe construction and repair of the wells and other oil producing facilities. We have organized a supervising service that monitors compliance of the production technology with legal requirements.

We have an opportunity to conduct purification and recovery of contaminated soil as the need arises, as well as recovery of the oil sludge earlier collected in ponds.

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Through our joint venture TATEX we have been installing vapor recovery equipment on our oil storage tanks. In 2003, two additional vapor recovery systems became operational. In 2004, two more vapor recovery systems became operational and we completed construction on an additional three vapor recovery systems. Currently there are 40 vapor recovery systems in operation, equipping all of our storage tanks. This program has helped to reduce substantially emissions of hydrocarbons from our facilities into the atmosphere. We have reduced sulfur dioxide emissions by installing facilities for sulfur cleaning.

After making an economic assessment we created facilities and introduced technologies for processing used tires, luminescent lamps, oil sludge, used motor oils and wires and other production waste because environmental regulations changed and became more strict in respect of handling of waste.

We maintain special laboratories to monitor the surface and ground waters and control the atmospheric air in the territory where we conduct our activities.

When designing a project, the infrastructure projections take into account the possible impact of the designed project on the environment. This impact is evaluated by internal studies, which results are then submitted for independent ecological expertise. In addition, our operations are subject from time to time to ecological compliance reviews.

CORPORATE REORGANIZATION

Following the dissolution of the Soviet Union and due to the subsequent disruption of relations with oil industry equipment manufacturers located within the CIS, most of which were located outside Russia, our predecessor production associations created internal service enterprises such as the Central Production Service Department, the Electric Equipment Service Department and the Subsoil and Wells Repair Service Department. At the same time, in response to disruptions in other sectors of the economy, they increased the number of non-core activities, such as production and processing of agricultural products.

In order to reduce our operating costs and to improve our focus on our core business of exploration and production, we are currently implementing a program of corporate reorganization that was initially approved by our Board of Directors in 1996. The key tasks of the reorganization program are:

- enhancing oil and natural gas production potential;

- transferring to subsidiaries functions that are unrelated to our core activities;
- reducing extraction and auxiliary production expenses by: (i) reducing the number of divisions and (ii) optimizing utilization of production facilities;
- improving efficiencies in utilization of personnel; and
- reducing social benefit costs.

The first stage of the corporate reorganization program concentrated on transferring certain support services that had been provided within each NGDU or by other departments into newly formed subsidiaries expected to provide services on an independent and competitive basis and on divesting social assets and responsibilities by gradually transferring these to local authorities.

We have now completed the first stage of the reorganization by separating out more than 40 former departments engaged in oil production services and transferring a number of social assets to local authorities. We are currently in the second stage of our reorganization, in which we are seeking to transform our company into a vertically integrated holding company and improve management efficiencies. To this end, we are acquiring and increasing our interests in petrochemical and oil-refining enterprises, such as Nizhnekamskshina, ZAO Nizhnekamsk Oil Refinery, Yarpolymermash-Tatneft and Nizhnekamsk Industrial Carbon Plant, and in enterprises that sell crude oil and oil products or provide oil services, such as Tatneft Europe.

In order to improve our vertically integrated structure, in 2002 we created Tatneft-Neftekhim, a management company for our petrochemicals operations, and transferred to it our holdings in

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Nizhnekamskshina, Nizhnekamsk Industrial Carbon Plant, Yarpolymermash-Tatneft and other petrochemicals companies. We also proceeded with a merger of our natural gas and natural gas products collection, refining and transportation assets into the Tatneftegaspererabotka division, established a drilling management company OOO Tatneft-Bureniye, consolidated management of Tatneft-branded gas stations in OOO Tatneft-Centernefteproduct and continued with our internal restructuring in order to optimize costs and corporate governance. As part of our internal restructuring, we took additional steps to streamline management and improve efficiency by centralizing and restructuring our logistics services and reducing the number of employees engaged in general construction, machine tool, special-purpose machinery and related services. In 2003, we divested our stakes in 21 agricultural companies and formed a subsidiary, OOO Tatneft-Aktiv, to optimize leasing of various assets not necessary for our ongoing operations to third parties. In compliance with our long-term strategy to dispose non-core assets, in 2005, we sold our entire stake in Bank Devon-Credit, as well as a significant portion of our stake in Bank Zenit and IFK Solid.

Further Reorganization Plans

We have approved a corporate reorganization program for 2005 to 2007, which is aimed at further transferring support services, currently provided within each NGDU, to newly formed subsidiaries. In accordance with this program we plan to transfer the following functions unrelated to our core activities to subsidiaries:

- public transport;
- construction and installation works;
- repair and maintenance of our conventional pumping units;
- downhole logging works;

• chemical analytical works; and
• security of industrial facilities.

In an effort to reduce our costs, we intend to separate out some of our small service units into economically independent operations. In so doing, we intend to take advantage of the tax benefits available to small businesses. At this stage, we will continue with our program of divesting non-core assets.

We do not plan to retain a controlling interest in all of the newly created service companies and, where we do retain a controlling interest, we expect to transfer minority interests in these companies either to the management and workers of each company or to outside investors. We also plan to retain legal title to certain of the property to be used by the new service companies and to lease it to these companies. The service companies are expected to compete to provide services to Tatneft and to market their services to other exploration and production companies, though in the first several years following their creation we expect to remain the primary customer of such companies. We do not intend to retain control of the road construction companies or maintenance companies, and these entities may become independent of our group. The road construction and maintenance companies have already been registered as limited liability companies.

We do not expect that any significant financial charges will arise as a result of such reorganization.

Social Assets

We currently own certain social assets, including sports and leisure facilities. We manage other social assets, such as housing and kindergartens, which are the property of Tatarstan but have been provided to us under the principle of ‘‘economic management’’ pursuant to agreements with the Tatarstan government. At December 31, 2004, 2003 and 2002, we held social assets with a net book value of RR4,732 million, RR4,870 million and RR5,833 million, respectively. We transferred social assets with a combined net book value of RR455 million, RR2,162 million (including medical equipment with a net book value of RR1,917 million) and RR1,293 million in the years ended December 31, 2004, 2003 and 2002, respectively, to public ownership. We also incurred social infrastructure expenses of RR249 million, RR279 million and

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RR199 million for the years ended December 31, 2004, 2003 and 2002, respectively, for maintenance primarily relating to housing, schools and cultural buildings.

We have also developed a long-term home construction program, which is aimed at reducing housing shortages in the regions in which we operate. One of the most important aspects of the program is the provision of non-interest bearing loans to employees (except for executive officers) for home and apartment purchases. In 2003 and 2004, we issued RR58.63 million and RR50 million, respectively, in housing loans, enabling more than 5% of our employees who qualified as in need of improved housing to acquire new housing. From 2005, we construct houses for our employees financed by the Governmental Housing Fund of the Republic of Tatarstan.

RELATIONSHIP WITH TATARSTAN

As of May 15, 2006, Svyazinvestneftekhim, a company wholly-owned by the government of Tatarstan, held, directly and through its subsidiary Investneftekhim, approximately 33.59% of our capital stock and 35.87% of our Ordinary

Shares. The Tatarstan government also holds a Golden Share, which gives it the power to appoint a representative to our Board of Directors and Revision Committee and veto certain corporate decisions. The Golden Share currently has an indefinite term. For a description of the Golden Share rights see ''Item 7—Major Shareholders and Related Party Transactions—Major Shareholders'' and ''Item 3—Key Information—Risk Factors—Risk Relating to Tatarstan—Tatarstan legislation may be inconsistent with Russian legislation, and resolution of these inconsistencies is uncertain.'' Through its indirect participation in Tatneft, its legislative, taxation and regulatory powers, and also through significant informal pressures, the Tatarstan government is able to exercise considerable influence over us. The Tatarstan government has used its influence in the past to mandate oil sales and to cause us to raise capital for the benefit of Tatarstan or to pay the debts of Tatarstan when independently we may not have entered into such transactions. See ''Item 3—Key Information—Risk Factors—Risks Relating to the Company'' and ''Item 3—Key Information—Risk Factors—Relating to Tatarstan.''

Tatarstan continues to own, directly or indirectly, controlling or substantial minority stakes in virtually all of the major enterprises in Tatarstan, except for OAO Kamaz (a major customer of Nizhnekamskshina), which is controlled by the Russian federal government. The specific nature of Tatarstan's interest in each enterprise cannot be determined, however, and therefore detailed information is not available to us about the extent of Tatarstan's involvement in certain transactions into which we may enter. Nonetheless, we are aware that, as a result of Tatarstan's involvement in other enterprises, Tatarstan has an interest in a number of transactions involving us, including the following:

- Tatenergo. Our companies receive most of their electricity from Tatenergo, wholly-owned by Tatarstan, the primary provider of electric power in Tatarstan.
- Nizhnekamskneftekhim. Through domestic sales agents we deliver some of our crude oil products to Nizhnekamskneftekhim, the largest petrochemicals company in Tatarstan. Nizhnekamskneftekhim is also a shareholder in OAO Nizhnekamsk Oil Refinery and TKNK.
- TAIF. TAIF, which was previously affiliated with Tatarstan, owns the CDU at the Nizhnekamsk oil refinery, previously leased to OAO Nizhnekamsk Oil Refinery. In 2004, OAO Nizhnekamsk Oil Refinery returned the CDU to TAIF as a result of a court judgment. In early September 2005, we sold to TAIF our share in the production assets of OAO Nizhnekamsk Oil Refinery, including the refining units. See ''Item 3—Key Information—Risk Factors—Risks Relating to the Company—We are dependent on oil refineries outside of Tatarstan.'' In October 2005, we entered into a long-term supply contract with TAIF in order to supply up to 650,000 tons per month of crude oil to TAIF at market price to be refined by the Nizhnekamsk oil refinery.

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In the mid-1990s, we informally agreed with the Tatarstan government that we would use up to 50% of our export receivables to secure loans for the benefit of the Tatarstan government. See ''Item 3—Key Information—Risk Factors—Risks Relating to Tatarstan.'' In 1997 and 1998, we received funds under these loans and then on-loaned them to the Tatarstan government (and in certain cases retained a portion of the funds with respect of amounts then owed to us by the Tatarstan government). These on-loans were to be repaid directly by the Tatarstan government, or indirectly through a reduction in our obligations to Tatarstan. Our own loans obtained in order to make these on-loans to Tatarstan were restructured through the Restructuring Agreement entered into with our creditors on October 31, 2000 (we repaid all amounts due under the Restructuring Agreement in 2002). The Tatarstan government reduced its outstanding obligation to us under these on-loans by transferring controlling interests in a local telecommunications company, Tatincom-T, and a geophysical services company, Tatneftegeofizika, in 1999 and discharged RR73 million and RR4,368 million in 2000 and 1999, respectively, through relief of tax liabilities and cash and cash equivalent payments. In 2001, the Tatarstan government settled the remaining balance of the loan through tax liability relief and the transfer to us of shares in companies in Tatarstan, such as Bank Ak Bars and OAO Kamaz.

In the past we have also guaranteed the obligations of other Tatarstan entities in which the Tatarstan government had an interest. In 1998, we entered into a guarantee agreement for a U.S.$50 million loan made by Société Générale to TAIF, which was previously partly owned by the Tatarstan government. Under the terms of the guarantee, we agreed to meet all of TAIF's obligations under the loan agreement. As a result of TAIF's failure to repay the loan in full, we became liable for paying U.S.$19 million to Société Générale. This obligation was restructured under the terms of the Restructuring Agreement.

Through 2000, Tatarstan had a special tax regime in relation to our operations. This tax regime provided significant tax savings for us. We have not enjoyed any significant tax benefits from Tatarstan since 2000.

Resolution of the Cabinet of Ministers of Tatarstan No. 462 reduced tariffs for power resources used by us by 27% beginning in the third quarter of 1998 and continuing through the final quarter of 1999. We have not received any similar benefits since 1999.

The President of Tatarstan has publicly encouraged us to construct an oil refinery in Tatarstan, and we have made substantial investments in refining facilities at the Nizhnekamsk oil refinery through OAO Nizhnekamsk Oil Refinery. We sold our production assets in OAO Nizhnekamsk Oil Refinery to TAIF in September 2005. See ''—History and Development—Developments in 2005 and 2006'' under this Item. The Tatarstan government has also actively encouraged us to create a vertically integrated oil company in Tatarstan and to explore bitumen reserves. See ''—Strategy'' under this Item.

In 2003, at the request of the Tatarstan government, we provided an interest-free loan in the amount of RR1,197 million to the Republican State Unitary Company ''Nedoimka,'' which is wholly owned by the government of Tatarstan, in exchange for long-term notes receivable due in 2022. The government of Tatarstan used the proceeds of this transaction to finance social expenditures. We believe that these long-term notes receivable are not recoverable. Consequently, we wrote off the long-term notes receivable in fiscal year 2003, resulting in a charge to operations of RR1,197 million. See Note 10 to our audited consolidated financial statements.

In September 2004, we borrowed RR2 billion under a loan agreement with Svyazinvestneftekhim. The purpose of the loan was to finance construction of a new refinery by TKNK. See ''—History and Development'' under this item. The amount of loan outstanding as of December 31, 2004 was RR2 billion. The loan interest rate is 0.01% per annum, and the loan matures in March 2014. We repaid this loan in February 2005. See ''Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions.''

In January 2004, at the request of the Tatarstan government, we purchased interest-free promissory notes redeemable in 2024 in the amount of RR960 million from ''Tatgospostavki,'' which is wholly owned by the government of Tatarstan. The government of Tatarstan used the proceeds of this transaction to finance social expenditures.

PROPERTY, PLANT AND EQUIPMENT

Substantially all of our material tangible fixed assets, consisting of interests in crude oil and natural gas reserves, refining facilities, gas stations, storage, manufacturing and transportation facilities and other property, are located in Tatarstan. For a description of our reserves, sources of crude oil, refining facilities, gas station operations and other facilities see ''—History and Development,'' ''—Exploration and Production,'' ''—Refining and Marketing'' and ''—Petroch under this Item. In 1999, we started acquiring gas stations outside of Tatarstan, in particular in Moscow, the Moscow region, Vladimir, the Volga and Urals regions, the Leningrad region, Nizhny Novgorod and Arkhangelsk, as well as in Ukraine. In 2002, in a series of transactions we purchased 16,767 hectares of land underneath most of our production properties located in Tatarstan from the Tatarstan government for RR330 million. In early September 2005, we sold to TAIF our share in the production assets of OAO Nizhnekamsk Oil Refinery, including the refining units, for approximately U.S.$315 million.

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ITEM 5—OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion of our financial condition and results of operations is based on and should be read in conjunction with our audited consolidated financial statements as at December 31, 2004 and 2003 and for each of the years in the three-year period ended December 31, 2004. In each case, these statements should also be read together with the accompanying notes and supplemental information appearing elsewhere in this annual report. These financial statements have been prepared in accordance with U.S. GAAP. 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 Item.

For convenience, certain amounts of crude oil have been translated from tons to barrels. These translations were made at the rate of 7.123 barrels per ton of crude oil, reflecting the weighted average density of our crude oil reserves. However, the actual density of our crude oil reserves may vary by approximately 10% above or below this weighted average, such that actual barrel amounts may vary from this convenience translation. See ''Item 4—Information on the Company—Exploration and Production.''

Russia's economy was considered hyperinflationary for purposes of our consolidated financial statements for the year ended December 31, 2002 and prior periods, and such consolidated financial statements were prepared in accordance with APB 3. All ruble amounts for periods prior to January 1, 2003 are thus expressed in constant rubles as of December 31, 2002 purchasing power, except as indicated otherwise. At a meeting of the AICPA International Practices Task Force on November 25, 2002, the Task Force concluded that Russia will no longer be considered highly inflationary effective from January 1, 2003.

As discussed herein, this discussion of our financial condition and results of operations gives effect to the restatements of our consolidated financial statements for the year ended December 31, 2002 described below in ''Restatements of Previously Issued Financial Statements.''

Restatements of Previously Issued Financial Statements

Our consolidated financial statements for the year ended December 31, 2002 have been restated to reflect the effects of changes in calculation of deferred income taxes and depreciation, depletion and amortization as described below.

Deferred Taxes

For the year ended December 31, 2002, as permitted by the legislation of the Russian Federation, we recorded a statutory revaluation of its property, plant and equipment tax base amounting to RR 11,893 million, and inappropriately recorded a decrease in its deferred tax liability of RR2,854 million calculated on the entire amount of this statutory revaluation. Only a portion of this statutory revaluation, however, will be deductible in the future for tax purposes and as such the tax base of property, plant and equipment as of December 31, 2002 was overstated resulting in an understatement of deferred tax liabilities as of December 31, 2002 amounting to RR2,158 million. Deferred tax liabilities as of December 31, 2002 and the corresponding deferred tax expenses and benefits for the year then ended were also restated as a result of a restatement of property, plant and equipment, net of accumulated depreciation, depletion and amortization, as of December 31, 2002 as discussed below in the amounts of RR111 million and RR50 million, respectively.

Depreciation, Depletion and Amortization Calculation

We have been depleting oil and gas properties on a unit-of-production basis over total proved reserves, and not proved developed reserves, as required by U.S. GAAP. We originally believed that the difference between the two classes of reserves was not material and that the impact on the calculation of depreciation, depletion and amortization would also not be material. As a result of a recalculation of depreciation, depletion and amortization using proved developed reserves, on a cumulative basis, we no longer believe that assumption to be appropriate.

The consolidated financial statements for the year ended December 31, 2002 have been restated to adjust deferred income taxes for the non-deductible amount of the statutory revaluation and to adjust

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depreciation, depletion and amortization for the impact of using total proved reserves, instead of proved developed reserves as follows:

	Year Ended December 31, 2002	
	As reported	As restated
	(in RR millions)	
Deferred income tax benefit / (expenses)	1,488	(620)
Depreciation, depletion and amortization adjustments	(7,325)	(7,541)
Net income	15,793	13,470
Income per share		
Basic		
Common	7.32	6.24
Preferred	8.20	7.12
Diluted		
Common	7.32	6.23
Preferred	8.20	7.11

Developments in 2005 and 2006

In February 2005, we entered into a loan agreement with Bank Ak Bars, under which we borrowed U.S.$35.69 million at 5.5% per annum, which we repaid in full in September 2005.

In April 2005, we received a claim for back taxes from the federal tax authorities, based on their review of our tax filings for the years 2001, 2002 and 2003, in the amount of RR1,380 million. This amount includes both alleged non-payment and under-payment of taxes as well as fines and penalties. The amount of the tax claim was accrued in our financial statements as of December 31, 2003. While we could have challenged this claim, the issue of any such claim would have been uncertain, given the results of recent Russian companies' tax claims. In addition, the amounts claimed were significantly smaller than similar claims recently received by other Russian companies. Consequently, we paid in May 2005 the entire amount claimed.

In April 2005, our wholly-owned subsidiary, Tatneft Oil AG, sold its 26.75% stake in Bank Zenit to three companies acting for the benefit of certain beneficiaries of Urals Energy. The sale of Bank Zenit's shares resulted in a loss on disposal of approximately RR670 million. This transaction had the effect of reducing our ownership interest in Bank Zenit to 25.95%. In May 2006, we acquired 48.92% of newly issued shares in Bank Zenit, as a result of which our total shareholding in Bank Zenit currently is 39.73%.

In July 2005, we provided a subordinated loan to Bank Zenit in the amount of RR1.7 billion, maturing in 7 years, bearing interest at 8.5% per annum. See ''Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions.''

In early September 2005, we sold to TAIF our share in the production assets of OAO Nizhnekamsk Oil Refinery, including the refining units, for approximately U.S.$315 million.

In December 2005, we sold all of our shares, 92%, in Bank Devon-Credit to Bank Zenit, which already owned 3.2% shares in Devon-Credit bank. The sale of the shares of Bank Devon-Credit resulted in a loss on disposal of approximately RR700 million.

In late December 2005, we sold all of our shares in IFK Solid, representing 59.7% of the total outstanding shares of IFK Solid.

In March-April 2006, we acquired 100% of the shares of OAO LDS-1000, the owner of the ice hockey arena in the city of Kazan, for RR2.1 billion.

In February 2006, we transferred RR2 billion into fiduciary management to Investment Bank Vesta, LLC, a related party, which is controlled by an affiliate of one of our senior executives. See ''Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions.''

In April 2006, we provided a subordinated loan to Bank Devon-Credit in the amount of RR900 million, maturing in 7 years, bearing a 7.5% interest per annum. See ''Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions.''

OVERVIEW

Our financial results have been and will continue to be affected significantly by several factors attributable to the special characteristics of the Russian economy and our primary product markets. These factors include crude oil and refined product prices; constraints on the export sale of crude oil and refined products; transportation costs; and inflation and foreign currency exchange rate fluctuations. Each of these factors is discussed in more detail below.

Crude Oil and Refined Product Prices

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

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

Most of the crude oil that we sell is transported through the Transneft pipeline system. Transneft is a state-controlled company. Our 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. Although we pay Transneft a premium of U.S.$2.5 per ton (exclusive of VAT) of such blended and transported crude oil, we benefit from this blending, as the quality of our crude oil is generally lower than that produced by other Russian major oil companies (predominantly those producing crude oil in West Siberia) due to the relatively high sulfur content of the crude oil that we produce. There is currently no equalization scheme for differences in crude oil quality supplied to the Transneft pipeline system, and the implementation of any such scheme is not determinable at present. If these proposals are adopted, the current system will be changed to our significant detriment and our business and results of operations would be adversely affected. See ‘‘Item 3—Key Information—Risk Factors—Risks Relating to the Company—A significant proportion of our crude oil production and reserves consists of high sulfur content oil, for which we receive a lower price and which has lower marketability than lower-sulfur content crude oil.’’

Constraints on the Export Sale of Crude Oil and Refined Products

We transport substantially all of the crude oil that we sell in export markets through trunk pipelines in Russia that are controlled by Transneft. The Russian government is expected to retain control over Transneft for the foreseeable future. Although pipeline capacity in Russia has increased in recent years, this capacity has not kept up with increases in production experienced by Russian oil and gas companies, and therefore the capacity of the pipeline network acts as a constraint on exports and indirectly on oil production in Russia. Currently, there are government-sponsored and private programs to increase pipeline capacity.

Tatneft also used the Russian rail network to transport the crude oil and refined products. However, the Russian rail network has limited capacity and the Russian government may allocate use of the Russian railway system on a preferential basis to domestic deliveries. Moreover, the system is subject to disruption as a result of its declining physical condition, a shortage of railcars, the limited capacity of border stations and spills and leakages, including those due to poorly maintained tank cars.

A significant proportion of our crude oil and refined products transported by pipeline and rail is delivered to marine terminals for onward transportation. There are significant constraints present in Russia’s oil shipment terminals due to geographic location, weather conditions and port capacity limitations.

In addition, our ability to sell crude oil in export markets may be constrained by the Russian government and its agencies, which seek to ensure the availability of sufficient supplies of crude oil and

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refined products on the domestic market. We believe that physical and governmental constraints on export sales of crude oil and refined products may continue in the future.

Transportation Costs

We incur transportation costs for the delivery of crude oil to refineries and for the delivery of crude oil and refined products to export markets. Transneft collects, on a prepayment basis, a ruble tariff on domestic crude oil shipments and a combined ruble and hard currency tariff on exports. A significant proportion of our refined products are transported using the Transnefteprodukt pipeline system. However, the Transnefteprodukt system is not as extensive as the Transneft system for transporting crude oil.

Prior to March 2004, the Russian Federal Energy Commission periodically reviewed and set the tariff rates for each segment of the Transneft and the Transnefteprodukt pipelines. In March 2004, the Federal Energy Commission was reorganized into the Federal Tariffs Service, which has now assumed this role.

We are also subject to tariffs for crude oil and refined products that we transport by railway.

Inflation and Foreign Currency Exchange Rate Fluctuations

A significant part of our revenues are derived from export sales of crude oil and refined products, which are denominated in U.S. dollars. Our operating costs are primarily denominated in rubles.

Accordingly, the relative movements of ruble inflation and ruble/U.S. dollar exchange rates can significantly affect our results of operations. In particular, our operating margins are generally adversely affected by a real appreciation of the ruble against the U.S. dollar (i.e., by an inflation rate that is higher than the rate at which the ruble is devaluing against the U.S. dollar) because this will generally cause costs to increase relative to revenues. We have not historically used financial instruments to hedge against foreign currency exchange rate fluctuations. Our operating margins have been adversely affected recently due to the recent appreciation of the ruble against the U.S. dollar.

As measured by Russia’s CPI, annual inflation in Russia was 11.7%, 12.0%, 15.1%, 18.8%, 20.1% and 37.0% in 2004, 2003, 2002, 2001, 2000 and 1999 respectively. Given Russia’s past inflation history, Russia’s economy was considered hyperinflationary for purpose of our consolidated financial statements for the year ended December 31, 2002 and prior periods, and such consolidated financial statements were prepared in accordance with APB 3. These figures were thus expressed in millions of constant rubles as of December 31, 2002 purchasing power. At a meeting of the AICPA International Practices Task Force on November 25, 2002, the Task Force concluded that Russia would no longer be considered highly inflationary effective from January 1, 2003.

The following table shows the inflation rate in Russia, the period-end and average ruble/U.S. dollar exchange rates, the rates of nominal devaluation (appreciation) of the ruble against the U.S. dollar, and the rates of real change in the value of the ruble against the U.S. dollar for the periods indicated.

	Year ended December 31,			
	2005	2004	2003	2002
Inflation rate	10.9%	11.7%	12.0%	15.1%
U.S.$ period-end exchange rate	28.78	27.75	29.45	31.78
Average U.S.$ exchange rate	28.31	28.81	30.68	31.35
Nominal appreciation (devaluation) of the ruble	(3.7%)	5.8%	7.3%	(5.4%)
Real ruble appreciation	6.9%	18.5%	20.9%	9.2%

Sources: Goskomstat and Central Bank.

At present, the ruble is not a convertible currency outside the CIS. Exchange restrictions and controls exist with respect to the conversion of rubles into other currencies. For instance, between March 1999 and the first half of August 2001, we were required to sell 75% of our hard currency export proceeds to authorized banks in exchange for rubles. From the second half of August 2001, this rate was decreased

to 50%. In July 2003 the Central Bank was given the authority to set this rate between 0% and 30%, and established a rate of 25%. In November 2004, the Central Bank further reduced the rate to 10% effective from December 2004. In May 2006, the Central Bank abolished the requirement to convert hard currency proceeds. See ‘‘Item 10—Additional Information—Exchange Controls—Capital import and export restrictions.’’

In December 2003, the Currency Law was signed by President Putin. Most provisions of the Currency Law came into effect on June 18, 2004. The Currency Law significantly liberalizes the exchange control regime in Russia and expands the ability of Russian individuals and legal entities to engage in banking and financial transactions outside of Russia. Effective from January 1, 2007, the Currency Law will remove most of the restrictions previously imposed by the Russian Government and the Central Bank on transactions between Russian and non-Russian residents. However, pursuant to the Currency Law, from June 2004, the Russian Government and the Central Bank were empowered to regulate and restrict currency control matters, including operations involving foreign securities and foreign currency borrowings by Russian companies. The Central Bank has issued some regulations that introduce rules with respect to depositing mandatory reserves, opening offshore bank accounts and mandatory use of special-purpose accounts (all these regulations to be abolished from July 2006).

Taxation

We are subject to numerous taxes that have had a significant effect on the results of operations. Russian tax legislation is and has been subject to varying interpretations and frequent changes.

The Tax Code was amended in August 2001, effective from January 1, 2002. As a result of this amendment, two new chapters of the Tax Code were introduced that have affected our results of operations. Under the first of these chapters, the maximum income tax rate for income received from ordinary activities was reduced from 35% to 24%, the tax rate for dividends received from domestic companies was reduced from 15% to 6%, increasing to 9% in 2005, and the tax rate for dividends received from foreign companies was reduced from 35% to 15%. However, investment tax credits that could be used to reduce income tax by up to 50% were abolished. Under the second chapter, a unified natural resources production tax on the extraction of commercial minerals was introduced. This unified natural resources production tax replaced the mineral restoration tax, royalty tax and excise tax on crude oil. In addition, road users tax was abolished effective January 1, 2003.

In addition to income taxes, we are also subject to:

- unified natural resources production tax;
- export duties;
- excise taxes on refined products;
- value added taxes;
- property taxes;
- land tax;
- vehicle tax;
- other local taxes and levies; and
- tax penalties and interest.

These taxes have had a significant effect on our results of operations, and represented 34%, 28% and 22% of our total sales and other operating revenues in the years ended December 31, 2004, 2003 and 2002, respectively. These taxes also represented 35% of total costs and other deductions in the year ended December 31, 2004, 31% in the year ended December 31, 2003 and 25% in the year ended December 31, 2002.

These taxes are reflected in taxes other than income taxes in our consolidated statements of operations. In addition, we are subject to payroll-based taxes, which are included as salary costs within selling, general and administrative expenses or operating expenses, as appropriate.

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The table below presents a summary of statutory tax rates to which we and most of our subsidiaries were subject during the years ended December 31, 2005, 2004, 2003 and 2002:

	Year Ended December 31,				
Tax	2005	2004	2003	2002	Taxable base
Income tax—maximum rate	24%	24%	24%	24%	Taxable income
VAT	18%	18%	20%	20%	Added value
Unified natural resources production tax, average	RR1,873	RR1,053	RR801	RR668	Metric ton produced (crude oil)
Refined products excise tax:					
High octane gasoline	RR3,629	RR3,360	RR3,000	RR2,072	
Low octane gasoline	RR2,657	RR2,460	RR2,190	RR1,512	
Diesel fuel	RR1,080	RR1,000	RR890	RR616	
Motor fuel	RR2,951	RR2,732	RR2,440	RR1,680	Metric ton produced and sold domestically(1)
	U.S.$130.6	U.S.$55.9	U.S.$30.4	U.S.$18.6	Metric ton exported

Crude oil export duty, average[2]					
Refined products export duty, average:[3]					
Light distilled products (gasoline products) and mid-distilled products (diesel fuel)	U.S.$92.3	U.S.$38.0	U.S.$27.4	EUR30.0	
Fuel oil (mazut)	U.S.$52.7	U.S.$36.7	U.S.$27.4	EUR15.1	Metric ton exported
Road users tax[4]	—	—	—	1.0%	Net revenues
Property tax—maximum rate	2.2%	2.2%	2.0%	2.0%	Taxable property

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(1) Excise taxes are paid on refined products produced and sold domestically. Prior to January 1, 2003, following changes to the Tax Code, excise tax was paid by the producers of refined products. From January 1, 2003, excise taxes are paid by the sellers of refined products to end customers, while producers and intermediary re-sellers accrue excise tax and subsequently recover it subject to certain conditions set by the Russian legislation.

(2) From February 1, 2002, crude oil export duties have been denominated in U.S. dollars. Prior to February 1, 2002, crude oil export duties were denominated in euro.

(3) From January 1, 2003, refined products export duties have been denominated in U.S. dollars. Prior to January 1, 2003, refined products export duties were denominated in euro.

(4) Abolished from January 1, 2003.

In the year ended December 31, 2004 overall tax expense increased significantly compared with the year ended December 31, 2003. Unified natural resources production tax increased by 33%, average crude oil export duties by 84% and average refined products export duty by 37%. Excise tax on refined products decreased by 24%.

The unified natural resources production tax increased in 2004 as a result of the increase in the base tax rate due to the increase in Urals blend price by 26%, partly offset by the appreciation of the ruble against the U.S. dollar by 6%. Through December 31, 2003, the base tax rate for the unified natural resources production tax was set at RR340 per ton of crude oil produced, increasing to RR347 per ton of crude oil produced in 2004 and to RR419 per ton of crude oil produced effective from January 1, 2005. The rate is adjusted monthly depending on the market price of Urals blend and the ruble exchange rate, and becomes zero if the Urals blend price falls to or below U.S.$8.00 per barrel (U.S.$9.00 from January 1, 2005). From January 1, 2007, the unified natural resources production tax rate is set by law at 16.5% of the value of extracted crude oil, calculated either by reference to actual sale prices of natural resources or the deemed value of natural resources net of VAT less export duties, transportation expenses and certain other distribution expenses.

Pursuant to the draft law passed in the first reading by the State Duma on June 7, 2006 and introducing a differentiated rate for the unified natural resources production tax, the tax rate for the production of oil will be set at RR419 per ton starting January 1, 2007 through December 31, 2016. This tax rate will be applied with a coefficient based on the levels of the international oil prices and the levels of maturity of the oil fields. Under the draft law, the tax rate will be set at 0% up to a total of 25 million tons of oil produced in the oil fields in the Eastern-Siberian Oil and Gas Province. See ‘‘Item

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4—Information on the Company—Overview of the Russian Oil Industry—Current System of Oil-Related Taxes and Payments—The Unified Natural Resources Production Tax.''

Maximum rates of export duties for crude oil were established by Russian Federal Law No. 33-FZ dated May 7, 2004, as amended. The maximum rates depend on a lagged average of Urals blend prices. Effective from June 11, 2004, the export duty rates were increased as follows. These rates start at zero when the lagged Urals blend price is at or below U.S.$109.5 per metric ton. The export duty rates then increase by U.S.$0.35 per ton for each U.S.$1.00 increase in the lagged Urals blend price when the lagged Urals blend price is between U.S.$109.5 and U.S.$146.0 per ton, by U.S.$0.45 per ton for each U.S.$1.00 increase in the lagged Urals blend price when the lagged Urals blend price is between U.S.$146.0 and U.S.$182.5 per ton, and by U.S.$0.65 per ton for each U.S.$1.00 increase in the lagged Urals blend price when the lagged Urals blend price is above U.S.$182.5 per ton.

During the year ended December 31, 2003, export duties on refined products were limited to 90% of the export duties on crude oil. This limitation was lifted effective from January 16, 2004. Rates of export duties on refined products are now established by the Russian government based on the levels of demand of refined products in the domestic and international markets.

Crude oil and refined products exported to CIS countries, other than Ukraine, are not subject to export duties. We currently benefit from this provision only to a limited extent as the majority of our crude oil export sales are to the Kremenchug refinery in Ukraine.

From January 1, 2004, refined products excise tax rates increased to RR3,360 per metric ton of high octane gasoline, RR2,460 per metric ton of low octane gasoline, RR1,000 per metric ton of diesel fuel and RR2,732 per metric ton of motor fuel. From January 1, 2005 the excise tax rates are RR3,629 per metric ton for high octane gasoline, RR2,657 per metric ton for low octane gasoline, RR1,080 per metric ton for diesel fuel and RR2,951 per metric ton for motor fuel. Effective from January 1, 2006, excise tax for straight run gasoline (naphtha) was introduced at the rate of RR 2,657 per metric ton. Accrued excise tax for straight run gasoline could be subsequently recovered if it is used for petrochemical production.

From January 1, 2004, the maximum property tax rate was increased from 2% to 2.2%. However, local authorities set the actual tax rates. The property tax rate in Tatarstan is 2.2% for 2005 and 2004.

We are subject to VAT on most of our purchases. Until December 31, 2003, the VAT rate was 20%, reduced to 18% from January 1, 2004. VAT paid is 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. Our results of operations exclude the impact of VAT.

Effective income taxes have also had a significant effect on our financial results, representing 25%, 31% and 24% of income before income taxes and minority interest in the years ended December 31, 2004, 2003 and 2002, respectively.

In the context of the significant regulatory changes related to Russia's transition from a centrally planned to a market economy over the past decade and the general instability of the new market institutions introduced in connection with this transition, taxes, tax rates and implementation of taxation in Russia have experienced numerous changes. Although there are signs of improved political stability in Russia, further changes to the tax system may be introduced which may adversely affect our financial performance. In addition, uncertainty related to Russian tax laws exposes us to the possibility of enforcement measures and the risk of significant fines and could result in a greater than expected tax burden.

For more information on the current system of oil-related taxation see ‘‘Item 3—Key Information—Risk Factors—Risks Relating to the Company—The Russian tax system imposes substantial burdens on us and is subject to frequent change and significant uncertainty.’’

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RESULTS OF OPERATIONS

The following table shows certain key business and financial indicators:

	Year Ended December 31,				
	2004	% Change on prior year	2003	% Change on prior year	2002
Crude oil production (in millions of metric tons)	25.4	2.0%	24.9	0.1%	24.9
Refining and tolling throughput (in millions of metric tons)	7.2	(14.3%)	8.4	(1.2%)	8.5
Cash flow from operating activities (in RR millions)	27,791	39.0%	20,000	130.3%	8,683
Basic net income per share (in RR)					
Common	10.88	57.1%	6.93	11.1%	6.24
Preferred	11.91	52.3%	7.82	9.8%	7.12
Diluted net income per share (in RR)					
Common	10.84	57.1%	6.90	10.8%	6.23
Preferred	11.87	52.2%	7.80	9.7%	7.11

Year Ended December 31, 2004 vs. Year Ended December 31, 2003

Sales and other operating revenues

A breakdown of sales and other operating revenues is provided in the following table:

	Year Ended December 31,	
	2004	2003
	(in RR millions)	
Crude oil	122,323	90,327
Refined products	60,121	43,831
Petrochemicals	13,320	11,583
Other sales	9,408	9,076
Net banking interest income	1,610	1,001

Total sales and other operating revenues	206,782	155,818

Sales and other operating revenues totaled RR206,782 million for the year ended December 31, 2004, an increase of 33% compared to RR155,818 million for the year ended December 31, 2003. The increase is mainly attributable to an increase in crude oil and in refined products sales prices.

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The table below provides an analysis of the changes in revenues from sales of crude oil:

	Year Ended December 31,	
	2004	2003
Domestic sales of crude oil		
Revenues (in RR millions)	19,727	11,346
Volume (in thousand tons).	5,329	6,153
Price (in RR per ton)	3,702	1,844
CIS export sales of crude oil		
Revenues (in RR millions)	16,890	9,470
Volume (in thousand tons)	3,153	2,637
Price (in RR per ton)	5,357	3,591
Non-CIS export sales of crude oil		
Revenues (in RR millions)	85,706	69,511
Volume (in thousand tons)	13,035	13,124
Price (in RR per ton)	6,575	5,296

Revenues from sales of crude oil increased by 35% to RR122,323 million for the year ended December 31, 2004 compared to RR90,327 million for the year ended December 31, 2003. This increase is attributable to a RR16,195 million increase in non-CIS export sales, a RR8,381 million increase in domestic sales and a RR7,420 million increase in CIS export sales. Revenue from sales of crude oil increased to 59% of total sales and other operating revenues in 2004, from 58% in 2003.

Revenues from domestic sales of crude oil increased by 74% to RR19,727 million in 2004 from RR11,346 million in 2003, notwithstanding a 13% decrease in volumes sold. This increase resulted from the 101% increase in selling prices in the year ended December 31, 2004, compared to the prices at which crude oil was sold in the year ended December 31, 2003. Revenues from domestic sales increased to 10% of total sales and other operating revenues for the year ended December 31, 2004, as compared to 7% for the year ended December 31, 2003.

Revenues from CIS export sales of crude oil increased by 78% to RR16,890 million in 2004 from RR9,470 million in 2003 due to a 20% increase in volumes sold and a 49% increase in selling prices during the year ended December 31, 2004 compared to the year ended December 31, 2003. We continued to provide crude oil on a regular basis to the Kremenchug refinery in Ukraine, which accounted for almost all of our CIS export sales. Revenues from CIS export sales increased to 8% of total sales and other operating revenues for the year ended December 31, 2004, as compared to 6% for the year ended December 31, 2003.

Revenues from non-CIS export sales of crude oil increased by 23% to RR85,706 million in 2004 from RR69,511 million in 2003. While volumes of non-CIS crude oil export sales decreased by 1%, selling prices increased by 24% during the year ended December 31, 2004, compared to the year ended December 31, 2003. We decreased our crude oil rail shipments in 2004 as rail shipments are more costly than transportation via Transneft. Revenues from non-CIS export sales increased to 41% of total sales and other operating revenues for the year ended December 31, 2004, as compared to 45% for the year ended December 31, 2003.

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The table below provides an analysis of the changes in revenues from sales of refined products:

	Year Ended December 31,	
	2004	2003
Domestic sales of refined products		
Revenues (in RR millions)	28,063	23,545
Volume (in thousand tons)	6,202	7,271
Price (in RR per ton)	4,525	3,238
CIS export sales of refined products		
Revenues (in RR millions)	3,546	336
Volume (in thousand tons)	459	63
Price (in RR per ton)	7,725	5,333
Non-CIS export sales of refined products		
Revenues (in RR millions)	28,512	19,950
Volume (in thousand tons)	4,609	4,523
Price (in RR per ton)	6,186	4,411

Revenues from sales of refined products amounted to RR60,121 million for the year ended December 31, 2004 compared to RR43,831 million for the year ended December 31, 2003, a 37% increase. This increase is mainly attributable to a RR8,562 million increase in non-CIS export sales, together with a RR4,518 million increase in domestic sales and a RR3,220 million in CIS export sales. Refined products that we sell are primarily gasoline, fuel oil, diesel fuel and naphtha. Revenues from sales of refined products increased to 29% of total sales and other operating revenues in 2004, from 28% in 2003.

Revenues from domestic sales of refined products increased by 19%, to RR28,063 million in 2004, from RR23,545 million in 2003 due to a 40% increase in the average selling price during the year ended December 31, 2004 compared to the selling prices in the year ended December 31, 2003, partly offset by a 15% decrease in sales volumes. The decrease in volumes sold was due to a 49% decline in the processing throughput at the Moscow refinery due to the change from processing to direct sales arrangements in 2004, from 1,494 thousand tons in 2003 to 756 thousand tons in 2004, and a 6% decline in the refining throughput at the Nizhnekamsk refinery, from 6,081 thousand tons in 2003 to 5,735 thousand tons in 2004. This decrease was partly offset by a 2% increase in the volumes of refined products purchased for re-sale to 4,177 thousand tons in 2004 from 4,086 thousand tons in 2003. Revenues from domestic sales of refined products decreased to 14% of our total sales and other operating revenues in 2004, as compared to 15% in 2003.

Revenues from CIS export sales of refined products increased to RR3,546 million in 2004 from RR336 million in 2003. We significantly increased sales of refined products in Ukraine through a local retail network of gas stations and we also continued to provide refined products in Belarus and Kazakhstan.

Revenues from non-CIS export sales of refined products increased by 43%, to RR28,512 million in 2004, from RR19,950 million in 2003, primarily due to a 40% increase in average selling price per ton. Revenues from non-CIS export sales of refined products increased as a percentage of our total sales and other operating revenues, to 14% in 2004, as compared to 13% in 2003.

Revenues from sales of petrochemical products increased by 15% to RR13,320 million in 2004, from RR11,583 million in 2003. The increase was primarily attributable to a 20% increase in revenue from tire sales, to RR12,362 million in 2004, from RR10,302 million in 2003. This increase was attributable to both increased prices and higher volumes of tires sold. We increased production of tires by 6% to 11.2 million tires in 2004 from 10.7 million tires in 2003. The average selling price increased due to an increase in CIS and non-CIS export sales of tires, where average tire prices are higher than in Russia. Revenues from sales of petrochemicals constituted 6% of our total sales and other operating revenue in 2004, decreasing from 7% in 2003.

Revenues from other sales increased by 4%, to RR9,408 million, in 2004 from RR9,076 million in 2003. Other sales primarily comprise sales of materials and equipment and various field services provided

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by our production subsidiaries to third parties (such as drilling, lifting, construction, repairs and geophysical works). The increase in other sales is mainly attributable to growth in our drilling sales and in processing fees received by the Nizhnekamsk oil refinery from third parties. Revenues from other sales constituted 5% of our total sales and other operating revenue in 2004, down from 6% in 2003.

Net banking interest income increased by 61%, to RR1,610 million, in 2004 from RR1,001 million in 2003, largely as a result of an increase in the volume of the banking activities of Bank Zenit and Bank Devon-Credit. Banking interest income increased by 34%, to RR3,844 million, in 2004 from RR2,859 million in 2003 due to an increase in banking loans and advances to customers from RR20,146 million as of December 31, 2003 to RR29,692 million as of December 31, 2004. Banking interest expense increased by 20%, to RR2,234 million, in 2004 from RR1,858 million in 2003 due to the increase of activity of our banking subsidiaries.

Costs and other deductions

Total costs and other deductions increased by 20% to RR169,818 million in 2004 from RR141,474 million in 2003. This increase resulted primarily from a 37% increase in taxes other than income taxes, a 20% increase in transportation costs and a 35% increase in purchased oil and refined products, partly offset by a 78% decrease in loss on disposals and impairment of investments and a 79% decrease in transfer of social assets constructed after privatization. A breakdown of costs and other deductions is provided in the following table.

	Year Ended December 31,

	2004	2003
	(in RR millions)	
Operating	34,227	31,799
Purchased oil and refined products	39,107	28,997
Exploration	861	812
Transportation	9,142	7,635
Selling, general and administrative	16,941	15,499
Bad debt provision and write-offs	(714)	(262)
Depreciation, depletion and amortization	9,237	8,850
Loss on disposals of property, plant and equipment and impairment of investments	726	2,325
Taxes other than income taxes	59,587	43,378
Maintenance of social infrastructure	249	279
Transfer of social assets constructed after privatization	455	2,162
Total costs and other deductions	169,818	141,474

Operating expenses increased by 8%, to RR34,227 million, in 2004 from RR31,799 million in 2003. Operating expenses include the following main categories: lifting expenses; refining and processing expenses; cost of petrochemical products; cost of materials other than oil and gas refined products purchased for re-sale; and other direct costs. Lifting expenses remained approximately unchanged in 2004 in comparison with 2003 due to a cost-saving program implemented by the management. Refining expenses increased by approximately RR700 million primarily due to the increase in renting expenses of the Nizhnekamsk oil refinery. Processing fees paid to external refineries decreased by approximately RR600 million in 2004, primarily due to the termination in 2004 of processing at the Moscow oil refinery. Cost of petrochemical products increased by approximately RR1,100 million to RR8,950 million in 2004, mainly due to the increased raw materials prices, transportation costs and other associated costs. Accretion of asset retirement obligation under SFAS 143, which is included in operating costs, increased by 10% to RR1,709 million in 2004 from RR 1,548 million in 2003. Other costs increased as a result of the increase in compensation expense in respect of the stock compensation plan approved by our Board of Directors on December 31, 2000, from RR179 million in 2003 to RR426 million in 2004, as well as the change in crude oil and refined products inventory in 2004 resulting in an increase of costs.

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A summary of purchased oil and refined products for 2004 and 2003 is as follows:

	Year Ended December 31,	
	2004	2003
Purchased refined products (in RR millions)	22,725	14,158
Volume (in thousand tons)	4,177	4,086
Average price per ton (in RR)	5,441	3,465
Purchased crude oil (in RR millions)	16,382	14,839
Volume (in thousand tons)	3,673	5,310
Average price per ton (in RR)	4,460	2,795

Total purchased oil and refined products (in RR millions)	39,107	28,997

Expenses related to the purchase of oil and refined products totaled RR39,107 million for the year ended December 31, 2004, an increase of 35%, compared to RR28,997 million for the year ended December 31, 2003. Purchases of refined products increased by 61%, to RR22,725 million, in 2004 from RR14,158 million in 2003, due to a 57% increase in average purchase price per ton, both in the domestic market and in Ukraine, where we had increased purchases in 2004 and where the prices are higher than in Russia. Purchases of crude oil increased by 10%, to RR16,382 million, in 2004 from RR14,839 million in 2003, as a result of a 60% increase in average purchase prices, partially offset by a 31% decrease in volumes purchased. The increase in the average purchase price resulted from increased purchases in the international market (primarily in Ukraine), where purchase prices are higher than in the domestic market, to 553 thousand tons in 2004 from 104 thousand tons in 2003. Purchases of crude oil and refined products constituted approximately 19% of our total sales and other operating revenues both in 2004 and 2003. Purchases of crude oil and refined products are related to swap transactions with other Russian oil companies whereby we undertake to deliver our oil to certain refineries in Russia or the CIS in exchange for delivery of oil of equivalent value to refineries in or adjacent to regions of Russia where we have retail operations. The total volume of such swap transactions amounted to 0.4 million tons and 2.1 million tons in 2004 and 2003, respectively.

Exploration expenses increased by 6% to RR861 million in 2004 from RR812 million in 2003. This increase is due to increased exploration activities in Kalmykia, the Nenetsk Autonomous District, the Orenburg region and the Samara region. Exploration expenses represented less than 1% of our total sales and other operating revenues in both 2004 and 2003.

Transportation expenses increased by 20%, to RR9,142 million, in 2004 from RR7,635 million in 2003. This increase was primarily due to an increase in Transneft's transportation tariffs as well as increased export sales of crude oil within the CIS. Transportation expenses are incurred in the delivery of crude oil and refined products to final customers and to refineries for processing. Transportation expenses constituted 4% of our total sales and other operating revenues in 2004, as compared to 5% in 2003.

Selling, general and administrative expenses increased by 9%, to RR16,941 million, in 2004 from RR15,499 million in 2003. This increase resulted mainly from an increase in charity and sponsorship expenses and land leasing expenses. Certain selling, general and administrative expenses are by nature fixed costs, which are not directly attributable to production, such as general business costs, insurance, advertising, management expenses, legal fees, consulting, audit services and others. Production overhead costs remained on the same level as in 2003. Selling, general and administrative expenses constituted 8% of our total sales and other operating revenues in 2004, a decrease from 10% in 2003.

Bad debt provision and write-offs amounted to RR714 million credit in 2004 compared with RR262 million credit in 2003. This increase primarily resulted from the reversal of bad debt provision on certain long-term loans as we no longer considered them non-recoverable.

Depreciation, depletion and amortization increased by 4%, to RR9,237 million, in 2004 from RR8,850 million in 2003. The increase is attributable to continued investments in oil and natural gas properties and retail gas stations. Depreciation, depletion and amortization constituted 5% of our total sales and other operating revenues in 2004, as compared to 6% in 2003.

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Loss on disposals of property, plant and equipment and impairment of investments decreased by 69% to RR726 million, in 2004 from RR2,325 million in 2003. This decrease is mainly due to a RR1,197 million write off in 2003 of long-term notes receivable, issued by the Republican State Unitary Company ''Nedoimka,'' which we do not consider to be recoverable. See ''Item 7—Major Shareholders and Related Party Transactions—Related Party Transactions'' and Note 19 to our audited consolidated financial statements. Decrease in loss was also attributable to decreased loss on disposal of fixed assets. Loss on disposals and impairment constituted less than 1% of our total sales and other operating revenues in 2004.

Taxes other than income taxes increased by 37%, to RR59,587 million, in 2004 from RR43,378 million in 2003. Expenditures on export duties increased by 61%, to RR29,232 million, from RR18,174 million, and expenditures on the unified production tax increased by 33%, to RR26,418 million from RR19,818 million. Export duties and the unified production tax rates are linked to crude oil market prices, which increased in 2004 compared with 2003. Expenditures on excise tax decreased by 24% to RR1,548 million in 2004 from RR2,031 million in 2003, as a result of the decrease of refining and processing in 2004 and decrease of purchases of taxable refined products (diesel fuel and petrol fuels). Tax penalties and interest decreased to virtually nil in 2004 from RR686 million in 2003. Tax penalties and interest in 2003 resulted from recognition of restructured tax interest on VAT related to prior years (RR501 million) and partially from a claim for back taxes from the federal tax authorities, received in April 2005 and recognized in the year ended 31 December 2003. See ''—Developments in 2005 and 2006'' under this Item. We expect to repay all the restructured VAT payable in accordance with the schedule agreed. See ''Item 3—Key Information—Risk Factors—Risks Relating to the Russian Legal System and Russian Legislation.'' Other taxes mainly include land tax and VAT, which was not qualified for recovery.

Maintenance of social infrastructure expenses decreased by 11%, to RR249 million, in 2004 from RR279 million in 2003. Social expenses are subject to variations depending on social needs, which were as important in 2004 as they were in 2003. Maintenance of social infrastructure remained well below 1% of total sales and other operating revenues in both 2004 and 2003.

Transfer of social assets constructed after privatization decreased by 79% to RR455 million in 2004 from RR2,162 million in 2003. Transfer of social assets in 2003 was primarily driven by the transfer of medical equipment to Medical Center with a net book value of RR1,917 million. Expenses related to the transfer of social assets constituted less than 1% of total sales and other operating revenues in 2004 and 2003.

Production costs per barrel

Below is an analysis of our production costs in U.S. dollar per barrel:

	Year Ended December 31,		
	2004(1)	2003(2)	Change
	(in U.S.$)		
Lifting expenses	2.48	2.46	1%
General and administrative expenses	1.13	1.12	1%
Transportation expenses	1.15	1.01	14%
Total taxes other than income tax	9.40	6.05	55%
Depreciation, depletion and amortization	1.39	1.28	9%
Total production costs per barrel	15.55	11.92	30%

(1)The conversion factors are 1 ton = 7.123 barrels and U.S.$1 = RR28.81.

(2)The conversion factors are 1 ton = 7.123 barrels and U.S.$1 = RR30.69.

Lifting and general and administrative expenses are expenses related to oil and natural gas production and incurred by our oil and natural gas producing divisions and subsidiaries. Total production expenses include lifting, general and administrative and transportation expenses, and exclude costs incurred in conjunction with services rendered to third parties, goods produced or purchased and then subsequently sold and other auxiliary activities of the exploration and production segment unrelated to the extraction of oil and natural gas reserves.

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Our lifting expenses averaged U.S.$2.48 per barrel in 2004 compared to U.S.$2.46 per barrel in 2003. Lifting expenses increased due to the real appreciation of the Russian ruble against the U.S. dollar partially offset by our cost-saving program. Direct operating costs do not include accretion of liability in accordance with SFAS 143.

General and administrative expenses include expenses incurred by our production divisions relating to crude oil production. The 1% increase in general and administrative expenses per barrel of produced oil was primarily the result of the real appreciation of the Russian ruble against the U.S. dollar.

The 14% increase in transportation expenses per barrel of produced oil was primarily due to the increased CIS export sales of crude oil and to the increase in transportation tariffs.

The increase in total taxes other than income tax per barrel of produced oil was primarily the result of increases in export duty and the unified natural resources production tax, which are linked to market crude oil prices. The effective unified natural resources production tax increased by 40% to U.S.$5.07 per barrel in 2004 from U.S.$3.64 per barrel in 2003, while the export duty rate per barrel (applied to total produced crude oil) increased by 79% to U.S.$4.25 per barrel in 2004 from U.S.$2.38 per barrel in 2003.

The increase in the depreciation expense per barrel of produced crude oil was primarily the result of continued significant investment in the development of oil fields.

Other income and expenses

Other expenses totaled RR1,668 million for the year ended December 31, 2004, a substantial increase compared to other income of RR313 million for the year ended December 31, 2003. As a percentage of total sales and other operating revenues, other income (expenses) accounted for less than 1% during 2004 and 2003.

Earnings from equity investments increased to RR748 million in 2004 from RR101 million in 2003 due to higher income received from our equity affiliates and joint ventures in 2004, in particular TATEX.

Foreign exchange gains amounted to RR41 million in 2004 compared to a loss of RR225 million in 2003. The gain resulted from the appreciation of the Russian ruble against the U.S. dollar.

Interest expense net of interest income decreased by 58% to RR640 million in 2004 from RR1,524 million in 2003, as a result of an increase in interest income to RR746 million in 2004 from RR303 million in 2003 due to the interest income collected from the loan granted to Efremov Kautschuk GmbH in connection with the proposed acquisition of the shares of Turkey's oil refining monopoly Tupras (loan granted from the proceeds of U.S.$375 million bridge loans from BNP Paribas and Credit Suisse First Boston). This increase was accompanied by a decrease in interest expense to RR1,386 million in 2004 from RR1,827 million in 2003, which resulted from the repayment of debt (average debt decreased in 2004 compared with 2003 by 6%) and appreciation of the ruble, as the majority of our debt is denominated in foreign currency.

Other net income amounted to RR1,817 million loss in 2004 compared to a RR1,961 million gain in 2003. In 2003, we recorded a gain of RR2,251 million as a result of the offset of income tax, VAT and unified production tax liability due to a favorable court decision in a lawsuit filed by us against the Tax Ministry of Tatarstan in December 2002. Other net income partially offsets other net banking expense, which increased to RR1,888 million in 2004 from RR1,362 million in 2003, primarily due to increased net gains from dealing in foreign currencies and securities.

Income taxes

Income taxes increased to RR10,861 million in 2004 from RR4,582 million in 2003. Current income tax increased by 65% to RR10,032 million in 2004 from RR 6,070 million in 2003, as a result of higher statutory profit recognized by us. The deferred tax decreased to a RR829 million expense in 2004 from a RR1,488 million benefit in 2003.

Minority interest

Minority interest amounted to RR1,025 million charge in 2004, down from RR63 million credit in 2003 reflecting increased income recognized in 2004 by our non-wholly owned subsidiaries, such as Tatoilgas, Chulpan, Nizhnekamskshina, Bank Zenit and Bank Devon-Credit.

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Year Ended December 31, 2003 vs. Year Ended December 31, 2002

Sales and other operating revenues

A breakdown of sales and other operating revenues is provided in the following table:

	Year Ended December 31,	
	2003	2002
	(in RR millions)	
Crude oil	90,327	81,297
Refined products	43,831	44,376
Petrochemicals	11,583	9,920
Other sales	9,076	9,890
Net banking interest income	1,001	845
Total sales and other operating revenues	155,818	146,328

Sales and other operating revenues totaled RR155,818 million for the year ended December 31, 2003, an increase of 6% compared to RR146,328 million for the year ended December 31, 2002. The increase is mainly attributable to an increase in crude oil sales and petrochemical sales, partially offset by a decrease in sales of refined products and other sales.

The table below provides an analysis of the changes in sales revenues of crude oil:

	Year Ended December 31,	
	2003	2002
Domestic sales of crude oil		
Revenues (in RR millions)	11,346	11,901
Volume (in thousand tons).	6,153	5,402
Price (in RR per ton)	1,844	2,203
CIS export sales of crude oil		
Revenues (in RR millions)	9,470	11,510
Volume (in thousand tons)	2,637	4,077
Price (in RR per ton)	3,591	2,823
Non-CIS export sales of crude oil		
Revenues (in RR millions)	69,511	57,886
Volume (in thousand tons)	13,124	10,861
Price (in RR per ton)	5,296	5,330

Sales revenues of crude oil increased by 11% to RR90,327 million for the year ended December 31, 2003 compared to RR81,297 million for the year ended December 31, 2002. This increase is attributable to a RR11,625 million increase in non-CIS export sales, partially offset by a RR555 million decrease in domestic sales and a RR2,040 million decrease in CIS export sales.

Revenues from domestic sales of crude oil decreased by 5% to RR11,346 million in 2003 from RR11,901 million in 2002, notwithstanding a 14% increase in volumes of crude oil sold. Domestic prices were exceptionally low in the first half of 2003 and increased only at year-end. As a result, selling prices were 16% lower in 2003 than in 2002. Revenues from domestic crude oil sales decreased to 7% of total sales and other operating revenues for the year ended December 31, 2003, as compared to 8% for the year ended December 31, 2002.

Revenues from CIS export sales of crude oil decreased by 18% to RR9,470 million in 2003 from RR11,510 million in 2002. This decline was due to a 35% decrease in volumes sold, partially offset by a 27% increase in average selling prices to RR3,591 per ton for the year ended December 31, 2003 compared to RR2,823 per ton for the year ended December 31, 2002. Revenues from CIS export sales decreased to 6% of total sales and other operating revenues for the year ended December 31, 2003, as compared to 8% for the year ended December 31, 2002.

Revenues from non-CIS export sales of crude oil increased by 20% to RR69,511 million in 2003 from RR57,886 million in 2002. The price per ton of non-CIS exports decreased because we increased volumes of crude oil shipped by rail in 2003. Rail shipments are more costly than transportation via Transneft. The 21% increase in volumes sold is attributable to the use of railway deliveries for crude oil in 2003. Prior to 2003, we did not engage in railway deliveries on a commercial basis. Non-CIS average crude oil prices remained relatively unchanged in 2003 as compared to 2002. Revenues from non-CIS export sales increased to 45% of total sales and other operating revenues for the year ended December 31, 2003, as compared to 40% for the year ended December 31, 2002.

The table below provides an analysis of the changes in sales revenues of refined products:

	Year Ended December 31,	
	2003	2002
Domestic sales of refined products		
Revenues (in RR millions)	23,545	24,378
Volume (in thousand tons)	7,271	7,403
Price (in RR per ton)	3,238	3,293
CIS export sales of refined products		
Revenues (in RR millions)	336	30
Volume (in thousand tons)	63	7
Price (in RR per ton)	5,333	4,305
Non-CIS export sales of refined products		
Revenues (in RR millions)	19,950	19,968
Volume (in thousand tons)	4,523	5,216
Price (in RR per ton)	4,411	3,829

Sales revenues of refined products amounted to RR43,831 million for the year ended December 31, 2003 compared to RR44,376 million for the year ended December 31, 2002, a 1% decrease. This slight decrease was primarily due to a decrease in the volume of refined products sold domestically, partially offset by an increase in both the price and volumes of CIS export sales. Refined products that we sell are primarily gasoline, fuel oil, diesel fuel and naphtha. Sales revenues of refined products decreased to 28% of total sales and other operating revenues in 2003, from 31% in 2002.

Revenues from domestic sales of refined products decreased by 3%, to RR23,545 million, in 2003 from RR24,378 million in 2002 due to the combined effects of a 2% decrease in sales volumes and a 2% decrease in prices. Average selling prices decreased due to a shift in the mix of products to heavier, generally less expensive refined products than in 2002. The share of light refined products, especially gasoline, decreased due to a 50% decline in processing throughput at the Moscow refinery of our products, from 2,968 thousand tons in 2002 to 1,494 thousand tons in 2003. This decrease was partially offset by a 22% increase in refining throughput at the Nizhnekamsk refinery, from 4,992 thousand tons in 2002 to 6,081 thousand tons in 2003. Revenues from domestic sales of refined products decreased to 15% of our total sales and other operating revenues in 2003, as compared to 17% in 2002.

Revenues from CIS export sales of refined products increased to RR336 million, in 2003 from RR30 million in 2002 primarily due to sales to new customers in Belarus and Kazakhstan.

Revenues from non-CIS export sales of refined products decreased, to RR19,950 million in 2003, from RR19,968 million in 2002, due to a 13% decline in volumes sold, which was largely offset by a 15% increase in average selling price per ton. The decline in volumes sold was due to decreased processing throughput at the Moscow refinery. Revenues from non-CIS export sales of refined products decreased slightly as a percentage of our total sales and other operating revenues, to 13% in 2003, as compared to 14% in 2002.

Revenues from sales of petrochemical products increased by 17% to RR11,583 million in 2003, from RR9,920 million in 2002. The increase was primarily attributable to a 17% increase in revenues from tire sales, to RR10,302 million in 2003, from RR8,768 million in 2002. This revenue was attributable to both increased prices and higher volumes of tires sold. We increased production of tires by 9% to 10.7 million

tires in 2003 from 9.8 million tires in 2002. The average selling price increased due to an increase in CIS and non-CIS export sales of tires, where average tire prices are higher than in Russia. Sales of petrochemicals constituted 7% of our total sales and other operating revenue in 2003, unchanged from 2002.

Other sales decreased by 8%, to RR9,076 million, in 2003 from RR9,890 million in 2002. This decrease is attributable to our ongoing strategy to reduce the number and level of our non-core activities. Other sales primarily comprise sales of materials and equipment and various field services provided by our production subsidiaries to third parties (such as drilling, lifting, construction, repairs and geophysical works). Other sales constituted 6% of our total sales and other operating revenue in 2003, down from 7% in 2002.

Net banking interest income increased by 18%, to RR1,001 million, in 2003 from RR845 million in 2002, largely as a result of an increase in the volume of our banking activities. Interest income increased 28%, to RR2,859 million, in 2003 from RR2,236 million in 2002 due to an increase in banking loans and advances to customers from RR11,352 million as of December 31, 2002 to RR20,146 million as of December 31, 2003, partially offset by a decrease in weighted average interest rates. Interest expense increased by 34%, to RR1,858 million, in 2003 from RR1,391 million in 2002 due to the issuance of Eurobonds with a face value of U.S.$125 million by Bank Zenit and an increase in term and demand banking customer deposits.

Costs and other deductions

A breakdown of costs and other deductions is provided in the following table:

	Year Ended December 31,	
	2003	2002
	(in RR millions)	
Operating	31,799	36,389
Purchased oil and refined products	28,997	28,372
Exploration		