



# Growth Redesigned

ANNUAL REPORT  
2010



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**JSOC Bashneft is one of the top-10 producers of crude oil in Russia and numbers in the Russian top-5 by oil refining volumes**

**Bashneft's production is sold inside Russia and is also exported to Eastern and Western Europe, Kazakhstan, and Ukraine**

**The Company employs about 28,000 people**

## Bashneft is a new and fast-growing vertically integrated oil company



# MILESTONES IN THE HISTORY OF BASHNEFT

## The history of Bashneft is the history of endeavour by many generations of oil industry workers in Bashkiria



### 1700

- The first recorded references to mineral oil presence in Bashkiria date from the start of the 17th century

### 1929

- A group of geologists headed by Alexei Blokhin is dispatched to Ishimbayevo District in Bashkiria on the initiative of the Russian geologist and scientist Ivan Gubkin. Work by the group established that that detailed oil prospecting in the District was justified.

### 1932

- The first oil strike was made by a prospecting well at the Ishimbayskoye oil field on May 16, 1932, marking the start of industrial production of crude oil in Bashkiria.

### 1935

- Bashneft was set up as an independent trust, comprising the Ishimbayskoye oil field and construction office, the Sterlitamak oil exploration unit, a geology and field development office, and various other sub-divisions.

### 1937

- Discovery of the Tuimazinskoye field, creation of the Tuimazinsky field development unit, commissioning of the Ufa Oil Refinery.

### 1944

- Discovery of Devonian oil pools at the Tuimazinskoye field signals new prospects for oil production in the Urals and Volga region.

### 1945

- Creation of Bashneft Production Union, comprising the trusts Ishimbayneft, Tuimazaneft, Bashnefterazvedka, and Bashneftestroy, the Krasny Proletary and Ishimbay Machine-building factories, as well as the engineering procurement organizations, Bashnefteprojekt and Bashtekhsnabneft.

### 1951

- Commissioning of the Novo-Ufimsky Refinery (Novoil) in preparation for rapid increase of oil production in Bashkiria.

### 1955

- Discovery of the Arlanskoye oil field, the largest in Bashkiria, with reserves of about 1 billion tonnes. Bashkiria becomes the biggest oil producing region of the USSR, with annual output in excess of 15 million tonnes.

### 1956

- Completion of the Ufa Synthetic Spirit Plant (now Ufaneftekhim). The Plant was the first petrochemical facility in Bashkiria and one of the biggest facilities in the Soviet Union making organic synthesis products.

### 1957

- Launch of the third refinery in the Ufa group: the Chernikovskiy Refinery (now Ufaneftekhim) focused on production of fuels and petrochemicals.

### 1980

- One billion tonnes of oil produced in Bashkiria since the start of field development in the region.

### 1995

- Joint-Stock Oil Company (JSOC) Bashneft incorporated on January 13, 1995.

### 1998

- Bashneft starts production operations in Khanty-Mansi Autonomous District.

### 2005

- Sistema Corporation buys large share stakes in principal fuel and energy enterprises in Bashkortostan.

### 2009

- In March 2009 Sistema becomes the main shareholder of the six enterprises grouped in BashTEK. In December Bashneft buys controlling share stakes in OJSC Ufaneftekhim, OJSC Novoil, OJSC Ufa Refinery, OJSC Ufaorgsintez and OJSC Bashkirnefteprodukt from Sistema and becomes the management company for the new oil holding.

### 2010.

- Completion of work to transform Bashneft into a vertically integrated oil company with federal (national) status. Bashneft emerges as the Russian leader by depth of oil refining, standards of refinery equipment (Nelson Index), and rates of production growth.

### 2011

- Bashneft enters the Timan-Pechora oil province, obtaining licence rights at a subsoil area with federal status including the Trebs and Titov fields in Nenets Autonomous District. In April an agreement is signed with LUKOIL on joint project implementation in Timan-Pechora.

# CORE BUSINESSES

## EXPLORATION & PRODUCTION



CRUDE OIL PRODUCTION MILLION TONNES

**14.1** +15.6%

TOTAL RESERVES (3P UNDER PRMS)  
MILLION BARRELS

**2,947**

The Company holds development licences for more than 170 oil & gas fields in the Republic of Bashkortostan, Khanty-Mansi Autonomous District, Nenets Autonomous District, Orenburg Region and the Republic of Tatarstan.

According to results of an audit by Miller & Lents Ltd., proved reserves of Bashneft as of December 31, 2010 to PRMS (SPE) standards were 1912 million barrels, representing reserve life of 19 years. Proved and probable (2P) reserves were 2322 million barrels. Overall reserves of Bashneft (including possible) were 2947 million barrels.

The Company has 166 fields in commercial production. Bashneft maintained its leadership in 2010 among Russian vertically integrated oil companies (VICs) by rates of production growth, achieving an increase of 15.6% to 14.1 million tonnes of crude oil.

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## OIL REFINING AND PETROCHEMICALS



CRUDE OIL REFINING MILLION TONNES

**21.2** +2.1%

AVERAGE REFINING DEPTH

**86.3%**

Bashneft's refining capacities consist of three refineries — OJSC Ufaneftekhim, OJSC Novo-Ufimsky Refinery (Novoil), OJSC Ufa Refinery, — as well as refining capacities of the petrochemical producer, OJSC Ufaorgsintez. The Company's refineries are Russian leaders by standards of equipment, refining depth, and quality of petroleum product outputs.

Bashneft refined 21.2 million tonnes of crude oil at its refineries in 2010, which is 2.1% more than in 2009. Average depth of refining at Company facilities during the year was 86.3%, which is the best result among Russian VICs.

Bashneft accounts for about 13% of Russian production of gasoline.

The Company's engine fuels meet the standards of the Russian Government's Technical Regulation for fuels (equivalent to Euro-3), and the Company also produces fuel to Euro-4 and Euro-5 standards.

OJSC Ufaorgsintez is a major producer of phenol, acetone, high-pressure polyethylene and polypropylene.

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## MARKETING



PETROLEUM PRODUCT SALES  
MILLION TONNES

**18.8** +175%

OWNED AND PARTNER  
FILLING STATIONS

**642**

The Company has set up its own marketing service and made long-term contracts for deliveries of crude oil to its refineries in order to load refining capacities (Bashneft's own crude output is insufficient for this purpose). Refining of third-party crude on a fee basis is no longer practised. Bashneft sold more than 11.2 million tonnes of petroleum products on the domestic market in 2010 and exported more than 7.8 million tonnes. The Company also exported 3.2 million tonnes of crude oil.

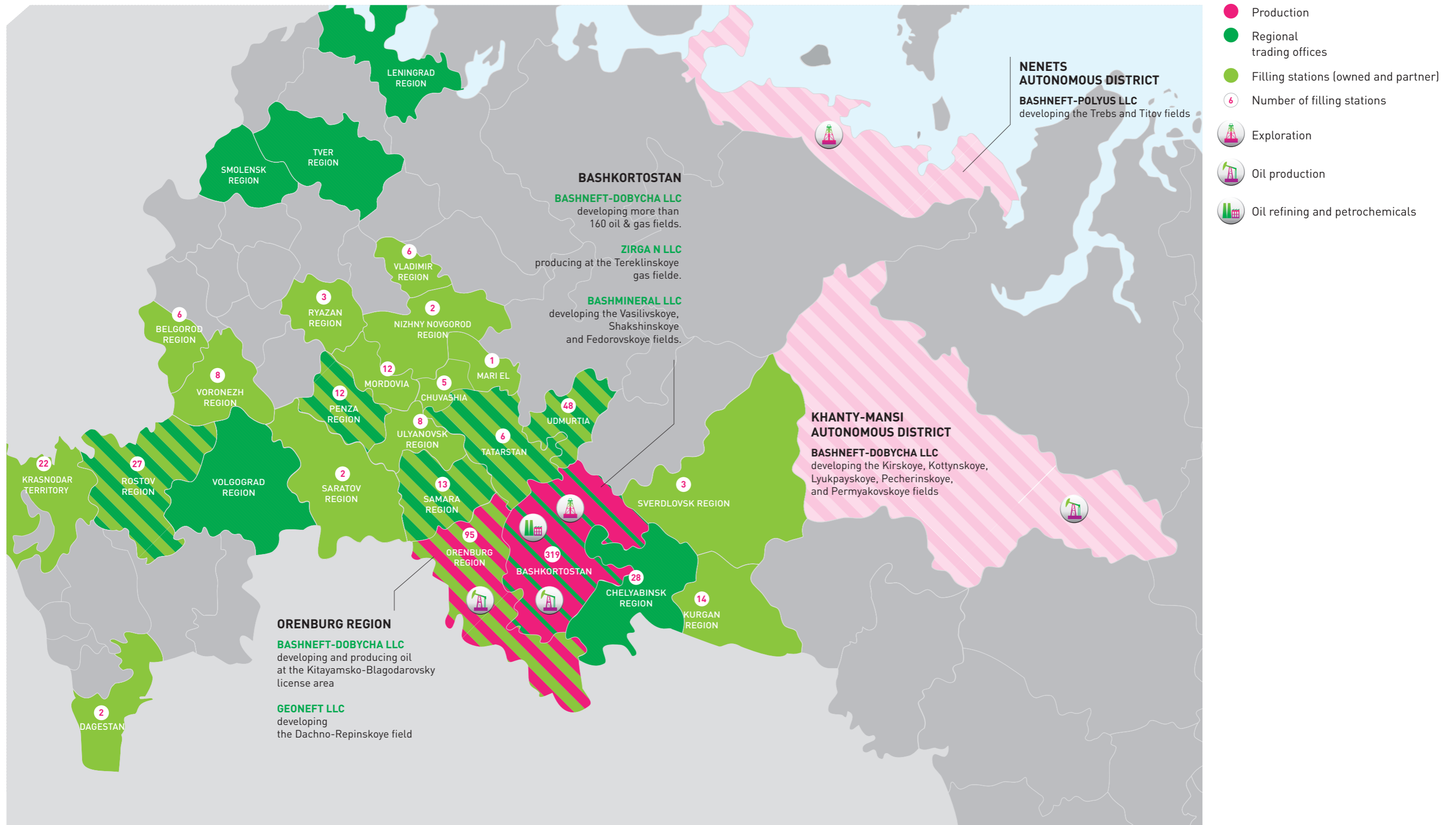
Bashneft carries out small-scale wholesale and retail sales of petroleum products via the oil-storage facilities and filling stations of three marketing organizations (OJSC Bashkirnefteprodukt, OJSC Orenburgnefteprodukt, and LLC Bashneft-Udmurtia), and also via 12 regional

branches of CJSC Bashneft-Region, and via filling stations, with which it has partner relationships (fuel supply agreements and franchise arrangements). Bashneft sold more than 1 million tonnes of high-quality fuels produced at the Ufa group of refineries at its own and partner filling stations in 2010.

In the future the Company plans to significantly extend geographical reach of its retail and small wholesale fuel marketing in priority regions.

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# GEOGRAPHY OF BASHNEFT'S BUSINESS



# KEY INDICATORS AND STRUCTURE OF THE COMPANY

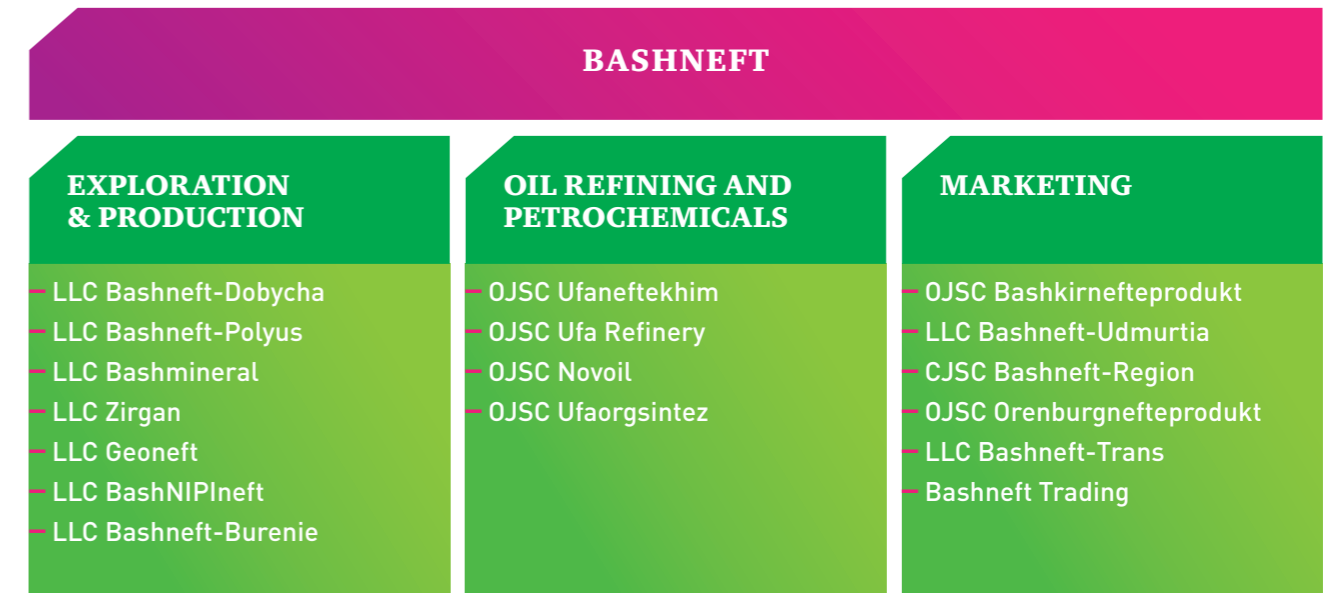
## KEY OPERATING INDICATORS OF BASHNEFT IN 2010

RESERVES as of December 31, 2010	PRODUCTION in 2010	REFINING in 2010	MARKETING in 2010
1P (proved) reserves to PRMS (SPE) standards <b>1,912 million barrels</b>	Crude oil production <b>14.1 million tonnes</b>	Refining capacities <b>24.1 million tonnes per year</b>	Crude oil exports <b>3.2 million tonnes</b>
2P (proved+probable) reserves to PRMS (SPE) standards <b>2,322 million barrels</b>	Average daily production of crude oil <b>276,000 barrels</b>	Primary oil refining <b>21.2 million tonnes</b>	Petroleum product exports <b>7.8 million tonnes</b>
3P (overall) reserves to PRMS (SPE) standards <b>2,947 million barrels</b>	Growth of production compared with 2009 <b>15.6%</b>	Growth of refining compared with 2009 <b>2.1%</b>	Wholesale deliveries to the domestic market <b>10.4 million tonnes</b>
Reserve life <b>19 years</b>	Growth of production obtained by new drilling, and by secondary and tertiary recovery techniques <b>44.4%</b>	Refining depth <b>86.3%</b>	Retail sales via own and partner filling stations <b>1.0 million tonnes</b>
Replacement ratio <b>738%</b>	Growth of output from new wells <b>112%</b>	Nelson Index <b>8.3</b>	Numbers of filling stations <b>319 in ownership 323 partner stations</b>

## MAIN FINANCIAL RESULTS OF BASHNEFT GROUP IN 2010

INDICATOR	2010	2009	TREND
Revenue	<b>USD 13,341 million</b>	<b>USD 6775 million</b>	+ 97%
EBITDA	<b>USD 2981 million</b>	<b>USD 1249 million</b>	+139%
EBITDA margin	<b>22%</b>	<b>18%</b>	
Net income (without minority interest)	<b>USD 1429 million</b>	<b>USD 420 million</b>	+226%
Net margin	<b>11%</b>	<b>6%</b>	
Capital expenses	<b>USD 492 million</b>	<b>USD 589 million</b>	-16%

## COMPANY STRUCTURE



# ADDRESS BY THE CHAIRMAN OF THE BOARD OF DIRECTORS OF BASHNEFT



Dear Shareholders,

I am very pleased to present the first public Annual Report by Bashneft. Although the Report refers specifically to 2010, it provides an account of Company development since April 2009, when the process of transforming Bashneft into a vertically integrated oil company with national (federal) status began.

We are still at the start of a long road, and much remains to be done, but we can already look back with pride at what has been achieved so far. In less than two years a number of good — even unique, — but disconnected assets have been brought together to form a vertically integrated company, comprising a complete production chain from exploration & production of crude oil to sale of petroleum products.

Implementing the strategy of its shareholders, Bashneft's professional management team has effected revolutionary changes. The Company has completely eliminated the practice, by which capacities of the Ufa refinery group were used for processing of third-party crude on a fee basis, and has instead made long-term contracts with the leading Russian oil companies, securing sufficient volumes of crude oil to load the refining capacities.

The company has created its own marketing service from the ground up, and the service is already capable of selling up to 20 million tonnes of petroleum products per year. Bashneft's marketing strategy is based on maximizing access to end-users. The Company target is to sell up to 25% of products via retail and up to 35% via small-scale wholesale channels by 2015. Consistently implementing this strategy in 2010, the Company bought 12 sales units specialized in small wholesale business in various Russian regions and a large chain of filling stations in the Republic of Udmurtia, as well as making a number of agreements with filling station chains in the framework of its retail partnership program. Bashneft also recently took strong positions on the fuel market in Orenburg Region. In its upstream business, the Company has made a breakthrough in levels of crude oil production, moving towards the strategic goal of a balance between levels of crude oil production and refining. Bashneft has increased output at old oil fields by more than 20% in two years. This result has been achieved without increase of capital expenditures, by optimizing operations at existing wells, and improving efficiency of drilling and enhanced oil recovery techniques.

**“ We are still at the start of a long road, and much remains to be done, but we can already look back with pride at what has been achieved so far. In less than two years a number of good — even unique, — but disconnected assets have been brought together to form a vertically integrated company, comprising a complete production chain from exploration & production of crude oil to sale of petroleum products. ”**

However, the Company understands that potential for increasing production at existing fields is not infinite and has therefore sought opportunities for acquisition of new production assets. These efforts have been successful: Bashneft has obtained licence rights for development of the large Trebs and Titov fields in the Timan-Pechora oil province.

Fundamental changes have not been limited to the production sphere. Bashneft has also worked to set up modern corporate governance mechanisms inside the Company. Optimization of management structure, and application of modern management technologies and oversight mechanisms to existing business processes have led to efficiency improvements in all aspects of Company operations.

These major steps for creation of a new vertically integrated company have been guided and controlled by the Board of Directors of Bashneft, which included independent directors for the first time in 2010. In order to improve the efficiency of decision-making and to prepare materials for discussion of key issues by the full Board, four Board committees have been set up and put to work: on strategy, budget and audit, appointments and remuneration, and corporate conduct.

Our combined efforts have had impressive results. IFRS revenue doubled last year to more than USD 13 billion, and net income rose by 3.5 times, allowing the Company to pay sizeable dividends to shareholders and lay plans for an increase of investments. The Bashneft share price has followed the upward trend in operating and financial results, and Company capitalization is now in excess of USD 10 billion. Bashneft still has enormous potential. We intend to realize this potential, and thereby propel the Company to the forefront of the Russian oil & gas industry.

Achievement of this goal will also depend on respecting the interests of all concerned parties, and combining business efficiency with a policy that can support social stability.

We see the future of JSOC Bashneft as a fast-growing, world-class Company, which will be highly attractive to investors.

**ALEXANDER GONCHARUK,  
CHAIRMAN OF THE BOARD  
OF DIRECTORS OF BASHNEFT**

## ADDRESS BY THE PRESIDENT OF BASHNEFT



Dear Shareholders and Employees of Bashneft,

In 2010 Bashneft was transformed into a genuine vertically integrated oil company with efficiency indicators and business processes that match the highest standards in the Russian oil sector. This was achieved in a very short space of time thanks to the efforts of Company staff and, particularly, of a highly professional management team.

We do not mean to rest on our laurels: we constantly compare the quality of management and business efficiency at Bashneft with results achieved by the best Russian oil companies, and we understand that much remains to be done now and in coming years. Nevertheless, there is no reason to play down the evident achievements of 2010.

The Company's management structure has been radically transformed. In a short period of time Bashneft has made

the step from operations based on processing of third-party crude oil to a classic form of vertical integration: purchase and refining of crude oil, and sale of petroleum products by the Company itself. This has required creation of our own marketing service, where no such business unit existed in the Company before. We have started making intensive use of new technologies and techniques for improvement of operating efficiency, and applying modern business processes in all key spheres of Company business. Results in 2010 showed that we are moving in the right direction.

Company strategy, approved by shareholders in 2010, has established our long-term development objectives. They are: organic growth of production accompanied by greater investment efficiency and reduction of operating expenses; acquisition of new production assets in order to achieve a balance between production and refining capacities; reinforcing the technology leadership now enjoyed by the Ufa group of refineries, bringing their outputs into compliance with the Government's Technical Regulation on fuel quality, and lowering refining costs; and, finally, expanding Company presence on retail and small wholesale markets for petroleum products, in order to sell products directly to end-users without sales intermediaries.

This strategy is immediately understandable, it is realistic, and some of its components were already implemented in 2010.

The Company produced more than 14 million tonnes of oil last year, making it the leader in Russia by growth rates (+15.6%). Bashneft's refining complex achieves refining depths that match levels in Europe (86.3%) and is already producing high-quality engine fuels to Euro-4 and Euro-5 standards. In 2010 the Company substantially increased its presence on premium markets (retail and small wholesale), added regional trading units, expanded its retail sales network by acquisition of filling stations in new regions, and made numerous jobbing and franchise agreements to extend its retail partnership network.

We ended the year with very strong financial indicators, confirming the efficiency of our investments. The Company nearly doubled its IFRS revenue to more than USD 13.3 billion. EBITDA increased by 138.7% to almost USD 3.0 billion, and net income less minority interest was above USD 1.4 billion, representing an improvement of 3.4 times compared with 2009.

**“ We ended the year with very strong financial indicators, confirming the efficiency of our investments. The Company nearly doubled its IFRS revenue to more than USD 13.3 billion. EBITDA increased by 138.7% to almost USD 3.0 billion, and net income less minority interest was above USD 1.4 billion, representing an improvement of 3.4 times compared with 2009. ”**

We laid the foundations in 2010 for growth in scale of Bashneft's business, entry to new geographical regions, and elimination of the imbalance between production and refining. Acquisition of development rights at the Trebs and Titov fields represents a further important step towards all these objectives. In order to enhance the economic efficiency of this project, Bashneft reached an agreement in April 2011 with LUKOIL on creation of a joint venture for development of the two fields. The agreement should enable Bashneft to obtain its first oil in Timan-Pechora as early as 2013.

Pursuing the goal of making the Company more attractive for investment, we have continued to install modern principles of corporate governance at Bashneft, focusing particularly on protecting the rights of minority shareholders and enhancing financial and informational transparency. The Company has adopted procedures for open conduct of tenders and has begun quarterly information disclosure to international accounting standards. Results of the first international audit of Bashneft reserves to be carried out for 10 years were published in 2010, and such audits will now be carried out on a regular basis. The latest audit, by Miller & Lents, shows that proved reserves as of December 31, 2010 were 1.911 billion barrels.

While working to increase the efficiency of its production assets, Bashneft has not neglected the social responsibilities of business. We have been and remain one of the largest tax payers in regions where we have business presence. Improving the quality of life of people in these regions (particularly those employed by our Company) and helping to develop social infrastructure are important objectives for Bashneft. Good working conditions, industrial safety and environmental security are required by standards imposed by Government, but their importance for Bashneft is also dictated by our sense of responsibility towards our employees and society at large. At the end of 2010 Bashneft subscribed to the Social Charter of Russian Business and produced its first Sustainable Development Report. We intend to adhere to these principles in the future.

I am convinced that progress by Bashneft in 2010 will reflect positively on value of the Company, levels of income in regions where we have operations, and the material well-being of our employees.

I wish our shareholders and employees every success in 2011!

**ALEXANDER KORSIK,  
PRESIDENT OF BASHNEFT**



# KEY EVENTS IN 2010

## JANUARY

- Bashneft completes acquisition of controlling stakes in OJSC Ufa Refinery (55.58% of charter capital), OJSC Novoil (61.57%), OJSC Ufaneftekhim (47.18%), OJSC Ufaorgsintez (51.49%) and OJSC Bashkirnefteprodukt (56.11%) from OJSC Sistema Corporation. Creation of a vertically integrated company is legally executed.

## FEBRUARY

- A Bashneft R&D project for processing of oil sludge using the Consortsium bio-agent wins a prize at the Sixth National Environment Competition (the only contest in Russia for achievements in the environment and sustainable development sphere).

## MARCH

- Bashneft is accredited as a member of the petroleum products section of the St. Petersburg International Mercantile Exchange (SPIMEX).

## APRIL

- As part of the new policy of information transparency, senior managers of Sistema Corporation and Bashneft give a presentation of Bashneft's development strategy for investment analysts and national media representatives, who also visit company production facilities.
- The Ufa branch of the charity foundation of Sistema Corporation signs an agreement with the Government of Bashkortostan on financing of social infrastructure development in 2010, by which Bashneft Group agrees to invest 1.2 billion rubles for this purpose.
- The Company begins electronic trading operations using the B2B-Bashneft trading and procurement vehicle, designed as part of the B2B-Center electronic trading system. Use of B2B-Bashneft improves efficiency and transparency of trading and procurement, as well as expanding the range of trading partners, with which Bashneft does business.
- Bashneft launches a partnership program for retail sale of its petroleum products via jobbing and franchise agreements with operators of filling station chains.

## MAY

- Bashneft publishes results of the Company's first independent oil reserve audit for 10 years. The audit was carried out to international standards by Miller&Lents using PRMS (former SPE) methodology as of April 1, 2009, when Bashneft came under the control of Sistema Corporation, and also as of December 31, 2009.

- Bashneft wins the sustainable development nomination at the All-Russian competition, Best Russian Enterprises in 2009. Trends, Efficiency, Responsibility.

## JUNE

- Bashneft Group publishes financial results for 1Q 2010 to International Financial Reporting Standards (IFRS), representing the first IFRS publication by the Company.

- Bashneft acquires further stakes in its subsidiaries through a required offer to minorities (as stipulated by the Federal Law on Joint-Stock Companies): 7.7% of OJSC Ufaneftekhim, 0.2% of OJSC Novoil, 0.7% of OJSC Ufa Refinery, 5.0% of OJSC Ufaorgsintez, and 0.8% of OJSC Bashkirnefteprodukt.

- Shareholders at the Company's Annual General Meeting (AGM) elect David Yakobashvili, a member of the board of directors of the company Wimm-Bill-Dann Food Products, as a member of Bashneft's Board of Directors. Mr Yakobashvili thus becomes the first-ever independent director of Bashneft.

- Bashneft signs a cooperation agreement with Ufa State Oil University on joint work in training, re-profiling and continuous education of specialists employed by the Company, and on work experience opportunities at Bashneft for students and post-graduates at the University.

## JULY

- Bashneft transfers all of its petrochemical sales to the electronic trading vehicle, B2B-Bashneft.
- Bashneft purchases 49.99% of shares in OJSC ASPEC as part of its strategy for development of retail and small wholesale marketing of petroleum products in target regions. The transaction gives Bashneft ownership of oil marketing assets of LLC ASPEC-Nefteprodukt (44 filling stations) and CJSC ASPEC (12 sales entities in Russian regions)

## OCTOBER

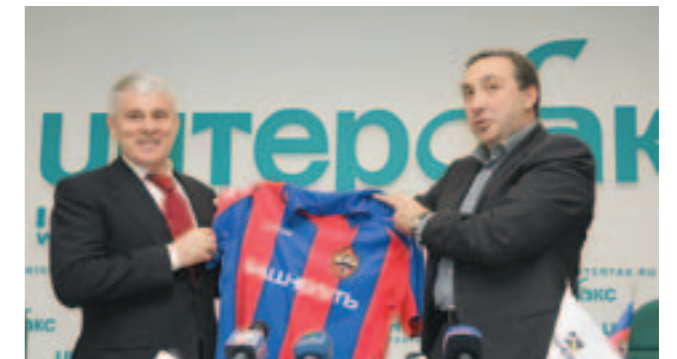
- Bashneft takes steps to improve corporate governance standards. The Board of Directors approves a Code of Corporate Conduct and Ethics, and a Regulation on the Corporate Secretary of JSOC Bashneft.

## NOVEMBER

- Bashneft sets up a transport subsidiary, LLC Bashneft-Trans, to operate a fleet of 4500 tank wagons. The new entity will effect up to 60% of rail transport for outputs of Bashneft and its subsidiaries.

## DECEMBER

- Bashneft adheres to the Social Charter for Russian Business and presents its first Report on Corporate Social Responsibility and Sustainable Development.
- An Extraordinary Meeting of Shareholders (EGM) of Bashneft on December 8 votes to appoint the former President of the Republic of Bashkortostan, Murtaza Rakhimov, and the Deputy Prime Minister of Bashkortostan, Yury Pustovgarov, as independent members of the Company's Board of Directors.
- An EGM on December 17 decides to pay dividends of 104.5 rubles per share for 9 months of 2011.
- Based on examination of the proposals submitted, a commission of the Federal Agency for Subsoil Use (Rosnedra) recommends that a licence should be issued to Bashneft for exploration & production of oil at a federal subsoil area, which includes the Trebs and Titov oil fields in Nenets Autonomous District with total recoverable reserves (C1+C2) in excess of 140 million tonnes. The licence was obtained by Bashneft in February 2011



# STRATEGY

**Bashneft's development strategy is ambitious and aims to realize the Company's potential and place it among oil & gas industry leaders**

The strategic objective of Bashneft is creation of a large and well-balanced vertically integrated company with growing levels of production, advanced refining technologies and sustainable marketing channels.

## STRATEGIC PRIORITIES



## STRATEGIC OBJECTIVES



## Bashneft's development strategy uses an optimal combination of efficiency and achievability in each business segment

### Creation of a vertically integrated oil company

Work continued in 2010 to optimize organizational and ownership structure. This involved transformation from a collection of self-sufficient business units to a system of unified vertical control, with general management functions consolidated at the level of the parent Company (Bashneft). The Company will pursue the process of corporate restructuring further in order to achieve maximum transparency in ownership and in the Group management system.

Bashneft is committed to executing a whole range of corporate governance tasks as part of VIC creation, including: standardization of key business processes; strengthening of the management team; construction of integrated mechanisms for business planning, oversight and reporting; implementation of a training and development program for personnel; and installation of a long-term incentive program for Company managers.

### Exploration & production

At present Bashneft has a large-capacity, high-tech refining complex, but has insufficient crude oil production of its own to load these capacities. Therefore the main task for the Company in the medium term is to achieve a balance between oil production and refining by major increase of extraction levels. Bashneft is targeting organic growth of output at developed fields to a optimal level of 15 million tonnes by 2013. Production growth will be achieved by further exploration at existing fields and application of enhanced oil recovery techniques. The Company is also looking at other means of increasing production levels, mainly by acquisition, at auctions and competitions, of licences for prospective areas and fields in Russia, which have not yet been allocated from the Government register of mineral resources, and also by acquisition of oil production assets, which are already in development.

As part of strategy implementation Bashneft took part in a competition in 2010 for exploration & production rights at a federal subsoil area, which includes the Trebs and Titov oil fields in Nenets Autonomous District with total recoverable reserves (C1+C2) in excess of 140 million tonnes. Bashneft obtained the licence for this area in February 2011 following a decision by the Russian Government. Oil production at the Trebs field is due to start in 2013.

The Company intends to lower unit costs in the exploration & production segment by 10% in the next three years. This will be achieved by use of the latest technologies for well construction and application of enhanced recovery techniques, optimization of the management system and improvement of productivity at all production stages, and comprehensive use of energy-saving technologies. Bashneft's development strategy selects and combines the best development approaches in each business segment, based on feasibility and efficiency criteria.

### Oil refining and petrochemicals

The Company attaches equal importance to maintaining and strengthening its leading positions in the oil refining segment.

Modernization of refining capacities is a key challenge for Russian oil companies, including Bashneft, at the present time. Company plans for upgrading of its refining business include construction of conversion facilities, which can raise output of light petroleum products, and of production units for improving the quality of outputs. Annual output of refined products is to be kept at an optimal level of 20 million tonnes.

A number of investment projects are planned at Bashneft refineries for modernization of existing capacities and installation of new capacities (for alkylation, hydrogen production, and hydrotreatment), which will enable the refineries to achieve 100% of production to Euro-4 and Euro-5 standards in compliance with the timetable set by the Russian Government's Technical Regulation on fuel quality.

Group refining enterprises will also achieve deeper refining levels, raising this indicator to 94-95% by 2017. New hydrocracking and delayed coking facilities will be built for this purpose and capacity of the existing delayed coker at Ufaneftekhim will be enlarged. Bashneft is taking scheduled steps to broaden the range of its products, improve quality and lower production expenses.

The Company is also taking actions to improve dependability of production processes, accident prevention, and industrial and environmental safety.

### Marketing

Strategic priorities for Bashneft in its trading business are development of sales infrastructure, creation of its own marketing channels, and establishment of a regional network of marketing enterprises as close as possible to end-users of petroleum products.

Bashneft is working to increase its presence on high-margin markets (export, small-wholesale and retail) in order to complete its production chain and achieve higher profitability. The Company plans aggressive development of its retail network of filling stations outside the Republic of Bashkortostan by jobbing and franchising agreements and also by acquisition of independent chains of filling stations.

A transaction in 2010 for acquisition of 49% of shares in OJSC ASPEC, as part of the strategy for expansion of the filling station network, put a network of 48 filling stations in the Republic of Udmurtia and a chain of 12 marketing entities in Russian regions under the control of Bashneft. A deal for acquisition of OJSC Orenburgnefteprodukt, which owns 16 oil storage facilities and 95 filling stations in Orenburg Region was prepared in 2010 and completed in April 2011.

Completion of the latter transaction raised the number of Bashneft's own and partner filling stations to 642. Further significant increase of their number is scheduled in coming years.

# OVERVIEW OF OPERATIONS

Rates of growth of Bashneft's core business indicators are the highest in the Russian oil industry.



# OVERVIEW OF OPERATIONS

## LICENSING

Work by Bashneft in the licensing sphere is focused on obtaining new licences for subsoil use, cooperating with supervisory bodies, extending the period of validity of licences and amending the terms of licence agreements

As of December 31, 2010 the Company held **291 licences** for subsoil use, of which **216** related to extraction of raw hydrocarbons, as follows:

- **196 licences** for oil & gas production (of which 192 at fields in the Republic of Bashkortostan; 1 in the Republic of Tatarstan; and 3 in Khanty-Mansi Autonomous District);
- **1 licence** for geological study of subsoil formations;
- **19 licences** for geological study, exploration and production of raw hydrocarbons (of which 17 at subsoil areas in the Republic of Bashkortostan, 1 in Orenburg Region; and 1 in Khanty-Mansi Autonomous District).

Most of the Company's licences for production of raw hydrocarbons run until 2014-2030.

The Company expands its resource base by participating in auctions and competitions to obtain subsoil usage rights.

In 2010 the Company obtained 2 licences at subsoil areas for geological studies, and exploration and production of hydrocarbons. The Company also obtained 8 licences for exploration and production of hydrocarbons. All of these subsoil areas are located in the Republic of

Bashkortostan. Cost of acquisition of subsoil rights in 2010 was 64.3 million rubles, of which 35.0 million rubles for 6 areas, where rights were assigned following discovery of a field, and 29.3 million rubles for the other 4 areas..

Constant expansion of the portfolio of geological exploration and production projects by acquisition of new licences in strategically important regions is an integral part of Bashneft's long-term strategy.

In December 2010 the Company took part in a competition for usage rights at a subsoil area with federal status, located in Nenets Autonomous District. The area includes 2 oil fields: the Roman Trebs field and the Anatoly Titov field. Based on consideration by the competition commission of proposals, which were submitted by applicants, the Federal Agency for Subsoil Use (Rosnedra) recommended the Russian Government to issue a licence to Bashneft.

On February 7, 2011 the Chairman of the Russian Government, Vladimir Putin, issued an instruction, ordering the Federal Agency for Subsoil Use to issue a licence to Bashneft for exploration & production of oil at the licence area.

The licence was registered on February 22, 2011. Total payment for the licence was 18.476 billion rubles.

### Licences held by Bashneft for various types of subsoil use

Type of subsoil use (activity)	Number of licences
<b>Licences held by Bashneft, of which:</b>	<b>291</b>
oil & gas production	196
oil & gas prospecting and evaluation	1
geological study, exploration and production of raw hydrocarbons	19
extraction of underground waters for drinking and household use, and for use by industry	56
extraction of underground waters and medicinal earths	4
extraction of refractory clay and manganese limestone	2
disposal of waste water	12
geological study of subsoil formations to assess potential for absorption of industrial and household waste water	1

### Subsoil use by Bashneft in 2010

Nº	Type of subsoil use (activity)	Number of licences
<b>1</b>	<b>Licences obtained in 2010, of which:</b>	<b>13</b>
	for production of raw hydrocarbons	8
	for geological study, exploration and production of raw hydrocarbons	2
	for geological study and extraction of underground waters	2
	for geological study of subsoil formations to assess potential for absorption of industrial and household waste water	1
<b>2</b>	<b>Changes and additions to licences, of which:</b>	<b>31</b>
	to licences for production of raw hydrocarbons	14
	to licences for geological study, exploration and production of raw hydrocarbons	2
	to licences for geological study and extraction of underground waters	10
	to licences for geological study of subsoil formations to assess potential for absorption of industrial and household waste water	5
<b>3</b>	<b>Applications for surrender of mineral use rights</b>	<b>2</b>
<b>4</b>	<b>Mining allotments obtained in 2010</b>	<b>19</b>

Total recoverable reserves at the licence area, which includes the Trebs and Titov oil fields, are estimated at more than 140 million tonnes (over 1 billion barrels), according to C1+C2 Russian classification. Arrival in Timan-Pechora substantially increases Bashneft's reserves and greatly expands the geography of its operations. Implementation of the project will help to support levels of Company production in the long term and improve the balance between production and refining.

Bashneft signed an agreement at the end of March 2011 with OJSC LUKOIL for creation of a joint venture (JV) for development of the Trebs and Titov fields. The agreement gives LUKOIL a 25.1% stake in the JV. The JV will also buy 29 LUKOIL exploration wells, which are currently out of operation, and will make use of infrastructure belonging to LUKOIL, including the oil-loading terminal at Varandey and power generating facilities, which will help to speed up commissioning of the fields.

The JV partners intend to clarify the quantity of reserves at the fields: drilling of a first exploration well will begin in 2011. According to the preliminary schedule, first oil will be produced at the Trebs field in 2013, and the project will achieve peak production in 2018.

Bashneft carried out work on amendments and additions to some of its current licences in 2010. A total of 16 additional agreements to oil & gas production licences and to licences for geological study, exploration and production of raw hydrocarbons were registered during the year, mainly concerning the period of validity of the licences. Bashneft also obtained licence extensions for 7 subsoil areas at the end of 2010.

The Law on Subsoil Resources states that validity of licences can be extended at the initiative of the subsoil user provided that no violations of licence terms have occurred. In its production activity Bashneft maintains high standards of responsibility as a subsoil user and a policy of strict observance of all its licence commitments. Supervisory bodies for subsoil use did not carry out any checks of proper observance of licence obligations and environmental measures by the Company in 2010.

The company gave notice that it is surrendering subsoil usage rights for geological study, exploration and production of raw hydrocarbons at the West Vesolvsky licence area, which has been found to be unprospective. The Company also surrendered a licence for the Aksenovsky area, where a field was previously discovered, after expiry of the licence period.

## GEOLOGICAL EXPLORATION

Long-term sustainable development of Bashneft depends on efficient implementation of geological exploration projects.

The challenges for Bashneft in its exploration business are to replace produced reserves and improve recovery rates at fields, which are already in development. The Company uses a wide range of modern exploration technologies and takes care to ensure environmental security in its exploration work.

The Company continues to carry out exploration work (seismic exploration, deep prospecting drilling, geochemical studies and thematic work) in the Republic of Bashkortostan, and also in other regions of Russia (Orenburg Region and Khanty-Mansi Autonomous District). Following acquisition of rights to a licence area, which includes the Trebs and Titov oil fields, the Company plans to start exploration drilling in Nenets Autonomous District from 2011.

Exploration work carried out by Bashneft in the Republic of Bashkortostan during 2010 was as follows:

- 2D seismic 125 linear km.
- The work prepared 2 prospective structures with total oil reserves of 0.62 million tonnes. Reduction of 2D work in comparison with 2009 was due to low rates of confirmation of oil presence in formations, due to their modest size and complex structure;
- the Company made greater use of 3D seismic surveying in 2010 in order to improve overall efficiency of geological exploration. Total 363 km<sup>2</sup> of 3D work was carried out in 2010, representing an increase of 21% in comparison with 2009;
- prospecting drilling in 2010 totaled 6788 meters. Reduction compared with 2009 was due to the need for more 3D seismic work before proceeding with drilling;
- 2 oil prospecting wells were completed in 2010, and they were 100% efficient (gushing flows of oil were obtained in amounts suitable for industrial production).

Prospecting drilling led to discovery of 2 new fields with 1.5 million tonnes of reserves under C1 Russian classification (0.5 million tonnes of recoverable reserves).

More than 82% of initial potential oil resources in Palaeozoic sediments in the Republic of Bashkortostan had been explored as of the start of 2011.

Despite the large amount of subsoil studies, which have already been carried out in Bashkortostan, potential for replacement of oil & gas reserves still exists, associated mainly with deposits in Permian sediments that are difficult to extract, and also with sub-surface studies at territories in the Republic, which have received little attention to date and are believed to contain some non-traditional oil & gas formations.

In 2011 Bashneft plans to:

- increase amounts of prospecting and exploration drilling to 32,500m (15 prospecting wells; deepening of 9 wells in order to study lower-lying horizons);
- carry out 265 km<sup>2</sup> of common-depth-point 3D seismic work
- carry out radial shooting at 5 wells.

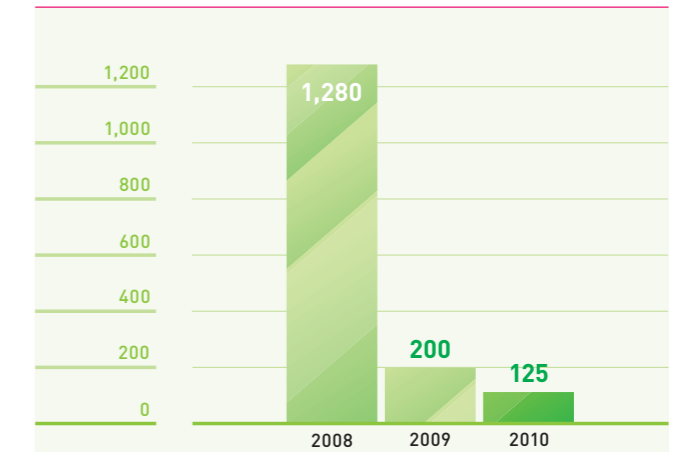
### Main exploration & production regions



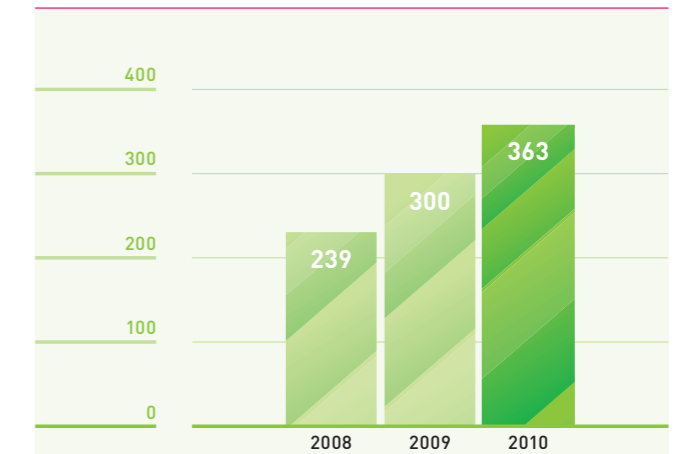
### Exploration work by Bashneft in 2010, main indicators

Indicator	Unit	Number
Deep prospecting drilling	m	6,788
Well completion	wells	2
of which, producing	wells	2
Seismic, of which		
2D (common-depth point)	linear km	125
3D (common-depth point)	km <sup>2</sup>	363
Fields discovered	fields	2
Prospective structures prepared	structures	6

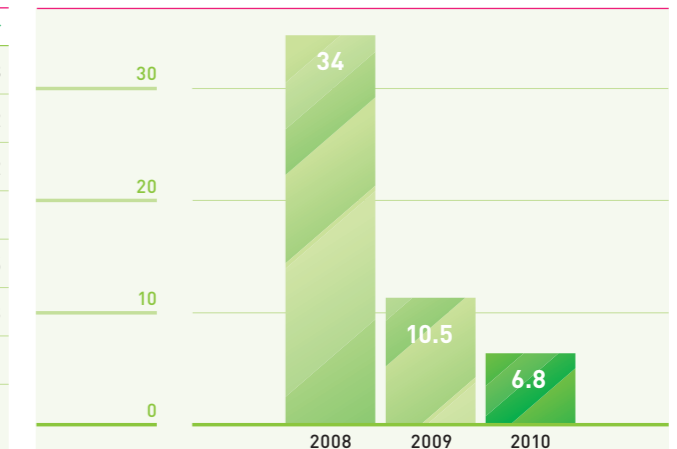
### Trends in 2D seismic (linear km)



### Trends in 3D seismic (km<sup>2</sup>)



### Trends in prospecting and exploration drilling (thousand m)



## RESERVES

The Company had rights to 189 fields as of January 1, 2011, of which 181 in the Republic of Bashkortostan, 3 in Orenburg Region, 5 in Khanty-Mansi Autonomous District, and a part of the large Tuimazinskoye field in the Republic of Tatarstan.

All of the Company's hydrocarbon reserves are traditional. About 60% of recoverable reserves are in Terrigenous deposits, and the remaining 40% are in Carbonaceous reservoirs.

48% of the Company's recoverable reserves are classified as difficult-to-recover.

Achieved recovery rates at Company fields are 36.7%. Residual recoverable reserves are characterized by a high level of exhaustion (82.4%) and high water cut (90.8%).

In March 2010 the company Miller & Lents Ltd. completed the first international audit of Bashneft reserves to have been carried out for 10 years. The audit, using PRMS (former SPE) methodology, was carried out at fields, which represent about 70% of Bashneft's ABC1 reserves under Russian classification and 81% of daily production by the Company. Proved reserves at these fields as of December 31, 2009 were evaluated at 1269 million barrels, and the figure including probable and possible reserves (3P) was 2132 million barrels.

Miller & Lents Ltd. subsequently carried out an audit of 96.6% of the Company's ABC1 reserves, accounting for 98.5% of daily output, as of the end of 2010. The audit results show that Bashneft had reserves amounting to 1912 million barrels of oil on December 31, 2010. Growth of proved reserves compared with the end of 2009 was 50%. The reserve replacement ratio in 2010 was about 740%, and reserve life at the end of the year was 19 years.

Miller & Lents evaluated probable and possible reserves of Bashneft under PRMS on December 31, 2010 at 1036 million barrels of oil, of which 410 million probable and 626 million possible. So overall audited reserves of the Company as of December 31, 2010 were 2947 million barrels, and growth for the year was 38.2%.

Bashneft continued to increase its resource potential in 2011. In February the Company obtained an exploration and development licence for an area in Nenets Autonomous District, including the Roman Trebs and Anatoly Titov fields. Overall recoverable reserves at these fields, estimated under Russian classification (categories C1+C2) at the start of the 1990s and reflected on the Government subsoil register, are 140 million tonnes (over 1 billion barrels). Evaluation to international standards of reserves at the Company's new fields in Nenets District will be possible after drilling of new wells and reopening and testing of wells, which were drilled there previously.

In order to further increase its resource base, Bashneft will carry out a schedule of works to improve standards of exploration operations, acquire new licences and assets, take part in foreign projects, and consistently broaden the geography of its exploration licences.

### Bashneft oil reserves as of December 31, 2010\* (million barrels)

Indicator	31.12.2010	31.12.2009	2010/2009, %
Proved	1,911.6	1,269.0	50.6%
Probable	410.0	328.7	24.7%
Proved and possible	2,321.6	1,597.7	45.3%
Possible	625.6	534.1	17.1%
<b>TOTAL RESERVES</b>	<b>2,947.2</b>	<b>2,131.8</b>	<b>38.2%</b>
Share of audited reserves in total ABC1 resource base	96.6%	70.0%	
Production at audited fields as share of total annual production	98.5%	81.0%	

\* 7.12 barrels = 1 tonne

### Main fields currently developed by Bashneft

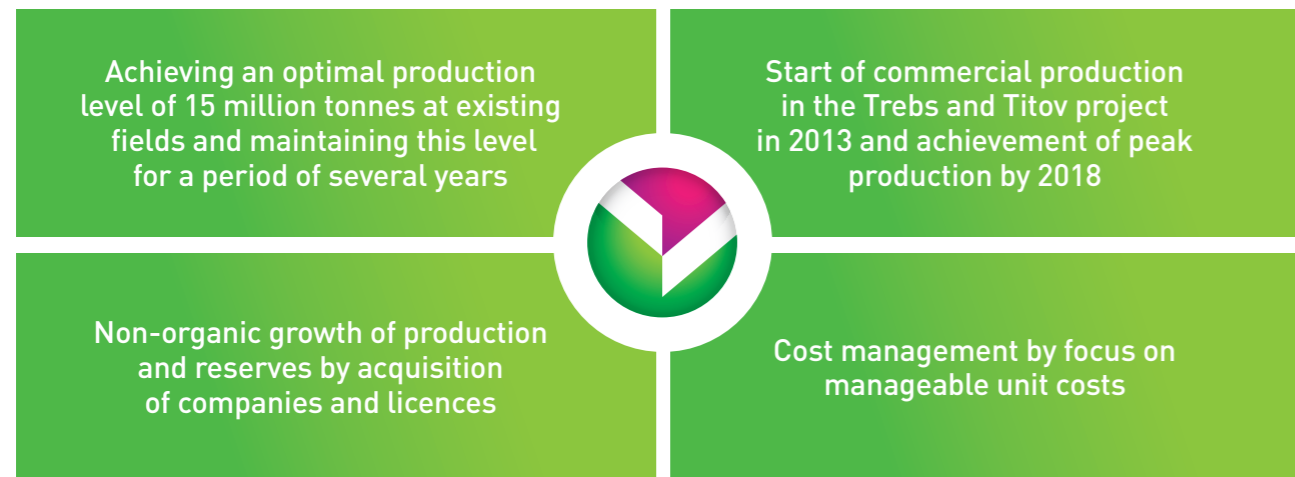
<b>ARLANSKOYE</b>	The Arlanskoye field extends over several districts of the Republic of Bashkortostan (Krasnokamsky, Kaltasinsky, Buraevsky, Ilishevsky, and Dyurtyulinsky districts). It was discovered in 1954 and brought into production in 1958. The field has area of 131,600 hectares and is being developed by the Arlanefit and Chekmagushneft production units of LLC Bashneft-Production.
<b>TUIMAZINSKOYE</b>	The Tuimazinskoye field is on the border between the Republic of Bashkortostan (the municipality of Oktyabrsky in Tuimazinsky District) and the Republic of Tatarstan (Bavlinsky and Yutazinsky Districts). The field was discovered in 1937 and brought into production in 1939. The field covers an area of 47,200 hectares and is being developed by the Tuimazaneft production unit of LLC Bashneft-Production.
<b>YUGOMASHEVSKOYE</b>	The Yugomashevskoye field is located in Yanaulsky and Tatyshlinsky Districts of the Republic of Bashkortostan. It was discovered in 1958 and brought into operation in 1966. Area of the field is 22,670 hectares and it is being developed by the Krasnokholmskneft production unit of LLC Bashneft-Production.
<b>CHETYRMANSKOYE</b>	The Chetyrmanskoye field is located in Yanaulsky and Tatyshlinsky Districts of the Republic of Bashkortostan. It was discovered in 1959 and brought into operation in 1964. Area of the field is 11,300 hectares and it is being developed by the Krasnokholmskneft production unit of LLC Bashneft-Production.

### The Trebs and Titov fields

<b>ROMAN TREBS FIELD</b>	The field was discovered in 1987 during studies of the prospective Varknavtskaya structure. It was named in honor of the Soviet geologist, Roman Vladimirovich Trebs, who organized and led the Varandey oil exploration by the Arkhangelsk Geological Division in 1974, which discovered the Varandeykoye, Laboganskoye, Myadseyskoye, Naulskoye, Toboyskoye, Toraveyskoye and other oil fields in the northern part of Timan-Pechora oil & gas province.
<b>ANATOLY TITOV FIELD</b>	The field was discovered in 1987 during studies of the Olenya prospective structure and named in honor of the Soviet geologist Anatoly Fedorovich Titov, who headed the Nenets structural and prospective drilling detachment and was afterwards in charge of the Khoreiverskaya office of Arkhangelsk Geology from 1979 to 1992. He played a crucial role in discovery of the Vasilkovskoye and Kumzhinskoye gas condensate fields, Vaneivskoye, Yareyskoye and South Khylichuyuskoye oil & gas fields, and the North Kharyaginskoye oil field.

PRODUCTION

STRATEGIC GOALS  
FOR OIL PRODUCTION



KEY RESULTS IN 2010

During the reporting year Company efforts in oil production were focused on measures to optimize operating and capital expenditures, and to improve efficiency of secondary and enhanced oil recovery (EOR) techniques.

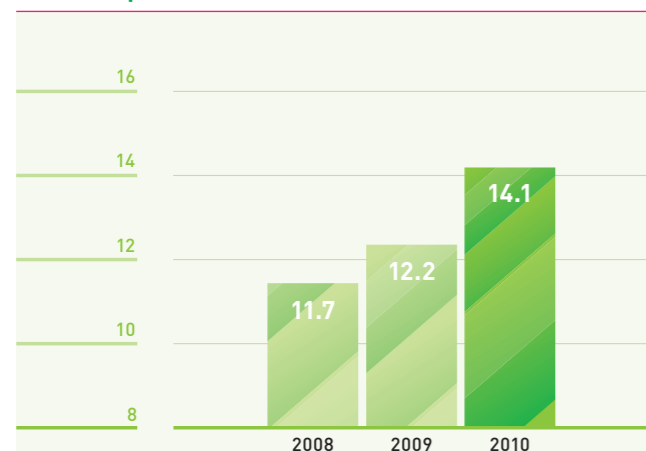
Bashneft confirmed its status as the sector leader by rates of oil production growth in 2010, extracting 14.1 million tonnes of oil, which is 15.6% more than in 2009. Growth of production was achieved by greater efficiency in drilling of new wells, drainage work, transfer of wells to new geological targets, hydrofracturing, water flooding in new strata zones, and greater use of various other

highly effective techniques for increasing oil recovery.

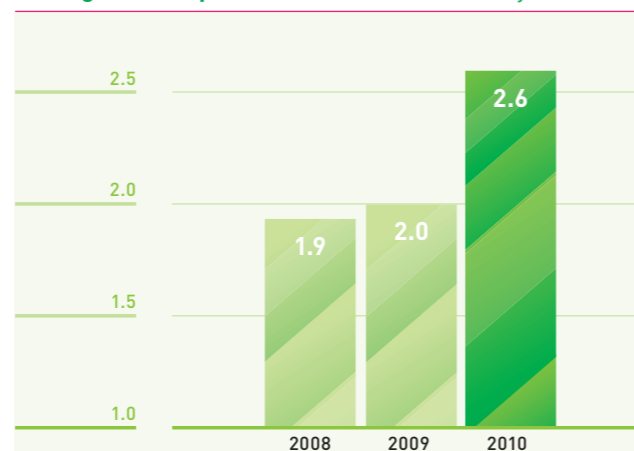
The amount of oil obtained from new drilling and from secondary and tertiary recovery operations grew by nearly 50% in 2010 to a level of 1.911 million tonnes although the actual number of such operations was unchanged from 2009.

The largest share of this additional output (890,000 tonnes) was obtained by improvement of pump equipment. Treatment of the down-hole zone added 389,000 to extraction volumes, which is double the additional amount obtained by such techniques in 2009. Production drilling in 2010 was 233,900 meters, and 146 new wells

Crude oil production (million tonnes)



Average flow at production wells (tonnes/day)



were brought into operation, giving 256,200 tonnes of oil. Average daily output from newly commissioned wells more than doubled, from 5.9 tonnes in 2009 to 12.5 tonnes in 2010.

Bashneft also made extensive use in 2010 of enhanced oil recovery techniques, such as drilling of sidetracks and hydrofracturing, to improve production efficiency at fields with high levels of exhaustion.

Bashneft's upstream strategy targets a production level of about 14.7 million tonnes in 2011. Slowdown of the growth rate compared with 2010 is intentional, as the Company is targeting an optimal oil production level of 15 million tonnes per year at existing fields, to be maintained for a number of years into the future.

Natural gas production by Bashneft in 2010 totaled 44.8 million m<sup>3</sup>, and output of secondary oil gas was 436 million m<sup>3</sup>, of which 362.5 million m<sup>3</sup> (83.1%) was used productively.

PRODUCTION GEOGRAPHY

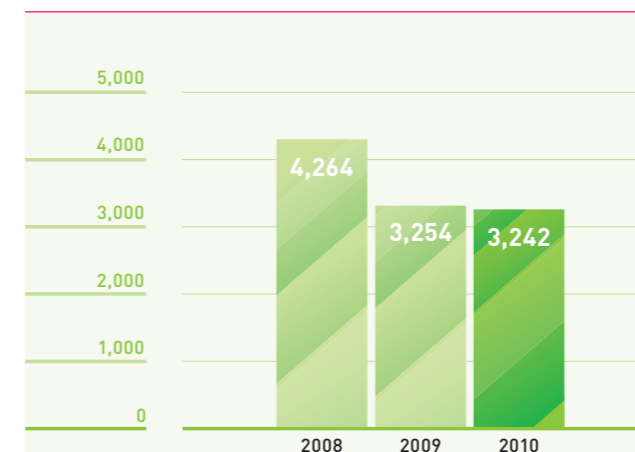
**Republic of Bashkortostan.** Bashneft's main oil fields (Arlanskoye, Tuimazinskoye, Sauzbashevskoye) are located in Bashkortostan, which remains the Company's core production region. Bashneft continued to extract its reserves in the Republic in a systematic fashion during 2010 through production and exploration drilling, and a total of 13.3 million tonnes of oil were recovered, representing 94% of total output by the Company and exceeding the respective figure for 2009 by 17%.

**Western Siberia (Khanty-Mansi Autonomous District).** The Company is developing 5 fields in Khanty-Mansi (Kirkoye, Kottynskoye, Lyukpayskoye, Permyakovskoye and Pecherinskoye). Oil output in 2010 was 485,000 tonnes, or 3.4% overall output by the Company.

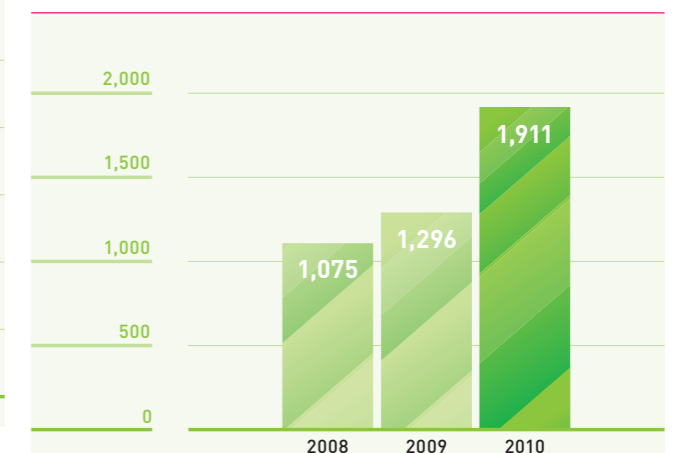
**Orenburg Region.** Bashneft produces oil at 2 licence areas in Orenburg Region (Kitayamsko-Blagodarovsky and Dacho-Repninsky). Total 150,000 tonnes of oil were produced at these fields in 2010 which is 4.4% more than in 2009 and represents 1.1% of total oil output by the Company.

**Republic of Tatarstan.** Bashneft produces oil in Tatarstan at the western part of the Tuimazinskoye field, extracting 219,000 tonnes in 2010, which is 1.5% of the Company's total output and exceeds volumes in 2009 by 12%.

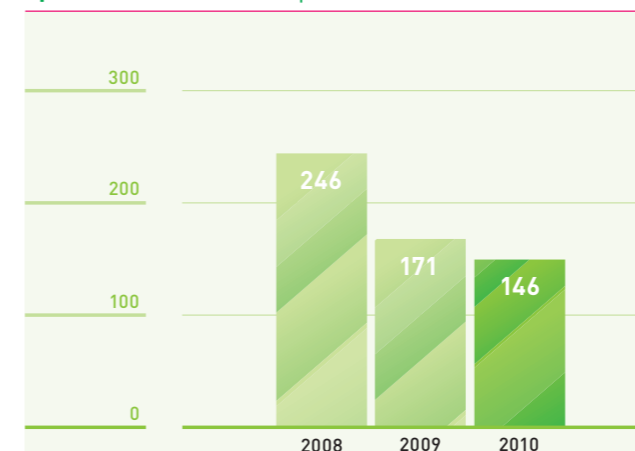
New well launches (wells)



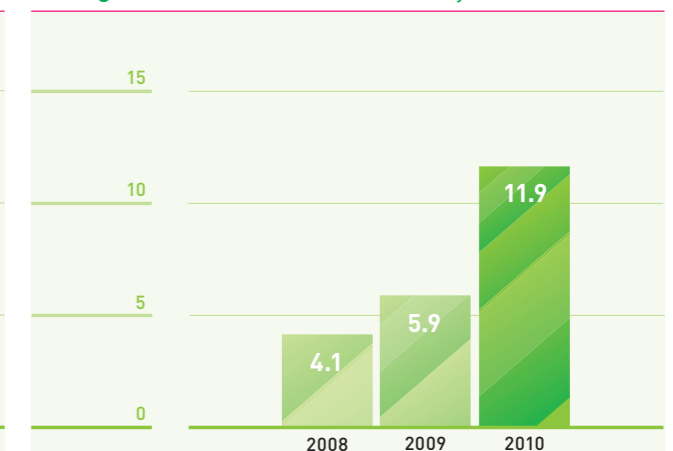
Additional production as a result of new drilling, and secondary and tertiary recovery operations (thousand tonnes)



New drilling, secondary and tertiary recovery operations (number of operations)



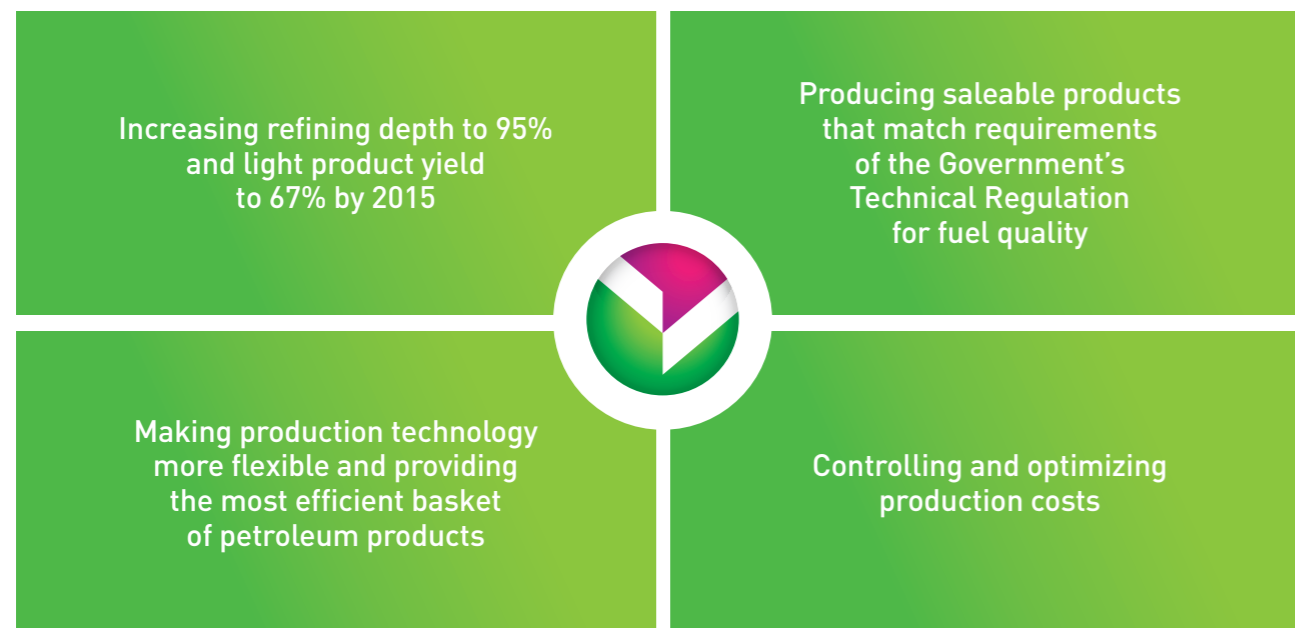
Average flow at new wells (tonnes/day)





OIL REFINING  
AND PETROCHEMICALS

STRATEGIC GOALS IN OIL REFINING  
AND PETROCHEMICALS



Equipment quality at Bashneft's oil refining and petrochemical assets is the best in Russia, and the assets are therefore Russian leaders by refining depth and standard of their outputs. The Company includes three refineries — Ufaneftekhim, Ufa Oil Refinery, and Novoil — and also has refining operations at its petrochemical plant, Ufaorgsintez. These facilities together are usually referred to as the 'Ufa refinery group'

The Ufa refinery group is unique because capacities at the various plants complement each other in nearly all specializations, so that optimal refining schemes can be selected to provide maximum financial advantage.

Unification of the assets as part of Bashneft has added significantly to financial efficiency of their operations.

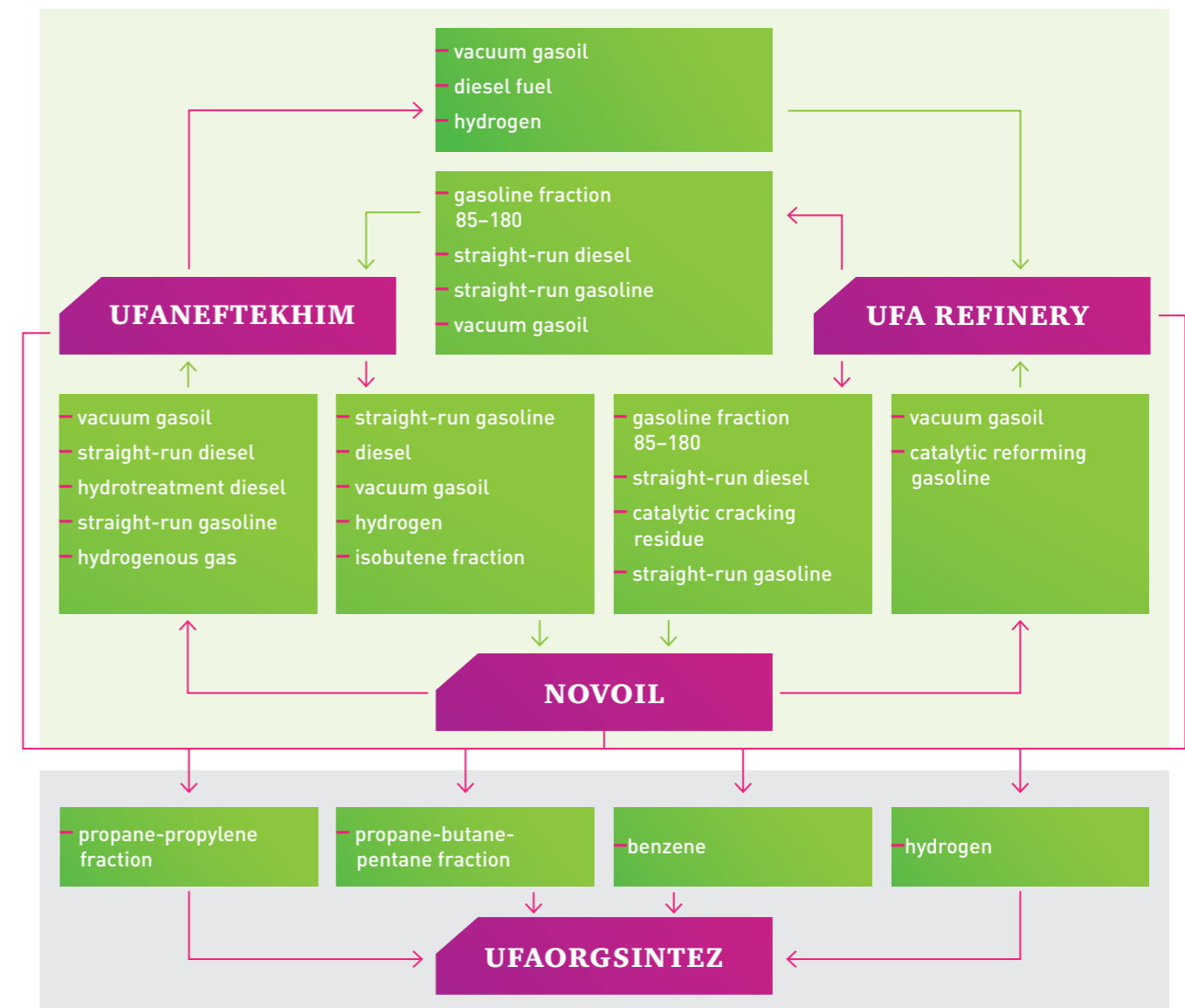
Oil refining in 2010  
(million tonnes)

	Primary refining capacities	2010		
		2008	2009	2010
Ufaneftekhim	7.5	7.6	7.8	
Ufa Oil Refinery	7.5	6.2	6.5	6.7
Novoil	7.1	6.7	6.6	6.7
<b>TOTAL</b>	<b>24.1</b>	<b>20.4</b>	<b>20.7</b>	<b>21.2</b>

Structure of production  
by Bashneft oil refineries in 2010

Output	Volume, thousand tonnes	Share, %
Gasoline	4,742	24.4
Diesel	7,665	39.5
Fuel Oil	2,646	13.6
Vacuum gasoil	1,699	8.7
Other	2,679	13.8

INTER-REFINERY  
PRODUCTION CHAIN



KEY RESULTS IN 2010

Refining

Bashneft has total primary refining capacity of 24.1 million tonnes of crude oil per year. In 2010 these capacities refined 21.2 million tonnes of oil, which is 446,000 tonnes or 2.2% more than in 2009. Capacity load was thus 87.9%, which is almost 4 percentage points more than in 2009.

Refining depth increased y-o-y from 83.4% to 86.3%, putting Bashneft in first place among Russian oil companies. Greater refining depth was achieved thanks to launch in 2009 of a new delayed coking facility at Ufaneftekhim with capacity of 1.2 million tonnes. The new facility raised the complexity factor of Bashneft's refining capacities to a Nelson Index score of 8.3, which is among the best in Russia.

Total output of Bashneft refineries in 2010 was 19.4 million tonnes, which is 2.8% more than in 2009. Since December 2009 Bashneft ceased to provide fee-based refining services for third-parties, which kept ownership of crude oil and petroleum products. In 2010 Bashneft was the owner of all the outputs, which its refineries produced.

Main refined products are diesel fuel, gasoline, fuel oil, vacuum gasoil, liquefied gas, oil coke, industrial sulphur and lubricants. The product basket was largely unchanged in 2010, although output of diesel fuel increased by 8% and fuel oil production dropped by 13%. Gasoline volumes were nearly constant y-o-y

The share of light products in Bashneft refinery outputs rose from 60.4% in 2009 to 61.7% in 2010. Bashneft is in second place among Russian vertically integrated oil companies by this indicator.

**BASHNEFT  
REFINERIES**



**OJSC UFANEFTKHEM**

Capacity:  
**9.5 million tonnes**

Outputs: high-octane gasoline, low-sulphur diesel, boiler fuel, bitumen, coke, lump and granulated sulphur, liquefied gas, benzene, orthoxylene and paraxylene.

Ufaneftekhim is one of the largest oil refineries in Russia and has one of the highest levels of complexity. It refines several types of crude oil (West Siberian, high-sulphur blends from the Arlanskoye field, and gas condensate), producing a variety of fuel grades and petrochemical products.

Ufaneftekhim has fuel, gas catalysis, goods production, and service units, and also produces aromatic hydrocarbons. A variety of equipment installations are in use at the plant, including nearly all installation types, which are needed to obtain a high indicator for refining depth (delayed coking, hydrocracking, catalytic cracking, desalting, visbreaking, and bitumen production).



**OJSC UFA OIL REFINERY**

Capacity:  
**7.5 million tonnes**

Outputs: high-octane gasoline, diesel, boiler fuel, liquefied gases, liquid and lump sulphur, bisphenol A.

The Ufa Refinery is one of the most up-to-date oil refineries in Russia, and is capable of producing a wide range of high-quality petroleum products.

The Refinery design enables complex and deep processing of crude oil using highly efficiency thermal, catalytic and hydrogenation processes. Modern equipment means that the Refinery can produce fuels that meet international quality requirements, M40 and M100 fuel oil with sulphur content under 3.0%, as well as a broad range of liquefied gases.

Scheduled modernization work will achieve 100% output of automotive gasoline to Euro-4/5 standards by upgrading arrangements for division of straight-run and secondary gasoline, and installation of a hydrotreatment facility to cleanse sulphur compounds from catalytic-cracking gasoline.

Future plans for the Refinery include construction of a delayed coker, which will enable increase of refining depth to 95%.



**OJSC NOVOIL**

Capacity:  
**7.1 million tonnes**

Outputs: gasoline, jet fuel, diesel, engine lubricants, transmission oils and other special oils, vacuum gasoil, paraffin-wax products, oil bitumens, fuel oil, coke, lump sulphur.

OJSC Novoil is one of the largest Russian producers of quality petroleum products. Main production units at the refinery are as follows: primary refining units, hydrotreatment, reforming and iso-reforming, sulphuric acid alkylation, thermoc cracking and visbreaking, coking and gas fractionation, solvent refining and de-paraffination of paraffinic oils, tar desalting and bitumen production, desulphurization of gases, and sulphur production. The refinery also has a number of environmental facilities.

Flexible technology enables the refinery to process various hydrocarbon inputs (low- and high-sulphur crude oil, various gas condensates, as well as medium and heavy distillates obtained at other refineries in the Ufa group), and to produce a broad range of high-quality petroleum products.

The refinery continued to produce engine oils to Euro-3 and -4 standards in 2010, and will begin production of Euro-5 fuel in the near future.

**MODERNIZATION AND DEVELOPMENT  
OF THE BASHNEFT REFINING COMPLEX**

A number of actions with overall cost in excess of 10 billion rubles were carried out in 2009-10 for strategic development of Bashneft's refining capacities.

**Raising engine fuel quality**

Special priority was given to projects for improvement of the quality of engine fuel outputs in compliance with the Russian's Government's Technical Regulation for fuel quality (in accordance with the Regulation, all engine fuels produced in Russia must comply with the Euro-3 standard from January 2011 and with the Euro-4 standard from the start of 2012). The Ufa Refinery began production of Euro-4 fuel in 2007 and Bashneft refineries have since begun production of Euro-5 diesel fuel.

The distinguishing feature of Euro-4 and Euro-5 fuels is their low sulphur content, achieved by hydrotreatment processes, which use considerable amounts of hydrogen. This has caused a sharp increase in demand for hydrogen, which Bashneft has addressed by installation of a new hydrogen unit at Ufaneftekhim. As a result, it has been possible to raise the quality and volume of light product output.

An L-24-7 hydrotreatment unit at Ufaneftekhim has been upgraded and all of the plant's diesel fuel output can now meet Euro-5 criteria.

At Novoil the catalytic system on the diesel hydrotreatment unit was replaced and an additional reactor was installed. In addition, old reactors and equipment on the LCh-24-7 unit were replaced and a set of high-efficiency catalysts were installed.

At the Ufa Refinery modernization and installation of new reactors on the G-43-107 unit for hydrotreatment of vacuum gasoil has substantially increased its capacity.

**OVERVIEW  
OF OPERATIONS  
OIL REFINING  
AND PETROCHEMICALS  
(CONTINUED)**

The development strategy for Bashneft refineries will give capability for 100% production of Euro-4 and Euro-5 compliant fuels. The Technical Regulation requires that all gasoline and diesel fuel sold by the Company inside Russia should meet Euro-4 standards by 2012 and Euro-5 standards by 2015.

In order to carry out this task, Ufaneftekhim will install capacities for separation of hydrocracking gasoline and for hydrotreatment of its heavy part, as well as completing upgrades of equipment for production of aromatics, and for catalytic cracking and hydrotreatment of diesel fractions. Work has begun at Novoil on construction of sulphuric acid alkylation units for regeneration of used sulphuric acid, and the Ufa Refinery plans to install a unit for hydrotreatment of catalytic-cracking gasoline.

A new hydrogen unit is to be built at Novoil, which will supply the hydrogen needs of all refineries in the Ufa group, including the new vacuum gasoil hydrocracking facility, which is to be installed by 2016.

**Planned actions to improve quality of fuel outputs**

Action	Year of completion
Separation of catalytic cracking gasoline and hydrotreatment of its heavy part at Ufaneftekhim	2011
Construction of a sulphuric acid alkylation unit and units for regeneration of used sulphur at Novoil	2013
Construction of a hydrogen unit at Novoil	2013
Construction of a hydrotreatment unit for catalytic cracking gasoline at the Ufa Refinery	2013

**Planned actions for increasing depth of refining**

Action	Year
Increase of capacity of the delayed coker at Ufaneftekhim	2012
Launch of a new hydrocracking unit at Novoil	2016
Launch of a new delayed coker at the Ufa Refinery	2016

**Increase of refining depth and light product yield**

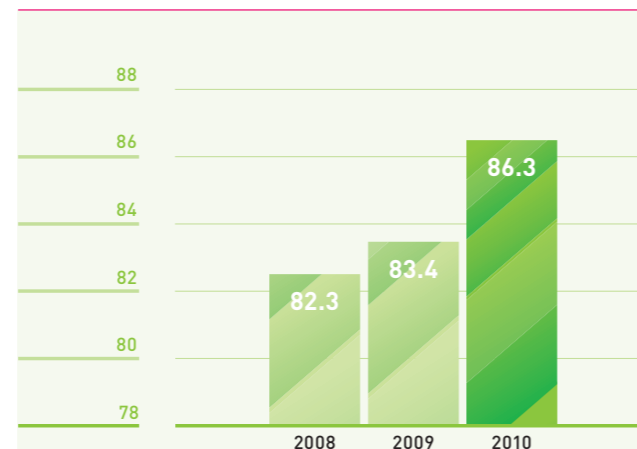
Bashneft has set ambitious tasks for increasing oil refining depth and light product yield in order to maintain and reinforce Company status as the technology leader in the Russian refining sector.

At the end of 2009 Bashneft launched operations with a combined delayed coker at the Ufaneftekhim plant. The unit was the first of its kind built in Russia since 1986, and has raised refining depth at Ufaneftekhim to best international levels (95-98%, depending on capacity load). The delayed coker is fitted with the most up-to-date equipment, enabling process automation, safe operation, and optimal environmental indicators. Smooth and efficient operation of the unit in 2010 led to confirmation of plans to expand its annual capacity from 1.2 million to 1.6 million tonnes, and this work will begin at the end of 2011. In the medium-term Bashneft plans to build a new delayed coker with capacity of 1.6 million tonnes at the Ufa Refinery.

Another project for increase of refining depth is construction of a hydrocracking complex for vacuum gasoil with 2 million tonnes annual capacity, which should be completed at Novoil in 2016.

Implementation of these large-scale projects will enable Bashneft refineries to achieve average refining depth of 94.7% by 2017 and raise their Nelson Index to 9.6, matching the level of leading international producers.

**Average crude oil refining depth at the Ufa group of refineries (%)**



**PETROCHEMICALS**

**Bashneft is in fourth place in Russia by volume of its petrochemical outputs, which have a diverse and balanced character.**

The Company produces petrochemicals at three enterprises: Ufaneftekhim, the Ufa Refinery and the organic synthesis plant, Ufaorgsintez. These three enterprises are part of a single production chain in Bashneft's refining complex.

Ufaorgsintez uses hydrocarbon gases, light gaseous gasolines and benzol from the three Ufa refineries as its inputs, and produces more than 30 petrochemical outputs, including polypropylene and propylene solopolymers, high-pressure polyethylene, acetone, phenol, alpha-methylstyrol, isopropyl and synthetic rubber.

There were no major changes during the reporting year in the range of products made by Ufaorgsintez. Main outputs were polypropylene (97,000 tonnes), high-pressure polyethylene (85,200 tonnes), phenol (67,000 tonnes) and acetone (41,700 tonnes).

Petrochemical production at Ufaneftekhim consists of one of Russia's largest facilities for production of aromatics.



**OJSC UFAORGSINTEZ**

Output: more than 30 petrochemical products, including polypropylene, high-density polyethylene, acetone, phenol, alpha-methylstyrol, rubber, as well as 25 types of consumer goods.

Ufaorgsintez is one of the biggest organic synthesis producers in Russia and the successor of the Ufa Synthetic Spirit Plant, which was commissioned in 1956.

The plant accounts for 40% of total Russian phenol output, 12-13% of the country's high-pressure polyethylene, and 20% of polypropylene, as well as being a leader by levels of acetone output. Main consumers of Ufaorgsintez outputs are companies in the chemicals sector, which use them for production of plexiglass, diphenylolpropane, phenolformaldehyde resins, alkylphenol, lubricant additives, other products for use in industry and agriculture, various rubber goods, etc.

Other Ufaorgsintez outputs are used in machine building, light industry, medicine, production of electronic and electrical appliances, for insulation of pipelines and cables in electrical appliances, and as corrosion-resistant coatings.

Petrochemical production processes by enterprises in the Ufa group are closely linked. The aromatics complex at Ufaneftekhim processes straight-run gasoline fraction from the other three plants, and produces value-added petrochemicals such as benzol, paraxylene and orthoxylene, and toluene. Production volumes at Ufaneftekhim in 2010 were 122,200 tonnes of paraxylene, 92,300 tonnes of benzol, 46,200 tonnes of orthoxylene and 13,900 tonnes of toluene.

Benzol from Ufaneftekhim is the feedstock for production of phenol and acetone at Ufaorgsintez, and these outputs are then used by the Ufa Refinery for production of diphenylolpropane (bisphenol-A), which is a raw material for epoxy resins and polycarbonates. Output of diphenylolpropane at the Ufa Refinery in 2010 totaled 55,000 tonnes.

High-quality paraxylene (99.8% pure) produced by the aromatics facility is sent for further processing by OJSC Polyef in Blagoveshchensk (Russian Far East), where it is used as the raw material for production of triflic acid, which is the base for a broad range of polymer production.

Bashneft's first-ever development strategy for its petrochemical business, prepared in 2009, took account of high volatility on the market for petrochemical outputs, which had not yet recovered after the crisis, and forecast maintenance of output at current levels.

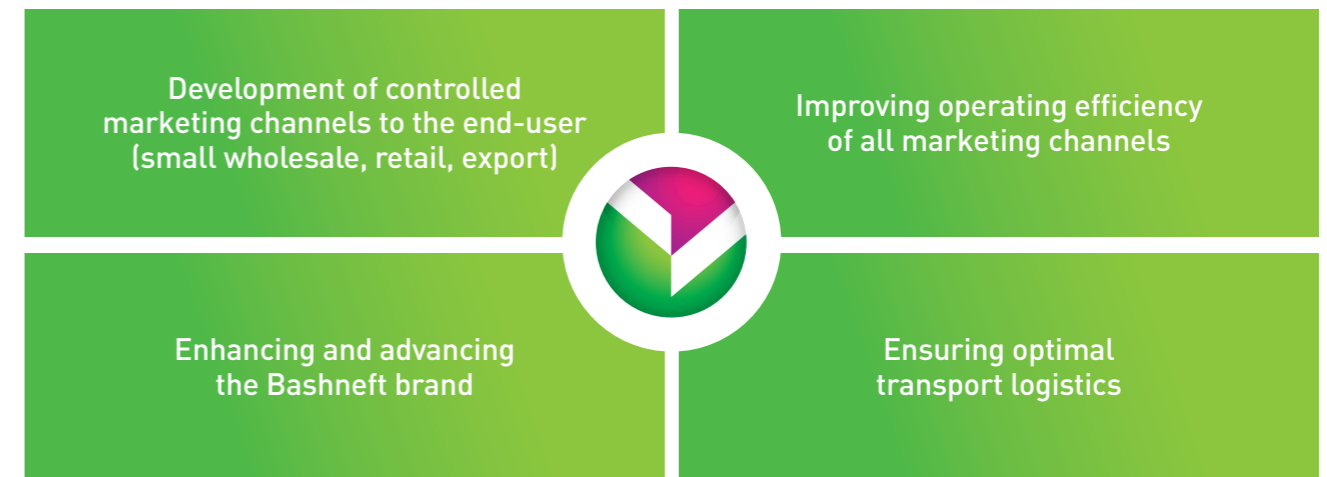
Medium-term objectives in the overall development plan for Bashneft oil refining and petrochemicals business in 2011-2020 (under preparation at present) include creation by Ufaorgsintez of polymer production targeting end-users, as well as construction of an ETBE unit. Launch of polycarbonate production at Ufaorgsintez is possible in the longer term.

## MARKETING

The Company's oil and petroleum product marketing business is still in the process of transformation. The recently created Bashneft marketing service carries out efficient monitoring of domestic and foreign markets for crude oil and petroleum products, allocating outputs in accordance with the current pattern of demand.

Having completely abandoned fee-based refining services for third-parties, the Company is steadily increasing the volume of its own product sales on domestic and foreign markets, making maximum use of its own marketing infrastructure.

## STRATEGIC OBJECTIVES IN MARKETING BUSINESS



### Key actions in 2010

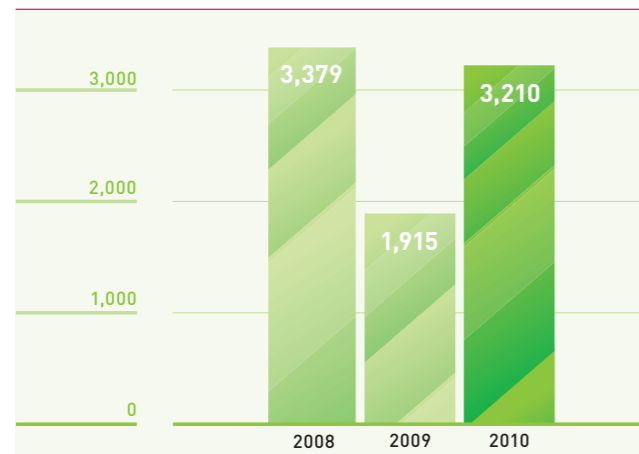
Purpose of action	Action
Securing supplies of crude oil to refineries.	Long-term agreements for procurement of crude oil have been reached with leading Russian VICs.
Development of retail sales	Acquisition of the ASPEC-Nefteprodukt chain of 44 filling stations in Udmurtia. Preparation of a deal for acquisition of OJSC Orenburgnefteprodukt (95 filling stations). Formation of a partnership network of filling stations (jobbers and franchises)
Development of small wholesale	Acquisition of CJSC ASPEC, which owns a network of 12 regional business units for small wholesale marketing of petroleum products
Wholesale development on the domestic market	Launch of commodity exchange trading of petroleum products and petrochemicals for purposes of market monitoring. Bashneft is accredited on the St. Petersburg International Mercantile Exchange
Development of the Company's own export channels	Introduction of an Internet-based customer relationship system (Customer Relations Management) in the export and large wholesale segments.
Optimization of logistics processes	Creation of LLC Bashneft-Trans for optimization of transport costs by centralized management of rail tank wagons owned by Company subsidiaries and affiliates.

**KEY RESULTS IN 2010**

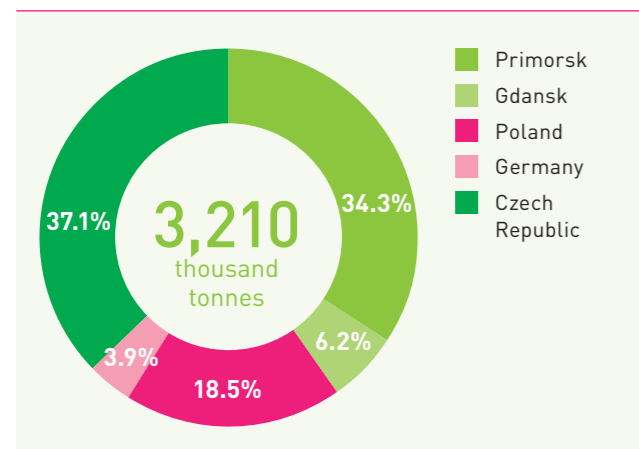
**Supplies of crude oil**

Trading operations by Bashneft in 2010 were determined by decisions taken in 2009, when the new VIC was set up. The most important of these decisions were to terminate fee-based refining at the Ufa group of refineries and switch to refining of Bashneft's own crude oil and oil bought from other major VICs on the basis of long-term agreements. The third major decision in the marketing sphere was that the Company would sell all of its petroleum products itself, on both domestic and export markets. Implementation of all these decisions was made the responsibility of a newly created marketing service inside Bashneft.

**Export deliveries of crude oil (thousand tonnes)**



**Export deliveries of crude oil by export routes (destinations) in 2010**



Bashneft supplies its own crude production to its refineries and sells a part of it on the international market.

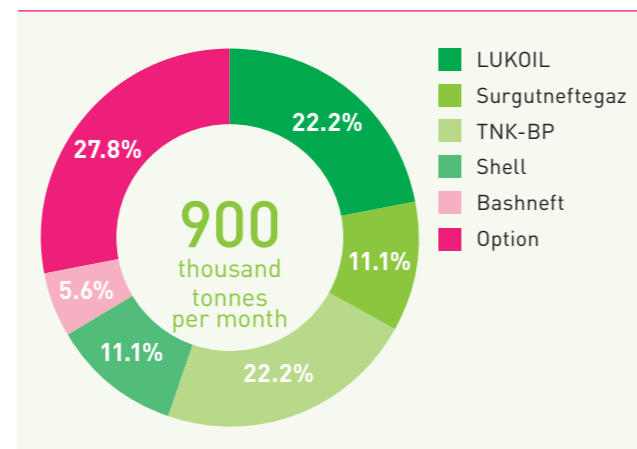
In 2010 Bashneft shipped 14.0 million tonnes of its own crude oil, of which 10.7 million tonnes to Company refineries and 3.2 million tonnes to export.

In order to make up the shortfall in oil supplies to its refineries, Bashneft signed contracts for oil deliveries in 2009 with LUKOIL, TNK-BP, Shell and Surgutneftegaz. The Company bought a total of 11.2 million tonnes of oil and gas condensate under these contracts during 2010. All contracts for purchase of crude oil for refining were renewed in the course of 2010 and the start of 2011.

Bashneft significantly increased exports of its own crude oil in 2010 compared with 2009. Nevertheless, the Company exported only 22.7% of its oil production, which is one of the lowest indicators among Russian VICs. Increase of export duties on crude oil and growth of margins in oil refining meant that increased refining of the Company's own oil made economic sense in the reporting year.

Most export deliveries of crude oil were dispatched via the Druzhba pipeline to the Czech Republic, Poland and Germany, and also through the ports of Primorsk and Gdansk.

**Structure of Western Siberian crude oil supplies to Bashneft refineries**



**Petroleum product deliveries**

Changeover to independent sale of the production of Bashneft enterprises was effected in the period from June to November 2009, so that volumes of production sold in 2010 cannot be properly compared with figures for 2009.

**Petroleum product exports**

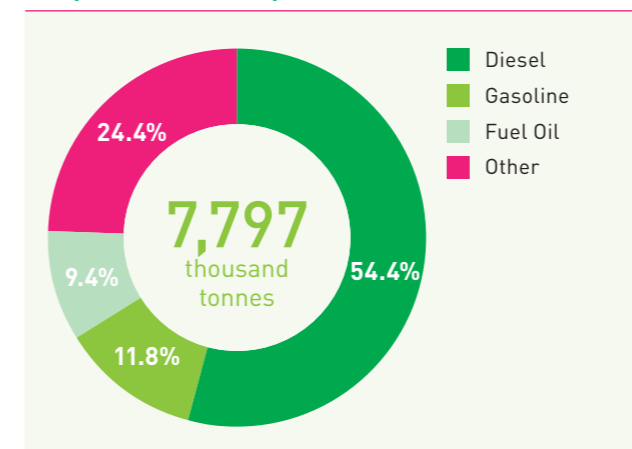
Bashneft entered the petroleum product export market in the second half of 2009. Product exports in 2010 were about 7.8 million tonnes, mainly to countries outside the CIS (6.5 million tonnes, or 83.6% of deliveries), particularly in North-West Europe, while exports to CIS countries were 1.3 million tonnes, or 16.4% of total exports. Bashneft exports used the Transnefteprodukt system of product pipelines as well as railways to Kazakhstan and to ports in Murmansk and Kaliningrad.

Product exports had a diverse structure and included gasolines, diesel, fuel oil, vacuum gasoil and other products. Diesel fuel accounted for the largest share of exports (about 57%), while vacuum gasoil represented 22% and boiler fuel was less than 10%. Gasoline exports were insignificant.

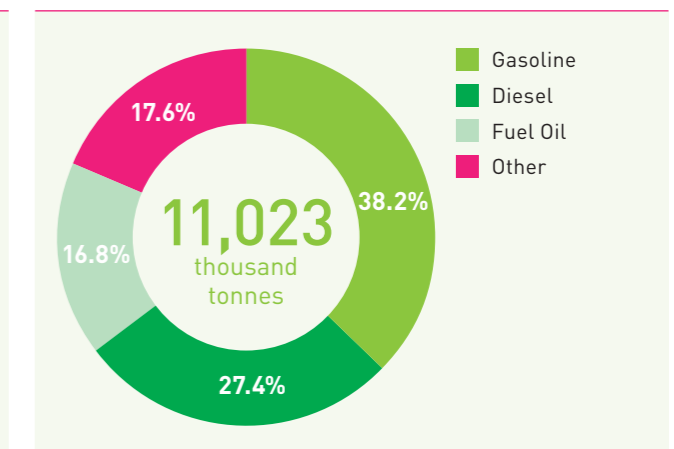
Exports were made under both long- and short-term contracts in order to maximise benefits relevant to the price environment.

Bashneft also exported some of its petrochemicals in the reporting year, mainly diphenylpropane (bisphenol-A) produced at the Ufa Refinery. Significant quantities of lump sulphur and alpha-methylstyrol were also exported.

**Structure of petroleum product and petrochemical exports in 2010**



**Structure of petroleum product sales on the domestic market in 2010**



**Wholesale deliveries of petroleum products on the domestic market**

The greater part of the Company's petroleum products are sold on the domestic market (60% of outputs from the Ufa refineries in 2010).

Total product sales by Bashneft inside Russia were in excess of 11 million tonnes in 2010, of which 10.4 million through wholesale.

Bashneft's strategic priority in development of its marketing structure is to create its own sales channels, offering maximum access to end-users. The Company is working to create a network of marketing enterprises in Russian regions to expand small-scale wholesale business in engine fuels. Bashneft has selected priority regions for development of small wholesales business, including Moscow and St. Petersburg, which are the biggest domestic markets for petroleum products.

The Company has set a strategic goal of increasing small-scale wholesale to 30-35% of total domestic product sales by 2013.

Taking a step toward this goal, Bashneft acquired 49% of shares in OJSC ASPEC, a petroleum products marketing company based in the Republic of Udmurtia, in 2010. The transaction gives Bashneft control over operations of two trading subsidiaries of the holding: CJSC ASPEC, which unites 12 small-wholesale units in various Russian regions, and LLC ASPEC Nefteprodukt, which owns two oil storage facilities and 44 filling stations in Udmurtia. From October 1, 2010, these enterprises were renamed as 'CJSC Bashneft-Region' and 'LLC Bashneft-Udmurtia', respectively.

Under another agreement, prepared in 2010 and signed in April 2011, Bashneft bought a 94% stake in OJSC Orenburgnefteprodukt (previously owned by Rusneft), which owns a developed network of filling stations and 16 oil storage facilities in Orenburg Region.

Bashneft has established further channels for its petroleum product marketing and helped to ensure transparency in its product sales business by starting to trade on commodity exchanges: the Company was accredited as a market participant at the Interregional Oil & Gas Exchange in autumn 2009, and this was followed by accreditation on the St. Petersburg International Mercantile Exchange (SPIMEX) in 2010. Bashneft views exchanges as an important marketing channel, and expects that exchange trading will have substantial importance for future development of the market for petroleum products inside Russia.

**Retail sales of petroleum products on the domestic market**

Bashneft sold more than 600,000 tonnes of engine fuels via its own filling station network during 2010. Including sales by filling stations of partner retail companies (which obtain products from Bashneft wholesale), the volume of retail sales was more than 1 million tonnes. So sales via the Company's own filling stations represented 5.3% of total supplies to the domestic market and the share including partner stations was 9.3%.

Bashneft has continued to increase retail sales of high-quality gasoline and diesel fuel, which match the latest European environmental and quality standards. The Company is also working hard to improve service standards, broaden its product range, and strengthen customer loyalty.

**Development of the filling station network**

In 2010 Bashneft began rapid development of its own retail network, which represents the most sustainable product marketing channel and will help to reinforce vertical integration and profitability. The deal with OJSC ASPEC, by which Bashneft acquired operating control over a chain of 44 filling stations of LLC ASPEC Nefteprodukt (now renamed 'LLC Bashneft-Udmurtia'), was an integral part of this strategy, as were preparations for takeover of OJSC Orenburgnefteprodukt, which owns 95 filling stations in Orenburg Region (the transaction was completed in April 2011).

The Company intends further step-by-step increases of the number of filling stations in ownership by acquisition of independent chains, and will also implement partnership programs, working with owners of efficient and up-to-date retail networks to create sales channels for Bashneft's high-quality products through long-term, mutually beneficial contracts.

The Company's partnership program only began in April 2010, but 6 long-term contracts have already been set up with companies that now sell outputs of the Ufa refinery group at 168 filling stations in 18 regions of Russia. Bashneft's partners operate in the Republic of Bashkortostan and neighbouring Urals and Volga regions, including the republics of Tatarstan, Mordovia, Chuvashia and Mari El, and the regions of Chelyabinsk, Sverdlovsk, Kurgan, Samara, Saratov, Ulyanovsk and Nizhny Novgorod. Bashneft also has partner filling stations in more distant parts of Russia: Ryazan, Vladimir, Belgorod, Voronezh, Rostov, Dagestan, and Krasnodar.

Development of the partnership program will focus on franchise agreements, which bring partner stations under the Bashneft flag, and will speed up after work on design of a new Bashneft brand is completed in 2011.

The number of Bashneft's owned and partner filling stations will be substantially increased in coming years, as the Company's marketing strategy targets increase of own and partner retail sales to 25% of total domestic sales of Company products by 2013.

**Logistics**

Bashneft and its subsidiaries have their own transport infrastructure, including a fleet of 4,500 rail tank wagons, enabling a high level of service to end-users and helping to keep transport costs under control.

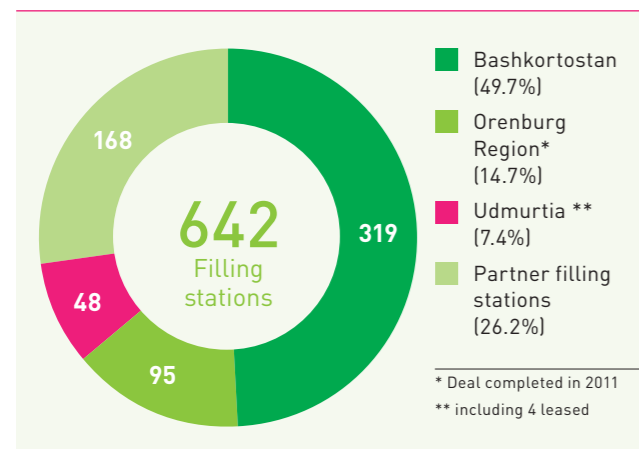
At the beginning of the reporting period rolling stock of Bashneft subsidiaries was still under operational management of the railway division of the Company's marketing enterprise, OJSC Bashkirnefteprodukt. However, a new 100% subsidiary, LLC Bashneft-Trans, was set up in November 2010 to consolidate all transport assets of Bashneft's main subsidiaries.

The Bashneft-Trans rail tank fleet carried more than 6.5 million tonnes of goods in 2010 (dark and light petroleum products, chemicals, coke, lump sulphur), representing nearly 60% of the total volume of goods, shipped by Bashneft using rail transport.

As well as organizing rail transport, Bashneft-Trans is responsible for maintenance, repair and daily use of rolling stock and transport infrastructure belonging to other Bashneft subsidiaries, as well as dispatching and management of tank wagons on the railway system of the state monopolist, Russian Railways.

Priority tasks of LLC Bashneft-Trans include lowering transportation costs, and making the rolling stock fleet more manageable by introduction of unified standards and service structuring.

**Structure of the retail network**



# TECHNOLOGY AND INNOVATION

Bashneft aspires to be a sector leader in application of the latest technologies and innovations in all spheres of its business and management.



# TECHNOLOGY AND INNOVATION

## INNOVATION MANAGEMENT

Bashneft places high importance on design and application of the latest technologies. Innovation work is among the Company's principal competitive strengths and an important factor for future development .

The key directions for R&D and innovative development by Bashneft are: improvement of production quality, raising business efficiency, and ensuring environmental and industrial safety.

The Company is therefore modernizing its existing industrial capacities, optimizing technology processes, making extensive use of the latest high-tech equipment and cutting-edge international practice, raising the quality of management and control of business processes, and ensuring that its production facilities comply with the highest standards for industrial safety. Bashneft lends equal importance to creating the best-possible conditions for continuous professional development and increase of knowledge levels among its specialists, and to development of their expertise.

Bashneft's Scientific and Technical Council acts as a coordination center for innovation and development of promising technologies at the Company. The Council collects, structures and analyzes information, which is needed for designing recommendations on current and prospective issues of scientific, technical and industrial importance for Bashneft. The Council assists senior management of Bashneft in design of technical policy

for the Company as a whole and its distinct subsidiaries (technical development plans have been designed for each sub-division of Bashneft for a period up to 2015).

Bashneft specialists take part in the work of Government and non-governmental R&D and innovation organizations, and are implementing various joint projects with foreign companies and designers.

Bashneft is also working hard to develop its own R&D potential. Investment in re-equipment and modernization of the Company's design institute — LLC BashNIPIneft — will ensure that it plays a role as an R&D organization of major regional significance . A system of quality management was introduced at BashNIPIneft in 2010.



## KEY RESULTS IN 2010

The Company made substantial progress in R&D and innovation during the reporting year. Significant results were obtained in all key aspects of Bashneft's business.

### INNOVATION IN EXPLORATION & PRODUCTION

#### Exploration

The objective of innovation projects in the exploration sphere is to reduce geological risks and improve efficiency of geological work:

- Bashneft is making use of the latest geochemical techniques (GORE™ Surveys for Exploration), gravimetrics (instability of the gravitational field) and other approaches. These technologies help to evaluate prospects at discovered and prepared formations before proceeding with deep prospecting and exploration drilling. So the least prospective structures can be discarded, which reduces financial risks in drilling of prospecting and exploration wells;
- the latest software programs have been used for a complex analysis of geological and geophysical materials from areas in Bashkortostan, which have not been sufficiently studied before, in order to prepare recommendations for licence issue at prospects. The software enables structural and stratigraphic interpretation of 2D/3D common-depth point and well logging data, and rapid construction of a geological model to locate formations with oil & gas potential, map the formations and evaluate prospective C3 hydrocarbon resources. The Company plans to enlarge this project to include data from all 2D/3D common-depth point seismic work that has been carried out for the Republic of Bashkortostan;
- specialists of LLC BashNIPIneft and LLC Bashneft-Dobycha have developed a method for evaluation and assessment of acquisition (non-acquisition) of new exploration and oil production assets;
- the Company has purchased the Strategy software system, which enables rapid calculation of the potential costs of geological work;

- Company specialists made conclusions on prospects and advisability of bidding for more than 50 subsoil areas in various regions of European Russia, and Western and Eastern Siberia, which were offered at auctions during 2010. The conclusions were based on collection, analysis and extrapolation of geological and geophysical information;
- geological feasibility studies were carried out for 8 prospective areas in Bashkortostan, as a result of which it was recommended that 2 areas should be included in the licensing program for 2011;
- geological feasibility studies were carried out for 17 Company licence areas (15 areas and fields in Bashkortostan, one field in Orenburg Region and one field in Khanty-Mansi Autonomous District). Based on results, it was recommended that 3 exploration licences in Bashkortostan should be surrendered;
- geothermal analysis of oil prospects in Bashkortostan was carried out as part of an innovative project for use of geothermal energy;
- available geological information on Domanic sediments was analyzed, reflecting heightened interest in the potential offered by oil shales.



**Field development: drilling and production**

In the production sphere the Company has continued to implement the latest and most efficient technologies for increase of hydrocarbon reserves, raising production levels and lowering costs, as follows.

- a Center for hydrodynamic well studies was set up to address issues at hydrocarbon pools with insufficiently studied hydrodynamic features. The Saphir software program is being used for this purpose. Training in use of the software was provided to specialists of LLC Bashneft-Dobycha and the BashNIPIneft institute;
- field development monitoring was initiated at BashNIPIneft in 2010. A new software package, BNView, which enables analysis of development work at key fields, was acquired for this purpose. Recommendations were made for optimizing the development system, and some fields were selected for additional secondary and tertiary recovery operations. Proposals were made for hydrofracturing work, shift to higher horizons, and application of enhanced recovery methods. These interventions helped to increase daily output rates and optimize the well structure;
- a range of new methods were tested for modeling of Carbonaceous reservoirs. The methods take account of specific structural features of reservoirs and improve the predictive power of geological models:
  - a technique for litho-facies modeling was developed, which defines the most prospective zones in a reservoir by analysis of the sediments;
  - a technology was developed for constructing fracture structures of fractured reservoirs. This makes it possible to predict how strata will react to flooding, which helps to define an optimal well grid and forecast dynamic features of reservoirs.
- an optimal well grid and completion methods for reservoir development were calculated for future work in the Timan-Pechora region. Conclusions were reached based on analysis of geo-mechanical data;
- calculations were made in association with St. Petersburg State University regarding strata injection of displacement reagents in order to alter wettability of reservoirs;
- testing was carried out of new core analysis methods, which give more accurate information on reservoir features for drilling purposes.



**BashNIPIneft Institute**

LLC BashNIPIneft (Bashkortostan Oil R&D and Design Institute) is an R&D and design organization, whose main purpose is to assist production operations by Bashneft.

The Institute dates from 1947, when the Ufa Oil R&D Institute was set up around the Central R&D Laboratory of the oil production trust, Vostokneft. Main tasks of the Ufa Institute were R&D support for development of Devonian oil accumulations. In 1970 the Institute was included in Bashneft and renamed 'BashNIPIneft'. This brand name was kept for 34 years until 2004 when the institute was renamed once again, first as 'LLC Geoproject', then LLC Bashgeoproject' and finally 'LLC Bashneft-Geoproject'. In July 2010 the Institute reverted to its traditional name of BashNIPIneft, which has kept strong recognition in Russia and abroad. Understanding the importance of a strong knowledge base for balanced development of a new vertically integrated company, Bashneft is doing much to enhance the R&D capacity of BashNIPIneft. Investments are planned for re-equipment of laboratories, hiring of staff with top qualifications, and development and application of innovative technologies, which will reinforce status of the Institute as a regional knowledge centre.

Priority activities of LLC BashNIPIneft are as follows:

- studies in the spheres of geology, exploration, field development, drilling, production, enhanced recovery, collection of oil & gas, well workovers, and environmental protection;
- design, development analysis and monitoring of oil and oil & gas fields;
- construction of updateable field models, developing well-construction technologies and new enhanced recovery methods;
- geological and financial justification for design decisions;
- selection of technologies and reagents for oil production, laboratory study of core materials and strata fluids;
- ecological and radiation monitoring;
- studies for development of new reagents and materials to be used in well construction;
- design for construction of wells and all other field facilities, overhaul and reconstruction of production facilities.

Bashneft carried out R&D and prototype work for development of new equipment and technologies in 2010, as follows:

- further work was carried out on a hydraulic calibrator-centralizer, which was developed earlier;
- a new calibrator-centralizer with adjustable diameter was developed;
- a new calibrator-centralizer modification was developed for down-hole work;
- new equipment for turbine drilling;
- recommendations for use of PDC-type drilling bits;
- assessment of potential use of 'energy-saving' profiles for sloping and horizontal wells at the Trebs and Titov fields;
- analysis of results from use of the previously developed tool for sidetrack drilling and design improvements. The 'KGB tool' developed by Bashneft has much better performance parameters than analogous Russian and foreign whipstocks, and costs less.

Testing results and financial efficiency in operations using new technologies in 2009-2010:

- trouble shooting technologies (drilling column, non-producing well section). Application achieved hermetic sealing of the well bore, including full prevention of absorptions with intensity up to 10 m<sup>3</sup>/hour, greater solidity of terrigenous sediments (lowering of cavity formation by 12-18%), and 25-75% improvement in the quality of well cementing. Total financial benefit was 6.636 million rubles;
- technology for penetration of the productive horizon (production string, productive horizons);
- a new open-hole flush system. Results showed low infiltration and high transporting qualities of the solution, increase of productivity by 1.7-3.6 times, lowering of water-cut by 14.3%, and increase of oil flow rate by 2.2 times. Testing was carried out in 2010 at 3 wells on Kashirian and Bashkirian horizons. Financial benefit was 4.75 million rubles;
- inhibiting drilling liquid with high transporting qualities. Results: average increase of drilling speed by 27%; reduction of time and resources spent on trouble-shooting; reduction of cavity formation in the borehole by 1.16 times. Testing was carried out in 2009 at Well № 726 along the entire drilling interval from the conductor to the target horizon. Financial benefit was 3.56 million rubles;

- clay solution + hydrodynamic colmatator (GI-203) + 'Quartz' modified dispersed silicas. Results: preservation of reservoir qualities of the productive layer; average oil flow of 11.1-23.6 tonnes/day, water cut of 7-13% (for comparison, average oil flow at standard wells was 8.6 tonnes/day with 11% water cut). Testing was carried out in 2010 at Well № 1685 (Turnian stage, 1710-1784m). Financial benefit was 3.177 million rubles;
- use of expanding backfill material in the productive interval of the production string: use of the backfill improved solid adhesion by 15-20%. There are no cross-flows at wells cemented using the backfill. Financial benefit was 4.32 million rubles;
- Use of a light gel-cement backfill solution in the upper part of the production string. Use of the solution gave 20-25% improvement of solid adhesion. Financial benefit was 1.050 million rubles.

**Laboratory studies**

- LLC BashNIPIneft began development of petro-physical study work in 2010 using core-sample laboratories. Re-equipment of laboratories was carried out to make them suitable for standard petro-physical work and specialized innovative study techniques. Implementation of new technologies will give BashNIPIneft capabilities for a whole range of core and strata fluid analysis, improving the quality and accuracy of research. This will reduce informational risks and raise the quality of output data for preparation of project documentation and planning of field interventions;
- a new system for storage and analysis of core studies has been set up, enabling monitoring of core data, tracking whereabouts of core samples in the storage facility, and conduct of further analysis of laboratory data concerning core samples;
- an innovative technology has been developed for defining micro-components of fresh ground water, using an atomic emission-absorption method of analysis. The technology makes studies more comprehensive and enhances accuracy, which has much significance for proper monitoring of environmental impacts. Bashneft also plans to implement new innovative methods for measuring phenol and benzol content in ground water, and use of the atomic emission-absorption method with a constant spectrum source for ground and soil studies.

**Development of anti-corrosion materials**

- LLC BashNIPIneft carried out laboratory and industrial testing of 16 promising materials and systems of coatings for external surfaces of pipelines. Materials found by tests to be best-suited to operating conditions of Bashneft pipelines have been recommended for use;
- 8 coating systems for interior surfaces of steel pipelines were tested and materials based on epoxy powder paint and liquid epoxy-phenol primer were recommended for use;
- 20 different paint and varnish substances were tested for suitability as external and internal coatings for container equipment at Bashneft facilities. 12 coating systems were selected as a result of laboratory testing and testing in use.

In 2010 LLC Bashneft-Dobycha designed and deployed a System for Implementation of Innovative Technologies. Main tasks of the Innovation System are to identify promising technologies on Russian and foreign markets, and to adapt and apply them in order to improve development and production efficiency at Company fields. Testing in accordance with the System was carried out in the following spheres during the reporting year:

- repair and sealing operations;
- acid stimulation and large-scale acid treatment;
- hydraulic strata fracturing;
- mechanized production;
- new well technologies.

Principal actions as part of the Innovation System in 2010 were:

- execution of the Company's first large-scale hydrofracturing project, involving 73 operations at 26 fields, and giving overall accrued additional oil production in excess of 85,000 tonnes. The project included construction of stress models for fields and strata, and assessment of impacts from technology applications. A total of 15 acid fracturing operations were carried out as part of the project, and future priorities were determined for improving the efficiency of large-scale acid treatment;
- large-scale work to establish how acid compounds used in fracturing operations react with core and oil at Company fields, and preparation of a matrix of applicable compounds, based on results of the work. Work began for identification and testing of new, more complex and efficient acid compounds using flow deviations systems. 6 new acid compounds were brought into use;
- development and application of a quality control system for compounds used in acid treatment operations to investigate formation of non-soluble residues and stable emulsions;
- application of a technology for acid treatment operations using flexible tubes, which avoids negative impact of the well-kill fluid on strata, reduces outage time at the well, and reduces cost of the treatment;
- 14 remedial cementing technologies, 4 of which were recommended for testing in production conditions;

- analysis of 5 technologies for enhanced oil recovery in difficult geological conditions (thin divisions or absence of divisions between oil saturated and water/gas saturated seams). The technology has been recommended for industrial testing.

Bashneft currently holds more than 10 valid Russian patents (remedial cementing technologies and materials for repair and sealing and for reconstruction of wells), which have passed industrial tests and are being used at fields in Bashkortostan.

**INNOVATION IN REFINING BUSINESS**

Bashneft is applying new technologies in the oil refining and petrochemicals segment to ensure that products meet the highest environmental requirements and to deepen refining levels (Bashneft is already the leader in Russia by refining depth).

For this purpose the Company is building and expanding the capacity of delayed coking units, has begun vacuum processing of visbreaking residues, and is upgrading deasphalting units for tar, vacuum blocks on distillation towers, and catalytic cracking equipment. Launch of a delayed coker with 1.2 million tonnes capacity at Ufaneftekhim in 2009 raised refining depth at that plant to 94-96% (depending on load), which is one of the highest indicators in the world.

Low-temperature isomerization technology has been installed at Novoil, raising operating efficiency and providing additional high-quality components for automotive gasoline. Future plans for Novoil include construction of a sulphuric acid alkylation unit, a hydrogen unit and a hydrocracking complex. Further modernization will increase refining depth, overcome shortages of hydrogen and achieve balance between vacuum gasoil processing capacities at all of Bashneft's refineries.

Rebuilding of the vacuum oil hydrotreatment unit at the Ufa Oil Refinery reduced sulphur content in saleable automatic gasoline to the level required by Euro-4 and increased the share of gasoline and diesel fuel in total outputs. Further plans at the plant include construction of a delayed coker and a hydrotreatment unit for catalytic-cracking gasoline.



## DEVELOPMENT OF INFORMATION TECHNOLOGIES

**Bashneft views development and extensive use of information technologies as an important instrument for achieving strategic objectives in quality improvement and operating efficiency.**

IT work by the Company is focused on installation of the SAP Enterprise Resource Planning (SAPERP) system in a 3-year program for development of integrated planning and management at main Bashneft enterprises. SAP's ERP platform automates information flows in main business spheres, including cash flows, production, inventory, property, etc. Installation of the system will create a unified IT space for all Company enterprises and substantially enhance Bashneft's management efficiency.

Personnel Management software, which was installed and activated in 2010, has unified Company processes for wage calculation, management of personnel structure and administration, and accounting of work time, and preparation of reporting. Also in 2010 main tasks were carried out for creation of the Refinery Template solution, based on SAPERP. Its launch at Company refineries is scheduled in 2011.

A program will be implemented in 2010-2015 for upgrading of telemechanics equipment and installation of remote control systems and telemechanical systems for production wells. The objective of the program is to increase oil output and reducing downtime and equipment

failures at wells by ensuring smooth operation of equipment and safeguarding of Company property at oil production facilities.

Measures for implementation of the program in 2010 included installation of telemechanical systems at 2704 wells in Bashkortostan, and systems will be installed at further 2606 wells in 2011. Once the program is completed, 100% of Bashneft's mechanized wells will be remote controlled.

In the refining segment design work has been completed and implementation has started as part of a program for installation of IT systems to manage production operations at Company refineries.

The program will enhance accuracy and transparency of production accounting, enable gradual modernization of measuring and automation equipment, improve efficiency of the dispatching department, optimize and centralize control of technology installations, and ensure quality control.

In the marketing segment the Company has developed a program for automation of marketing, shipping and transportation of oil and petroleum products, to be implemented in 2010-2012. The program encompasses:

- retail sales (retail and small-scale wholesale), including instrumentation and control, and automation of technology facilities at filling stations;
- wholesale business (export and domestic);
- loading and transport.

Various initiatives are planned in the framework of the program, and the first stage of a customer relations management system for export sales was set up in 2010.



An information infrastructure solution has been prepared, which will integrate the communication networks of all subsidiaries and affiliates into a single network. Work on implementation has begun, including laying of fiber-optic cables, and standardization and modernization of window equipment to ensure dependable and sustainable operation of corporate applications. Plans have been completed and work has started on construction of a data processing center in the city of Ufa. The center, which complies with the Tier III+ standard and uses Lampertz technologies to minimize risks from fire and explosion, will house the Company's high-speed servers. Completion and commissioning of the unified data-transfer network and processing center is scheduled in 2011.

The Boss-Referent electronic document processing system was disseminated at Company subsidiaries and affiliates in 2010, which will assist corporate governance, and speed up decision making and implementation. A video conference telecommunications system was also put in place, connecting various Company units and subdivisions in Ufa and Moscow.

### Information technology management

IT development issues at Bashneft are the responsibility of the Committee for Management of IT, Telecommunications and Metrology, which was set up in 2010. The Committee includes Company IT specialists and other representatives of Bashneft sub-divisions, and its responsibilities include approval of new IT projects as well as supervision of projects, which are in the process of implementation.

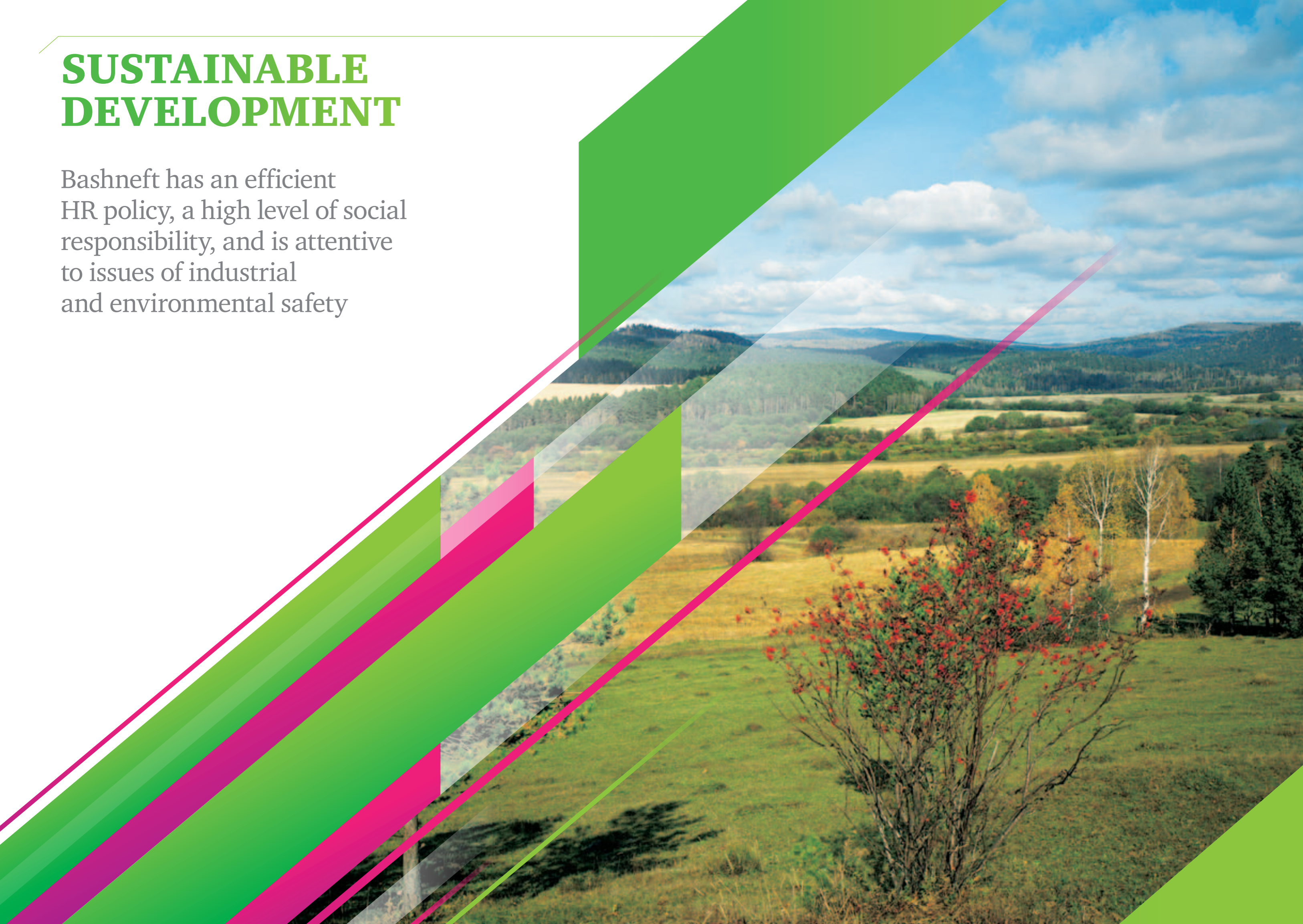
Scheduled work is being carried out to improve IT operating efficiency by updating processes, standardizing equipment and software, setting up a unified IT subsidiary, and outsourcing ancillary business processes.

Virtualization is extensively used to raise the efficiency of equipment use and eliminate redundancy. A Computer Help Desk was set up in 2010 for Company personnel, providing a high standard of service to IT users inside the Company and at subsidiaries and affiliates. A monitoring system was installed and integrated with the Help Desk to improve control over quality of IT service provision and technical support to IT end-users.



# SUSTAINABLE DEVELOPMENT

Bashneft has an efficient HR policy, a high level of social responsibility, and is attentive to issues of industrial and environmental safety



# SUSTAINABLE DEVELOPMENT

## HR POLICY

The Company's employees are its most valuable asset and main strategic resource, enabling Bashneft to be competitive and achieve its objectives. Bashneft's HR policy is therefore based on helping our employees to work more efficiently and encouraging their personal commitment to achieve best results. The Company's relationship with its personnel is based on full compliance with the rules and principles of Russian and international law, equal opportunities, and mutual respect.

Bashneft is a responsible employer, providing equal rights, competitive wages and steady improvement in the quality of life of its employees and their families. The Company strives to ensure comfortable and safe working conditions, and to maximize opportunities for personal development and professional growth.

In 2010 Bashneft approved a Code of Corporate Conduct and Ethics, which meets international standards.

Also in the reporting year, the Company designed and approved a functional strategy for HR management. Key criteria for success of the strategy are: development of the Company's executive reserve, lowering the average age of personnel, broadening the reach of employee training and development programs, and retaining employees.

### Personnel numbers and structure

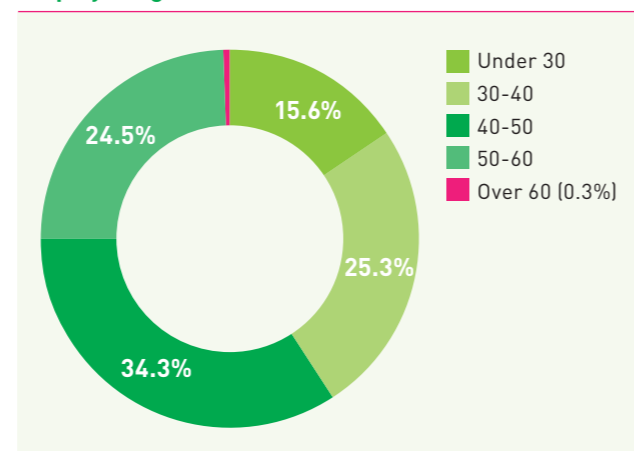
Various measures for optimization of organizational structure of Bashneft and its subsidiaries and affiliates caused reduction of headcount by 1049 (3.7%) in 2010.

However, headcount increased in some business segments as a result of new asset acquisitions. Growth of personnel numbers in the management company was due to creation of Bashneft's own full-cycle marketing service (dealing with crude oil procurement, petroleum product marketing and logistics, etc.) following termination of fee-based refining, as well as creation of various other new departments and specializations, such as IR, GR, marketing, and electricity.

### Personnel numbers at Bashneft subsidiaries and affiliates, by business types

Business type	Average headcount in December 2009	Average headcount in December 2010
Management company	395	854
Drilling	6,270	4,489
Oil & gas production	8,337	7,931
Oil refining and petrochemicals	8,247	8,173
Marketing and logistics	4,936	5,659
R&D	852	882
<b>TOTAL</b>	<b>29,037</b>	<b>27,988</b>

### Employee age structure



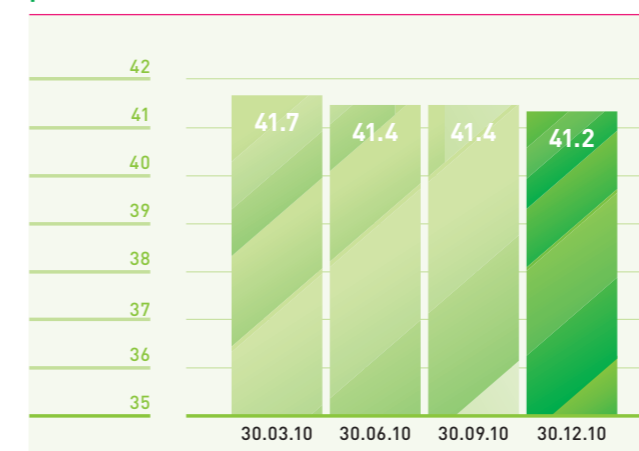
### Work with personnel

The Company seeks to recruit top-rank specialists, who are ambitious, energetic and creative, have initiative, can work as members of a team, and are keen to expand their professional knowledge and experience. Nearly all of Bashneft's employees have specialized education and considerable experience. About 15% of employees are under 30-years old, and the Company regularly hires talented graduates. Inflow of young employees, and a core of employees with established knowledge and experience, enables Bashneft to look into the future with confidence.

Bashneft develops its HR potential using the following mechanisms:

- work with young specialists;
- creation of an executive reserve and individual development plans;
- application of modern systems for employee assessment;
- support and assistance for new employees, helping them to adapt to Company systems and achieve high levels of productivity as soon as possible;

### Average age of Bashneft personnel in 2010



- creation of an integrated further-training system, encompassing all personnel in management positions;
- development of a long-term program of cooperation with leading oil & gas institutes.

Bashneft has a set of measures in place to ensure that the Company can recruit the personnel it needs in a timely fashion:

- by fostering an image as a good employer on the labour market;
- by actively seeking managers and specialists with broad professional experience and initiative, who are able, energetic, and responsible;
- by ensuring transparent criteria in recruiting (standardized principles to assess job candidates, based on professional and management qualities, and the candidate's development potential);
- by use of a differentiated scale of remuneration for different employee categories;
- by regularly monitoring the causes and trends of employee 'churn', and auditing employee composition and mobility.

### Motivation and remuneration

Bashneft offers its employees a competitive wage relative to other companies in its region of presence and to other companies in the Russian oil sector.

The Company motivates its employees through:

- a competitive level of remuneration;
- payment of performance-related bonuses for achievement of key criteria;
- long-term incentive programs for senior management and middle management;
- a competitive package of social benefits, depending on job status;
- non-financial incentives.

In 2010 the Company installed a new remuneration and motivation system, based on a grading approach, which measures the personal contribution of each employee to Bashneft's business and sets a level of remuneration appropriate to that contribution. Thanks to the grading system, Bashneft has been able to structure its assessment of employee labour, making such assessment more comprehensive and objective. However, changeover to a grade system has not affected bonuses for hazardous work, night-work, and work at weekends and public holidays, which continue to be paid in full compliance with acting legislation.

**Bashneft as a responsible employer**

Labour and social guarantees, employer commitments to ensure favourable working conditions, and mutual commitment of the parties in employment contracts to obey the provisions of employment law, are enshrined in long-term collective agreements. All provisions of such agreements, including wage payment, job protection, work time and holidays, safety and discipline, as well as other issues, are implemented by the Company in full.

All acting collective agreements include social preferences and guarantees for employees. The Company spends significant sums on:

- holiday provisions and healthy lifestyle for its employees;
- healthcare;
- culture and sport events for employees;
- presents for children at New Year and organization of New Year celebrations;
- burial arrangements;
- financial assistance to retirees;
- employee anniversaries.

Bashneft does much for the well-being of Company pensioners, including special payments to mark anniversaries and to assist in purchase of holidays. One-off payments are also provided to help cover funeral expenses for Company pensioners.

All Bashneft employees have voluntary medical insurance policies.

The Company spent a total of 55.6 million rubles in 2010 on social payments for employees and pensioners, of which 32.6 million rubles for current employees and 23 million rubles for pensioners.

Bashneft spent 1.03 billion rubles in total for financing of the social sector at its business entities during 2010.

**Employee training and development**

Ensuring favourable conditions for professional and knowledge growth of Company specialists, and for raising their levels of competence, is a key objective of Bashneft's HR policy.

These tasks are addressed in a systematic fashion, including assessment of employee efficiency, all-round development of professional knowledge, skills and know-how, and work with the Company's executive reserve.

Trainings and courses for raising the level of qualification of Company specialists are delivered in the following forms:

- short-term study (trainings / courses / seminars lasting up to 72 hours);
- medium-term study (programs for raising of qualifications, lasting between 72 and 500 hours);
- long-term study (2-year master's program);
- remote learning.

Employees undergo both compulsory (legally required) training, and training for professional development on the initiative of the Company. Further training of senior managers and middle management is provided on a constant basis. Study seminars and trainings for professional development of Bashneft managers have been organized since 2010 in association with the Corporate University of Sistema Corporation. In 2010 more than 40,000 courses were delivered to Company employees (measured by the number of recipients of the courses) for purposes of raising professional qualifications and for re-training. About 7000 courses, devoted to development of professional and management competence, were delivered for the first time.

In April 2011 a program for development of management skills, developed specially for Bashneft, was initiated at the Higher School of Management attached to St. Petersburg State University (considered to be the best business school in Russia). Students of the program are 28 employees from the Company's executive reserve (heads of departments and sections). Bashneft also works closely with Ufa State Oil University, the further education department of Gubkin Oil & Gas University, and Tomsk Polytechnical University to support development of professional and technology abilities of its managers and specialists.

**Holidays and rest cures for employees**

The fuel and energy industry in Bashkortostan has strong traditions of social support, and the Company spends considerable amounts of money to maintain leisure infrastructure for its employees and their families. Each year tens of thousands of workers from the Republic's fuel and energy enterprises enjoy holidays and rest cures at sanatoria and holiday facilities that belong to Bashneft.

These facilities include 5 children's camps, 7 sanatoria, and 3 holiday bases.

In 2010 Bashneft spent 151.9 million rubles on health-related events, rest cures and holidays for its employees. In total, 8145 employees at Company subsidiaries and affiliates took holidays and benefited from rest cures thanks to these arrangements, and Bashneft spent 151.9 million rubles in order to provide these benefits. Spending by Bashneft Group on employee holidays and rest cures totaled 586.8 million rubles in the period from 2005 to 2009.

As stipulated by collective agreements, employees at Bashneft enterprises pay only a part (between 10% and 30%) of the real cost of holidays organized by the Company, while Bashneft itself pays for the rest. About 60 million rubles were spent by the Company for these purposes in summer 2010 alone.

**Support for a healthy lifestyle**

The Company devotes considerable funding to development of sport and a healthy lifestyle among its employees and their families. This involves the holding of sports competitions, lease of swimming pools, sports halls and ski bases, and purchase of sports clothing and equipment. Sports events at Bashneft enterprises help to develop team spirit, efficiency in issuing and obeying orders, and appreciation of a healthy lifestyle among employees.

Events held with active involvement of trade union organizations include winter and summer amateur sports festivals ('Spartakiada'), ski racing, chess, draughts and table tennis competitions, mini-football, weight lifting, and volleyball tournaments. Qualifying rounds are held through the year for participation in the Kandry Kul Games, held annually for the last 15 years to coincide with the Day of Workers of the Oil & Gas Industry at a resort by Lake Kandry Kul, which is one of the most picturesque lakeside settings in Bashkortostan.

A long-distance running club attached to the Bashneft production subsidiary, Arlanneft, holds an annual 21-km half-marathon. Most of those who take part are employees of Bashneft-Dobycha, and the event is included in the official calendar of the Russian Association for Marathons and Long-distance Athletics.

Company employees also take part in sports events organized by Sistema Corporation. The Bashneft team was the winner of Sistema's national amateur sport Spartakiada in 2010.

**Corporate events**

Bashneft traditionally holds corporate events to coincide with the Day of Workers of the Oil & Gas Industry and Senior Citizen Day. These events consist of award ceremonies for outstanding employees, gala concerts, and receptions for Company veterans.

Bashneft also holds annual receptions for war veterans who worked in the Bashkortostan fuel and energy industry, children's parties at New Year with present-giving and music, as well as starting-school celebrations, to which all young children entering their first class at school are invited.

A competition of children's drawings was held in the reporting year on the theme, My family works in the oil industry, as well as a competition of professional excellence, Best in the Profession, and an R&D Conference for young specialists with an exhibition of research work. The first-ever corporate award ceremony for outstanding employees of Bashneft was also held in 2010.

Total spending by the Company in the reporting year on cultural, sporting and other mass events was 26.6 million rubles.



## HEALTH AND SAFETY

In compliance with the Government's National Policy for Health, Safety and Environment and the Socio-Economic Strategy for Development of the Russian Federation up to 2010, Bashneft is prioritizing design and implementation of a health, safety and environment strategy.

### Health and safety management

In 2010 Bashneft designed and approved a functional health, safety and environment (HSE) strategy.

The strategy includes the following main objectives:

- protecting the life and health of Company employees;
- achieving HSE indicators that match standards defined by the Company;
- maximum safety provisions for Company employees in case of accident;
- reducing accident levels at hazardous production facilities;
- promotion of Bashneft's image as an environmentally responsible Company.

Bashneft designed an internal Regulation on HSE Management during the reporting period. The Regulation sets main tasks for organization of HSE work inside the Company, organizational structure, planning of HSE measures, definition of responsibility, resources to be deployed, and procedures for analysis of results and ways of improving the system.

Analogous HSE management systems are in place at Company subsidiaries and affiliates. The standards, on which the systems are based, are constantly updated as a result of efficiency analysis. All Bashneft subsidiaries and affiliates have certificates, confirming conformity of their health and safety provisions to established Government norms.

### Industrial safety

Bashneft gives priority in its industrial operations to ensuring that industrial safety requirements are met during implementation of all complex technological projects. Production control, consisting of all organizational and technical actions for observance of safety requirements at operating facilities, is an important component of the Company's industrial safety management system. A multi-level system of production control at hazardous production facilities ensures risk management, accident prevention, and compliance with all the necessary requirements in the sphere of industrial safety.

During the accounting year Bashneft used the services of the leading international consulting company, Ernst & Young, for design and implementation of a risk control system to reduce probability of accidents and for organization of a risk management system to address various issues, including matters of industrial and environmental safety.

A permanent Risk Committee and Risk Management Department have been set up at the Company, risk owners have been defined, risk passports have been prepared, and plans have been made for risk management measures. Implementation of the plans is being monitored and cases of risk occurrence are reported.

### Working conditions

Measures to ensure optimal working conditions at Bashneft and its subsidiaries and affiliates were fully financed during the reporting period. Attestation of all workplaces was carried out, workers were provided with appropriate protective clothing, prophylactic dietary supplements, etc., and improvements were made to working conditions. More than 176 million rubles were spent for these purposes in 2010. The number of injuries at work at Company subsidiaries and affiliates declined in 2010. There were 4 production accidents, including one fatality in a road accident, caused by a driver working for another organization who drove on the wrong side of the road and was involved in a collision with a Bashneft vehicle. The other three accidents occurred due to failure of operatives to use protective gear, which had been issued to them.

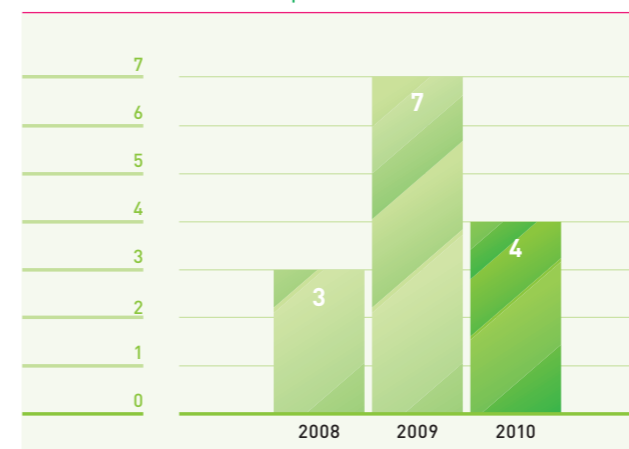
Incidence of accidents per 1000 employees in 2010 was thus 0.19, which is the same level as in 2009, (the number of accidents in both 2009 and 2010 was unchanged at 4).

### Civil defence and emergencies

Bashneft has a system for prevention and reaction to emergency situations, and the system was kept in working order during 2010 by 73 study sessions and trainings for actions to deal with possible oil spills, extinguishing fires, and localizing the sources of accidents. A total of 3692 Company employees took part in the trainings.

All emergency shelters at subsidiaries and affiliates are kept in a state of readiness for use in case of accidents. A total of 3.8 million rubles was spent in 2010 for maintenance of emergency shelters.

**Number of injuries as a result of industrial accidents (persons)**



Company subsidiaries and affiliates have 6 full-time accident and emergency services, manned by 228 employees, of whom 35 are in constant readiness.

Work began in 2010 on development of 3D models of potentially dangerous facilities, in order to ensure best-possible management decisions on safe operation of the facilities and identification of possible accident situations.

The Company spent a total of 4.5 million rubles in 2010 on prevention and reaction to emergency situations, and on ensuring fire and radiation security.

### Training in industrial safety and working conditions

Training and attestation on issues of working conditions, industrial safety and fire safety are obligatory under Russian law and are implemented at the Company on a compulsory basis, and in full and regular fashion. A total of 9098 employees were trained and attested in workplace standards during 2010 and the numbers for industrial safety and fire safety were 14,599 and 9585, respectively (total employee numbers at Bashneft are 28,000 people).

All subsidiaries and affiliates of Bashneft have potentially hazardous operations, so the Company is scrupulous in ensuring that employees are trained in provision of first-aid to anyone who is injured in an industrial accident. First-aid training was provided to 14,390 Company employees in 2010.

Total financing of compulsory training at subsidiaries and affiliates in 2010 was 34.1 million rubles. The training was provided using the resources of large study centers, which have many years experience in training of highly qualified personnel for the fuel and energy sector.

In addition to compulsory studies, Bashneft employees improved their skills in 2010 by attending seminars and trainings, studying the latest Russian and international experience, and taking part in R&D conferences.

**ENVIRONMENT**

Environmental protection has been and will remain an important concern of Bashneft, since proper care for the environment is essential for the health and happiness of future generations. Bashneft is one of the top-10 oil companies in Russia, so its operations inevitably have major impact on the environment.

**Measures to protect the environment**

Concentration and rates of growth of industrial output in the Republic of Bashkortostan are very high. Bashneft and its subsidiaries and affiliates have therefore acted in recent years to reduce potential negative environmental impacts, taking various measures to protect the environment and improve the conditions of natural resource use.

A total of 1.94 billion rubles was spent on measures to protect the environment at all Bashneft sub-divisions during 2010.

Processing and detoxification of oil sludge is one of the principal environmental challenges for Bashneft.

At present waste containing oil is processed using equipment provided by the company Alfa-Laval. The equipment had been used to treat 130,000m<sup>3</sup> of oil sludge as of the start of 2011, eliminating 16 sludge pits. Land reclamation work was then carried out at the sites.

A project for processing of oil sludge using the new Consortsium bio-agent, developed by the Company R&D institute, BashNIPIneft, has revolutionary implications for treatment of waste containing oil: applying years of experience and the results of laboratory studies, R&D specialists have designed a new substance for treatment of oil sludge by biological breakdown of waste at special sites. Efficiency of the technique is higher than that of existing analogues.

To date Bashneft has built two sites for application of the Consortsium agent and plans to install a further 6 sites in the future.

Avoidance of air pollution is another important issue for Bashneft. Atmospheric pollutant emissions at Company production facilities are within permissible limits, and they are on a steadily declining trend thanks to implementation of new organizational and technology measures.

All of the Company's main storage facilities have up-to-date hermetic systems for control of light hydrocarbon fractions, which prevent release into the atmosphere of up to 87,600 tonnes of pollutants each year. The fractions are captured by units, installed at Company refineries, for recuperation of hydrocarbon fumes and for hermetic loading of light hydrocarbons into rail tanks. Flare equipment at Company refineries is fitted with systems for capturing emergency gas releases, which are compressed and returned to the fuel system for repeat use.

A unit for removing sulphur from straight-run gases has been installed on a distillation tower at the Ufa Refinery in order to further reduce atmospheric emissions. The unit fully cleanses fuel gases before their use, much reducing emission of sulphurous gases into the atmosphere.

Changeover to production of engine fuels meeting the Euro-4 and Euro-5 international standards is of utmost importance for reduction of atmospheric pollutant emissions. Vehicle exhaust emissions account for 60% and more of all atmospheric pollutants in large Russian cities (including Ufa, where Bashneft has its main office). It has been calculated that total exhaust emissions fall by 10.5 times for gasoline and 7.5 times for diesel fuel when the advance is made from Euro-2 to Euro-4.

The Company's Ufa group refineries, which are the Russian leaders by equipment standards and refining depth, have already been producing Euro-4 fuels for 2 years. Planned actions for refinery modernization will enable complete changeover of Bashneft's light product output to Euro-4 and Euro-5 standards in the timescale required by the Government's Technical Regulation for fuel quality.

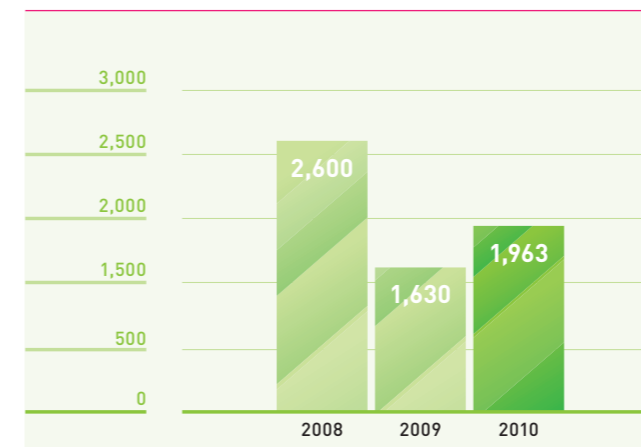


Bashneft has approved a corporate program for the period 2010-2013 to increase productive use of secondary gas, in compliance with the Russian Government Decree №7, dated January 1, 2009, on measures to reduce atmospheric pollution from burning of secondary gas at flare units.

Implementation of measures under the program will increase productive use of secondary gas from 83.1% in 2010 to 95% in 2013, and 1.57 billion rubles have been assigned to the program by Bashneft.

A good example of Bashneft's resource-saving application of secondary gas is injection by Bashneft-Dobycha of water and gas mixture into strata at the Ilishevskoye field, using multi-phase booster pumps. The technique both reduces harmful atmospheric emissions and helps to maintain strata pressure. Another unique productive use for secondary gas is its injection into the arch section of hydrocarbon pools at depleted Riphean sections of Ishimbay group fields by Ishimbayneft (a sub-division of Bashneft-Dobycha). This technique is a particularly efficient method of enhancing oil recovery rates.

**Bashneft current spending on environmental protection (million rubles)**



Bashneft also uses secondary gas to achieve greater energy efficiency by building gas-piston power stations at fields. Initiatives to date include installation of a gas-piston station at the Kirsko-Kottynskoye field in Nizhnevartovsk District (Khanty-Mansi), which raised productive use of secondary gas from 18% to 83.1% by the end of 2009 and reduced lifting costs thanks to electrical energy savings. In 2010 Bashneft began secondary gas supplies to the station from the Lyukpayskoye field, thereby raising the overall share of secondary gas at the Company's Western Siberian fields, which is used productively, to more than 96%.

Negative impact on surface and ground water at the Company's filling stations and oil storage facilities has been reduced by installation of drainage systems for collection of foul water and rain water. Equipment, including SUPER-PEK systems, is used to purify the water, which is then employed for technical purposes.

Mechanical purification equipment has been installed at all refineries in the Ufa group, and enables reduction of concentrations of petroleum products in foul water by 100 times (from 1000 mg/L at input to 10 mg/L at output). Foul water from all refineries is carried to biological purification equipment installed at Ufaneftekhim, from where 63% of purified water (more than 11.6 million m<sup>3</sup>/year) is returned to the refineries to be re-used, and the remaining 37% is released into the Belaya River (quality is almost indistinguishable from river water).

Bashneft has installed the first specialized refuelling station for boats in the Urals region at the Pavlovskoye Reservoir. Previously refuelling of boats caused a risk of fuel spillage into the Reservoir. The new refuelling station includes all of the mechanisms, which are necessary in order to prevent pollution by petroleum products: the facility has a modern fuel-distribution system, robust double-thickness reservoirs for fuel storage, cleansing equipment, and boom equipment and special absorbents in case of any product spillage. If correctly used, the facility provides 100% assurance that water pollution will be avoided.



## **SOCIAL POLICY**

Bashneft is determined to develop its role as a socially responsible business. At the end of 2010 the Company subscribed to the Social Charter of Russian Business, confirming its commitment to follow the principles set out in the Charter. Also, the Company completed work on a Corporate Social Policy and approved the document in 2010.

### **MAIN PRINCIPLES OF CORPORATE AND SOCIAL POLICY**

The Company's socially responsible approach to business is based on a philosophy of long-term, sustainable development, which harmoniously combines successful business with basic human values and corporate and national development priorities. The key components of Bashneft's corporate social policy are improvement in the quality of life of its employees and of people in regions where the Company has presence through innovative business development, ensuring industrial safety, investing in human potential, caring for the environment, and consideration for future generations.

Bashneft confirmed its reputation as a Company with a high level of corporate responsibility in 2010, and society and executive government in the Republic of Bashkortostan, where Bashneft's main production assets are located, highly value the Company's contribution to addressing priority social issues in the region.

Bashneft's achievements in corporate social policy have also been acknowledged at national level. In 2010 the Company was a prize winner in the Social Responsibility nomination at the annual national competition, Best Russian Enterprises. Development, Efficiency, Responsibility, organized by the Russian Union of Industrialists and Entrepreneurs and the Government of the Russian Federation.

### **WORKING WITH REGIONS OF COMPANY PRESENCE**

Bashneft has a constructive dialogue and a tradition of cooperation with Government bodies, business circles and local communities, based on mutually beneficial social partnership and ensuring a balance between the interests of all the parties concerned. The Company believes that its contribution to social development in regions of presence must be systematic, transparent and understandable to the local community, since these are essential conditions for ensuring that such social work helps to achieve sustainable development of the Company.

The main instrument for cooperation with regional Government and efficient solution of problems in the social sphere is a long-term agreement, which has been signed between the Republic of Bashkortostan and Sistema Corporation. This document enables work by Bashneft Group of companies to be coordinated with the needs of the region, and directs the joint efforts of the Company and regional authorities to solution of key problems. The Company monitors spending of funds, which it allocates, ensuring that they are spent efficiently and as intended. All financial assistance is earmarked for specific purposes, and a list of spending targets and actions is developed in close cooperation with regional Government.

The Company works with local as well as regional levels of government in regions of its presence. For example, Bashneft is working to address issues of employment, road-building, and a range of other social programs jointly with the administration of Nizhnevartovsk District (part of Khanty-Mansi Region), where the Company is developing a number of fields.



### **Social infrastructure development**

Improving living conditions and developing social infrastructure in regions of presence are an important part of Bashneft's corporate social policy.

Group companies spent a total of 1.2 billion rubles in 2010 to help upgrade social infrastructure in Bashkortostan. The money was used for construction and reconstruction of hospitals, polyclinics, kindergartens, schools, sports facilities, sanatoria, and children's camps, including several in remote districts of the Republic.

Social facilities in Bashkortostan, which have been financed by Bashneft, include (among many others) :

- a kindergarten in the village of Kandry (Tuimazy District);
- a social and cultural center in the village of Kirzya in Karaydelsky District;
- a covered ice-skating rink in the town of Sibay;
- the hospital in the town of Sibay;
- a leisure center at the Karagay sanatorium in Mechetlinsky District;
- the central district hospital in Sterlibashevsky District;
- a hospital complex in the village of Bazilevka;
- second stage of the Ufa-Arena sports complex;
- a paralympics sports center in the village of Mishkinoy.

As shown by these examples, the Company's efforts are expanding access for people in Bashkortostan to well-equipped, high-quality educational and medical services.

Bashneft makes significant contributions to the upkeep and development of buildings and sites of historical, religious, cultural and environmental significance. The Company provides financing for repair and construction of mosques and of churches.

Addressing Bashkortostan's environmental challenges, Bashneft designed a program in 2010 for connecting a number of villages in the Republic to mains water. The program includes construction work at fresh water springs, piping of water, and a number of other actions. The program will be continued in 2011 when work will be carried out at 25 fresh water springs in the Republic for their use as sources of mains water.



**Charity**

Charity programs for support of the most vulnerable groups in society are an important part of Bashneft's social policy.

The Company assigned about 28 million rubles for charity assistance in 2009-2010.

Bashneft sponsors the Ufa Social-rehabilitation Center for Juveniles, which cares for 50 young people, and the Company does all it can to ensure that they can live, study, and spend their leisure time in conditions no worse than their contemporaries who are being brought up in families. Bashneft spent 1.5 million rubles to support the work of the Center in 2009-2010.

The Company also helps to support the educational resource base of schools in the Republic. In 2010 Bashneft paid for installation of a new computer suite at School № 141 in Ufa and the School also received a new sports ground at the Company's expense.

**Support for education**

A long-term program for cooperation with the leading regional oil & gas institute, the Ufa State Oil University, was prepared in 2010 and a corresponding agreement was signed. The program envisages training, re-training and raising of qualifications for Bashneft specialists, and periods of work experience for the University's students and post-graduate students at Bashneft enterprises. A system of grants has been set up for students and post-graduates at the University, including personal stipends for those who show outstanding potential.

In 2010 a unique education project, I want to be an oilman, was launched as part of a pre-university program. The project is intended to encourage interest among young people in a career in the fuel & energy industry. As part of the project, cooperation is being developed with the University's specialized center for work with young people before they enrol as students.



**Supporting sport**

Bashneft provides sponsorship assistance to sports projects, clubs and groups of sport enthusiasts, and helps to organize large-scale sports events, competitions and championships at various levels.

The Company helps to finance the Bashkortostan Boxing Federation, as well as the Bashneft Chess Club, which has won recognition as a world-class center of chess expertise. The European championships for motor racing on ice were held in Ufa in January 2010, made possible in part by Bashneft sponsorship.

The Company's biggest sports project at national level is general sponsorship of CSKA professional football club, by which the Company makes an important contribution to Russian sport, and helps to develop involvement and interest in football in Bashkortostan. Cooperation between Bashneft and CSKA includes master-classes for young sportsmen and trainers in Bashkortostan, friendly matches for the youth team, visits by young footballers and trainers to sports schools, and CSKA matches.

# CORPORATE GOVERNANCE

Bashneft stands for modern principles of corporate governance and a strong team of professional managers

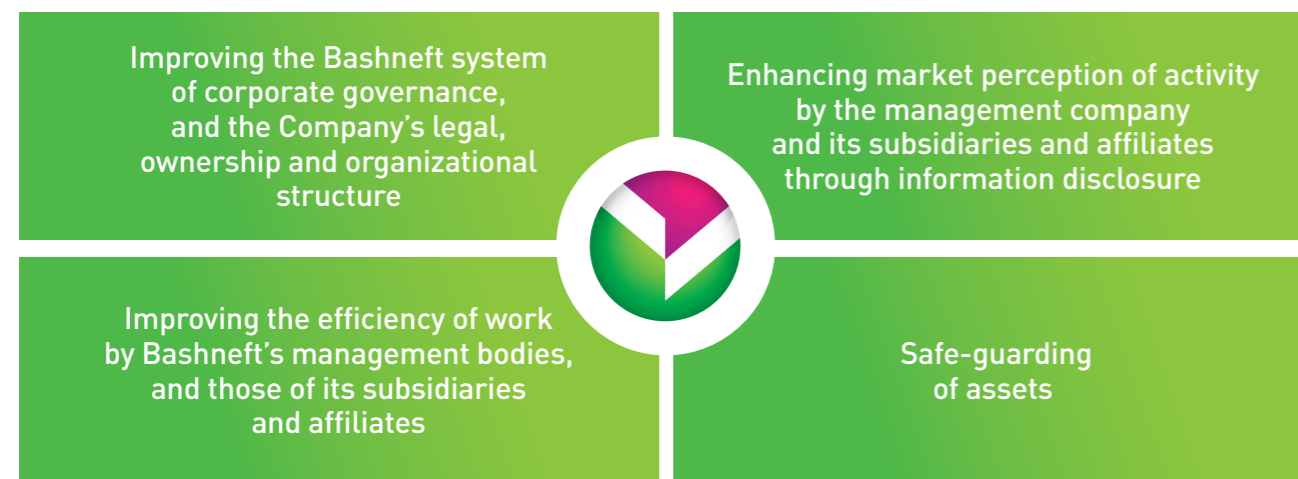


# CORPORATE GOVERNANCE

## CORPORATE GOVERNANCE SYSTEM

Bashneft places much emphasis on development of a modern system of corporate governance, which conforms with the requirements of Russian law, and is based on principles of openness and transparency. The change of shareholders in 2009 and restructuring of the Company inaugurated creation of a new system of corporate governance, development of which continued in the reporting year.

## STRATEGIC GOALS FOR CORPORATE GOVERNANCE



Bashneft is building a system of corporate governance that strictly adheres to the requirements of Russian law, and to principles of openness and transparency. Bashneft carries out constant monitoring and implements best international corporate governance practice in order to ensure that the highest international standards are met.

The main aspects of Bashneft's corporate governance policy are as follows:

- unconditional observance of the interests and protection of the rights of shareholders;
- installing unified governance standards in all Company structures;
- improving the Company's information policy and internal audit system;

- implementing principles of informational openness and transparency;
- constructive interaction with investors, employees, and the Company's business partners;
- instating best corporate governance practice at Bashneft.

The principles and procedures of corporate governance at Bashneft are enshrined in the Company Charter and various publicly available internal documents, which together define the structure and competence of the Company's governance and audit bodies.

Bashneft's Code of Corporate Conduct and Ethics contains further commitments with respect to openness and social responsibility, as well as ethical principles for conduct of business.

## KEY RESULTS IN 2010

Corporate governance initiatives at Bashneft in 2010 were as follows:

- shares in 6 Company enterprises (Ufa Oil Refinery, Novoil, Ufaneftekhim, Ufaorgsintez, Bashkirnefteprodukt and Bashkirenergo) were bought from minorities who accepted a Bashneft buy-back offer;
- preparations were made for spin-off of electricity business as a separate vertically integrated structure;
- charters and internal documents of Bashneft and its main subsidiaries and affiliates were brought into uniformity;
- boards of directors and other corporate governance bodies were set up at subsidiaries and affiliates, and most of the necessary work was carried out to ensure their smooth operation;
- directors and officers liability insurance was put in place for the Group;
- legal support was put in place for all corporate actions of Bashneft;
- a system for management of legal and corporate risk was put in place;
- efficiency improvements were achieved in use of various corporate property.

Corporate governance initiatives in 2010 provide a basis for growth of company capitalization and enable attainment of important strategic objectives.

## CORPORATE GOVERNANCE STRUCTURE

Bashneft's corporate governance structure is founded on a number of basic principles:

- transparency of all processes to shareholders, investors and partners;
- an active and professional Board of Directors;
- consistency and a collegiate principal in decision-making.

The Company's key management bodies are as follows:

- the General Meeting of Shareholders;
- the Board of Directors;
- the Executive Board (collegiate executive body) and President (one-person executive body).

There were 3 Extraordinary General Meetings of Shareholders of Bashneft during 2010:

January 18, 2010 (by absentee voting)	The Meeting agenda consisted of approval of the new version of the Company Charter. The new version envisages introduction of a collegiate management body, the Executive Board, and change of the official title of the one-person executive body.
December 8, 2010 (in the form of joint presence)	The Meeting agenda included: early termination of authorities of the Company's Board of Directors; definition of the number of members of the Board of Directors; election of the Board of Directors; early termination of the authorities of members of the Audit Commission; and election of members of the Audit Commission. The Meeting decided to increase membership of the Board of Directors to 13 people, including 2 independent directors.
December 17, 2010 (in the form of joint presence)	The Meeting agenda consisted of dividend payment on shares of the Company for business results in 9 months of 2010. The Meeting decided to pay dividends of 104.50 rubles per common and preferred share in cash no later than March 31, 2011.

## General Meeting of Shareholders of Bashneft

The General Meeting of Shareholders is the supreme corporate governance body of Bashneft. Its activity is regulated by the Law of the Russian Federation on Joint-Stock Companies, Charter provisions, and the Company's internal documents. The procedure for conduct of the General Meeting of Shareholders fully ensures observance of shareholder rights.

## General Meetings of Shareholders in 2010 and their results

There were 4 General Meeting of Shareholders of the Company during 2010.

The Annual General Meeting of Shareholders of Bashneft was held on June 29, 2010.

Decisions taken at the Meeting were as follows:

- approval of the Company's annual report;
- approval of financial accounts for the year, including the profit & loss account;
- approval of income distribution, including payment of (announcement of) dividends for 2009;
- definition of the number of members of the Company's Board of Directors;
- appointment of members of the Board of Directors;
- appointment of members of the Company's Internal Audit Commission;
- approval of external auditors to carry out audit of financial accounts for 2010 to Russian accounting standards and to international standards;
- approval of a new version of the Company Charter;
- approval of a new version of the Regulation on the General Meeting of Shareholders.

Decisions taken at the General Meeting of Shareholders had been fully implemented as of December 31, 2010.

**The Board of Directors of Bashneft**

- General management of Company business is carried out by the Board of Directors. A range of main issues directly connected with the Company's sustainable development are also the responsibility of the Board of Directors. These issues include:
- defining business priorities;
- considering and approving development strategy ;
- considering and approving investment programs;
- approving internal documents, which regulate the principles of Company business, including such spheres as new types of business, corporate governance, HR strategy, employee incentive systems and remuneration.

Membership of the Board of Directors, elected by the Annual General Meeting of Shareholders on June 29, 2010 is as follows:

- Anton Vladimirovich Abugov
- Ruslan Fedorovich Almakaev
- Alexei Nikolayevich Buyanov
- Anna Goldin
- Alexei Yurievich Goncharuk (Chairman)
- Sergey Alexeyevich Drozdov
- Alexander Leonidovich Korsik
- Igor Valentinovich Marchenko
- Leonid Adolfovich Melamed
- Viktor Gennadievich Khoroshavtsev
- David Mikhailovich Yakobashvili

**Changes in membership of the Board of Directors**

As of the start of 2010 the Board of Directors consisted of 9 members, appointed at the Extraordinary General Meeting of Shareholders on November 25, 2009. The Annual General Meeting of Shareholders on June 29, 2010 increased Board membership to 11, and 2 new members (Igor Marchenko and David Yakobashvili) were elected, while remaining Board members were elected for a further term.

The Extraordinary General Meeting of Shareholders on December 8, 2010 increased membership of the Board of Directors to 13 and elected 2 new members (Murtaza Rakhimov, Yury Pustovgarov), while remaining Board members were elected for a further term.

**The Board of Directors consists of:**

Executive director	1	Viktor Khoroshavtsev
Non-executive directors	9	Anton Abugov, Ruslan Almakaev, Alexei Buyanov, Anna Goldin, Alexander Goncharuk, Sergei Drozdov, Alexander Korsik, Igor Marchenko, Leonid Melamed
Independent directors	3	David Yakobashvili, Murtaza Rakhimov, Yury Pustovgarov

**Meetings of the Board of Directors**

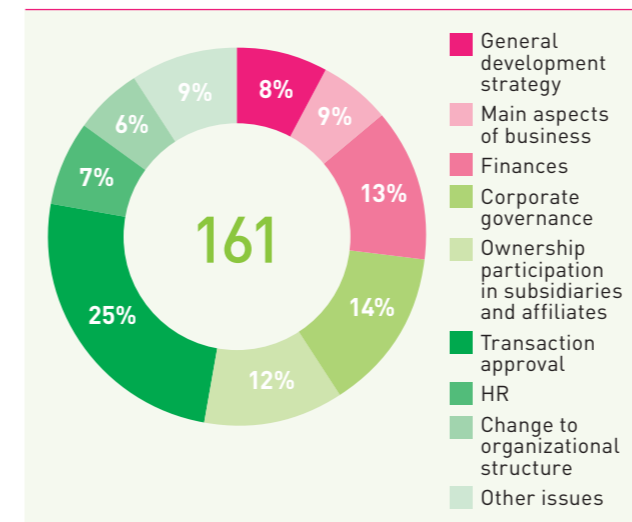
Meetings of the Board of Directors are held according to a schedule, and unscheduled meetings are called as and when necessary to take decisions on urgent issues.

The Board of Directors held 24 meetings in 2010, of which 17 were scheduled (12 in the form of joint presence and 5 by absentee voting), and 7 were unscheduled (1 in the form of joint presence and 6 by absentee voting).

	2010	2009
Number of meetings in the form of joint presence	13	7
Number of meetings by absentee voting	11	15
Number of agenda items according to the meeting schedule	116	18
Number of items considered at the meeting	161	57

Between 3 and 5 strategic issues, which are in the competence of the Board of Directors, are included as items in the agenda of each scheduled meeting of the Board, such as: company development strategy, financial strategy and financial reporting, corporate governance, and key aspects of Company business. Other issues in the competence of the Board of Directors, such as approval of transactions, and of amendments to provisions and regulations, are included in Board agenda as and when necessary.

**Subject matter of issues reviewed at meetings of the Board of Directors in 2010 was as follows**



**Committees of the Board of Directors of Bashneft**

Members of the Board of Directors have formed 4 Committees in order to enhance efficiency of decision-making by the Board, and to ensure more detailed preliminary consideration of key issues and preparation of appropriate recommendations. Various experts and employees of Bashneft also work on the Committees.

**The Strategy Committee** deals with long-term strategy of the Company as a whole and of its sub-divisions. Committee members also draw up plans for interaction with investors and shareholders. The Strategy Committee has 10 members: A. Korsik (Chairman), S. Bushers, A. Buyanov, A. Goncharuk, S. Drozdov, E. Madorsky, I. Marchenko, V. Khoroshavtsev, and D. Yakobashvili.

**The Appointments and Remuneration Committee** deals with main issues concerning incentives and remunerations to Company personnel, issues recommendations for methods of assessing work by management (including achievements with respect to sustainable development of the Company), and recommends candidates to senior management posts in the Company.

The Appointments and Remuneration Committee has 6 members: A. Goncharuk (Chairman), R. Almakaev, G. Yermakov, A. Korsik, L. Melamed, and V. Khoroshavtsev.

**The Budget and Audit Committee** provides assistance in ensuring accuracy of financial reporting by the Company, and efficiency of internal audit and risk management.

The Budget and Audit Committee has 5 members: Alexei Buyanov (Chairman), I. Badertdinov, I. Busarov, N. Demeshkina, and I. Marchenko.

The purpose of the **Corporate Conduct Committee** is to develop recommendations for creation of an efficient system of corporate governance, which ensures defence of the rights and interest of shareholders, and improves efficiency of interaction between the Board of Directors and Company management. The Committee has 5 members: S. Drozdov (Chairman), A. Goldin, N. Solomatina, V. Uvakin, and A. Shmakov.

The total number of meetings held by the Board of Directors and Committees of the Board of Directors in 2010 was 83, and a total of 349 issues were reviewed at these meetings.

## THE BOARD OF DIRECTORS OF BASHNEFT

Membership of the Board of Directors, elected by the Extraordinary General Meeting of Shareholders on December 8, 2010, was as follows:



ALEXANDER YURIEVICH  
GONCHARUK



ANTON VLADIMIROVICH  
ABUGOV



RUSLAN FEDOROVICH  
ALMAKAEV



ALEXEI NIKOLAEVICH  
BUYANOV



IGOR VALENTINOVICH  
MARCHENKO



LEONID ADOLFOVICH  
MELAMED



YURY LEONIDOVICH  
PUSTOVGAROV



ANNA GOLDIN



SERGEI ALEXEYEVICH  
DROZDOV



ALEXANDER LEONIDOVICH  
KORSIK



MURTAZA GUBAIDULLOVICH  
RAKHIMOV



VIKTOR GENNADIEVICH  
KHOROSHAVTSEV



DAVID MIKHAILOVICH  
YAKOBASHVILI

ALEXANDER YURIEVICH  
GONCHARUK

Chairman.  
Member of the Board  
of Directors of Sistema  
Corporation

ANTON VLADIMIROVICH  
ABUGOV

First Vice-President,  
Head of the Strategy and  
Development Division of  
Sistema Corporation

RUSLAN FEDOROVICH  
ALMAKAEV

Vice-President, Head  
of the Administrative  
Division of Sistema  
Corporation

ALEXEI NIKOLAEVICH  
BUYANOV

Senior Vice-President,  
Head of the Finance and  
Investment Division of  
Sistema Corporation

IGOR VALENTINOVICH  
MARCHENKO

Executive Vice-  
President, Director of  
the Strategy Department  
of the Fuel & Energy  
Business Unit of  
Sistema Corporation,  
currently also Executive  
Vice-President for  
Development of Oil  
Assets of the Principal  
Assets Business Unit of  
Sistema Corporation

LEONID ADOLFOVICH  
MELAMED

President of Sistema  
Corporation, currently  
also Member of the Board  
of Directors of Sistema  
Corporation, Chairman of  
the Board of Directors of  
Rusneft Oil Company

YURY LEONIDOVICH  
PUSTOVGAROV

Deputy Premier in  
the Government  
of the Republic of  
Bashkortostan, currently  
President of the  
Chamber of Trade and  
Industry of the Republic  
of Bashkortostan

ANNA GOLDIN  
Vice-President, Head  
of the Legal Division of  
Sistema Corporation

SERGEI ALEXEYEVICH  
DROZDOV  
Senior Vice-President,  
Head of the Corporate  
Governance Division of  
Sistema Corporation

ALEXANDER LEONIDOVICH  
KORSIK  
Senior Vice-President,  
Head of the Fuel &  
Energy Business Unit  
of Sistema Corporation.  
President and Chairman  
of the Executive Board of  
Bashneft from April 2011

MURTAZA GUBAIDULLOVICH  
RAKHIMOV

President of the Republic  
of Bashkortostan from  
December 1993 until  
July 2010

VIKTOR GENNADIEVICH  
KHOROSHAVTSEV

President of Bashneft  
until April 2011, currently  
Vice-President and  
Deputy Head of the  
Principal Assets Division  
of Sistema Corporation

DAVID MIKHAILOVICH  
YAKOBASHVILI

Member of the Board of  
Directors of Wimm-Bill-  
Dann Food Products

**Statistics on activity by the Board of Directors and Board Committees of Bashneft in 2010**

	Q1	Q2	Q3	Q4	Year
<b>BOARD OF DIRECTORS</b>					
Meetings held	6	6	5	7	24
joint presence	2	4	3	4	13
absentee voting	4	2	2	3	11
Items reviewed	31	33	41	56	161
at meetings in the form of joint presence	16	30	39	47	132
at meetings by absentee voting	15	3	2	9	29
<b>STRATEGY COMMITTEE</b>					
Meetings held	5	8	5	8	26
joint presence	5	8	5	8	26
absentee voting	0	0	0	0	0
Items reviewed	13	27	16	20	76
at meetings in the form of joint presence	13	27	16	20	76
at meetings by absentee voting	0	0	0	0	0
<b>BUDGET AND AUDIT COMMITTEE</b>					
Meetings held	2	3	3	4	12
joint presence	1	3	2	4	10
absentee voting	1	0	1	0	2
Items reviewed	7	8	7	16	38
at meetings in the form of joint presence	5	8	7	16	35
at meetings by absentee voting	2	0	1	0	3
<b>APPOINTMENTS AND REMUNERATION COMMITTEE</b>					
Meetings held	3	2	2	4	11
joint presence	1	1	1	2	5
absentee voting	2	1	1	2	6
Items reviewed	4	4	11	16	35
at meetings in the form of joint presence	2	3	10	12	27
at meetings by absentee voting	2	1	1	4	8
<b>CORPORATE CONDUCT COMMITTEE</b>					
Meetings held	1	3	3	3	10
joint presence	1	3	1	3	8
absentee voting	0	0	2	0	2
Items reviewed	6	8	9	16	39
at meetings in the form of joint presence	6	8	4	16	34
at meetings by absentee voting	0	0	5	0	5

**President of Bashneft**

The President of Bashneft is a permanent one-person executive management body, whose main task is to manage current business in order to ensure profitability and competitiveness of the Company, as well as its financial sustainability, and to safeguard the rights of shareholders and social guarantees of Company personnel.

The President acts within the limits of his competence and is answerable in his activities to the Board of Directors and the General Meeting of Shareholders of the Company.

The President of Bashneft in 2010 was Viktor Gennadievich Khoroshavtsev.

**Executive Board of Bashneft**

The Executive Board is responsible for managing current operations of Bashneft.

The Executive Board approves and organizes implementation of programs to raise investments for the Company, coordinates Company activity in respect of subsidiaries and affiliates, carries out preliminary review of major innovation and investment projects and programs, which are implemented by the Company and its subsidiaries and affiliates, and also carries out preliminary review of other issues, which are brought to the attention of the Board of Directors. As a rule, the Executive Board meets once a week. The Chairman of the Executive Board is the President of the Company.

**Remuneration of members of the Board of Directors and management of Bashneft**

Remuneration is not paid to members of the Board of Directors of Bashneft.

No additional remuneration is paid to managers of the Company for their work in governing bodies of Bashneft or of its subsidiaries and affiliates.

The financial incentive system for senior managers at Bashneft in 2010 consisted of the following elements:

- a monthly salary, fixed in accordance with the internal system of job grades;
- three quarterly bonuses and an annual bonus, paid for achievement of:
  - a) key financial performance indicators, set by the Company for the respective reporting period;
  - b) key personal performance indicators, set individually for each senior manager of Bashneft for the respective reporting period;
- additional remuneration in accordance with the Company's long-term program of material incentives.

**TWO-TIER SYSTEM OF CORPORATE OWNERSHIP**

Bashneft now has a transparent two-tier system for ownership of legal entities inside the Holding, which enables greater transparency in corporate governance.

The system for management of subsidiaries and affiliates ensures strategic expediency, connectedness, and continuity in decisions by the Board of Directors at all levels.

The Company manages its subsidiaries and affiliates with the objective of increasing efficiency and value of their business and business of the Company as a whole in order to achieve maximum profitability and a minimum investment payback period while maintaining an acceptable level of risk. The Company also uses mechanisms for management of subsidiaries and affiliates in order to :

- achieve detailed understanding of key assumptions in the strategy of subsidiaries and affiliates;
- ensure that business of subsidiaries and affiliates harmonizes with Company business;
- coordinate actions in key spheres of the business of subsidiaries and affiliates;
- ensure quick solution of problems, which arise for subsidiaries and affiliates;
- ensure that crisis programs for subsidiaries and affiliates are implemented when necessary.

The Company observes the following principles in its management of subsidiaries and affiliates:

- project management;
- different approaches to management of subsidiaries and affiliates with different levels of organizational maturity;
- management of subsidiaries and affiliates is effected through representatives of the Company who are elected to management and audit bodies of the subsidiaries and affiliates;
- coordinated use of functional, strategic and project management;
- observance of the requirement of applicable law, charters, and internal documents of companies, and the legal rights and interests of shareholders/participants of subsidiaries and affiliates;
- unified standards of corporate governance (internal decision-making procedures, management standards and management cycle);
- application of the best management practices.

**EXECUTIVE BOARD OF BASHNEFT  
AS OF DECEMBER 31, 2010**



**VIKTOR GENNADIEVICH  
KHOROSHAVTSEV**



**KIRILL IGORIEVICH  
ANDREICHENKO**



**VIKTOR ALEXANDROVICH  
GANTSEV**



**RUSLAN NEDIMOVICH  
GENSH**



**ALEXEI VALERIEVICH  
KURACH**



**VALERIY RAFGATOVICH  
NURGUTDINOV**



**ROMAN ANATOLIEVICH  
KHOMENKO**



**ALEXANDER VLADIMIROVICH  
DASHEVSKY**



**ELVIRA RIFOVNA  
KAMALOVA**



**IGOR OLEGOVICH  
KALYUZHNY**



**DMITRY STANISLAVOVICH  
PANKRATOV**



**ALI MUSSAEVICH  
UZDENOV**



**ROMAN ANATOLIEVICH  
KHOMENKO**

**VIKTOR GENNADIEVICH  
KHOROSHAVTSEV**  
President of Bashneft  
until April 2011,  
currently Vice-President  
and Deputy Head of the  
Principal Assets Division  
of Sistema Corporation

**KIRILL IGORIEVICH  
ANDREICHENKO**  
Vice-President for  
Corporate Governance  
and Legal Issues

**VIKTOR ALEXANDROVICH  
GANTSEV**  
Senior Vice-President  
for Oil Refining and  
Petrochemicals

**RUSLAN NEDIMOVICH  
GENSH**  
Vice-President for  
Export

**ALEXEI VALERIEVICH  
KURACH**  
Vice-President for  
Economics and Finance,  
Financial Director

**VALERIY RAFGATOVICH  
NURGUTDINOV**  
Director of the  
Administrative and  
Social Department

**OLEG YURIEVICH  
SIDOMONIDZE**  
Director of the HR  
Department

**ALEXANDER  
VLADIMIROVICH  
DASHEVSKY**  
Senior Vice-President  
for Production and  
Geology

**ELVIRA RIFOVNA  
KAMALOVA**  
Vice-President  
for Corporate  
Communications

**IGOR OLEGOVICH  
KALYUZHNY**  
Vice-President  
for Information  
Technologies

**DMITRY STANISLAVOVICH  
PANKRATOV**  
Vice-President for  
Petroleum Product  
Sales and Crude Oil  
Procurement

**ALI MUSSAEVICH  
UZDENOV**  
Senior Vice-President  
for Marketing

**ROMAN ANATOLIEVICH  
KHOMENKO**  
Vice-President for Retail  
Sales and Logistics.



## **INTERNAL CONTROL AND AUDIT**

Internal control and audit is an integral part of Bashneft's corporate governance structure. This function is exercised at the Company by the Internal Control and Audit Department (ICAD).

### **INTERNAL CONTROL AND AUDIT DEPARTMENT**

Activities of the ICAD are regulated by the Regulation on the Internal Control and Audit Department and the Regulation on Internal Audit. The ICAD is guided in its activities by international standards for control and audit, laws of the Russian Federation, the Company Charter, decisions of the Company's Board of Directors, Executive Board and President, and by local statutes.

- The ICAD works with the Board of Directors and senior management of the Company to improve Bashneft's system of risk management, internal control and corporate governance. The ICAD bears responsibility for the following tasks:
- assisting Company management to achieve agreed objectives, and ensuring efficiency of operations by the Company and transparency of its finances for shareholders;
- assessing reliability and efficiency of the system of internal control, risk management and corporate governance used by the Company and its subsidiaries and affiliates, and developing recommendations to improve their efficiency and reliability;
- checking compliance of financial and business operations by the Company and its subsidiaries and affiliates with requirements set by the Company's own statutes and regulations, and by applicable law of the Russian Federation, in order to safeguard Company assets;
- helping to identify and assess risks associated with corporate governance, business and information systems of the Company, with respect to: reliability and accuracy of information concerning financial and business activity of the Company; business efficiency and results, safeguarding of assets; and compliance with laws, statutes and contractual obligations;
- assisting Company management in design of measures to address issues (violations) identified by audit work, and in monitoring implementation of those measures;

- actions to ensure a sufficient level of confidence concerning accuracy of the Company's financial reporting and observance of proper procedures in its preparation, and for independent assessment of compliance with accounting requirements at the Company;
- provision of consulting to Company managers regarding issues of risk management, internal control and corporate governance;
- carrying out other tasks and taking part in other projects in the scope of the ICAD's competence at the request of the Budget and Audit Committee of the Board of Directors on the basis of special applications by senior management and heads of structural sub-divisions of the Company.

Organizational structure of the ICAD complies with the functional strategy for internal control and audit at Bashneft in the period 2010-2013, approved by the Board of Directors on June 28, 2010. By decision of the Board of Directors, the ICAD Director, who is also the Company's Chief Accountant, is in charge of control and audit bodies in the framework of the functional strategy. Organizational structure and full-time membership of the ICAD is established by decree of the Company President.

The ICAD Director is subordinate to the Company President, which ensures unrestricted exercise by the ICAD of its duties at all levels of the Company, and the ICAD Director is functionally answerable to the Board of Directors (the Budget and Audit Committee). This entails:

- approval of the Regulation on the ICAD by the Chairman of the Budget and Audit Committee;
- approval of the Annual Audit Plan (based on a risk-oriented approach) and the annual plan for activities by the ICAD by the Chairman of the Budget and Audit Committee of the Board of Directors;

- review by the Budget and Audit Committee of the results of activity by the ICAD with respect to reliability and efficiency of risk management, control, and corporate governance systems, on the basis of reports of completed auditing tasks, and on the basis of quarterly reports on implementation of the recommendations of external auditors;
- review by the Budget and Audit Committee of overall results of activity by the ICAD based on annual assessment reports on its activity and annual assessment reports on activity by the external auditor;
- review by the Chairman of the Budget and Audit Committee of special requests from senior managers of the Company and of its structural sub-divisions for checks by the ICAD of specific aspects of the business of the Company and of its subsidiaries and affiliates.

The ICAD carries out the following functions for fulfillment of the tasks, which are assigned to it:

- organization and design of audit programs, and implementation of audit checks at the Company and at subsidiaries and affiliates, with respect to:
  - assessment of the efficiency of internal controls over main business processes at the Company;
  - assessment of compliance with requirements of external and internal statutory documents (ComplianceAudit);
  - assessment of the quality of preparation and accuracy of financial reporting;
- preparation of reports on project outcomes, presenting main auditing observations and conclusions, and provision of recommendations for elimination of shortcomings, with a list of specific actions, timeframes and personnel at the Company and its subsidiaries and affiliates, who are responsible for implementation;
- monitoring of execution of the recommendations of internal auditors and preparation of reports for the Budget and Audit Committee on progress in implementation;
- working with external auditors, particularly in monitoring of their audit work on financial accounts of the Company and its subsidiaries and affiliates to Russian standards, in order to ensure that the auditor's opinion is finalized in a timely fashion;
- monitoring implementation of the recommendations of internal auditors and measures to eliminate shortcomings identified by external auditors, audit commissions and government bodies;

- provision of consulting to Company management on issues of risk management, internal control and corporate governance;
- identification and investigation of instances of fraud;
- conduct of special checks (reviews) at the request of the Company's senior managers;
- design of recommendations and proposals for organization of control measures to help achieve Company business targets, efficiency in financial and business activity and safeguarding of the assets of the Company and its subsidiaries and affiliates;
- monitoring implementation of recommendations for fraud prevention;
- checking accuracy in calculation of key factual performance indicators, which measure the efficiency of structural sub-divisions of the Company;
- checking proper implementation of operating plans of the Company's structural sub-divisions;
- selective checks of implementation of decisions and orders by the Company's executive and collegiate bodies, and of observance of internal procedures.

In order to ensure execution of strategic initiatives in the field of internal control and audit, the Company carried out tender procedures at the end of 2010 and made an agreement with CJSC PricewaterhouseCoopers Audit for provision of consulting services in 2011 (design and actualization of regulatory documents in the sphere of control and audit, design of a unified system of internal control and audit at Bashneft, design of a program of guarantees and improvement of work by the ICAD, etc.).

**EXTERNAL AUDITORS**

**FinExpertiza LLZ**

The Annual General Meeting of Shareholders decided to retain the services of LLC FinExpertiza to carry out independent audit of the accounts and financial reporting of Bashneft for 2010 in accordance with Russian Accounting Standards.

**Procedure for choice of auditor**

In accordance with Clause 1 of Paragraph 5 of the Federal Law on Audit and Clause 86 of the Federal Law on Joint-Stock Companies, the annual financial accounts of Bashneft, prepared to Russian Accounting Standards, are subject to compulsory auditing to confirm accuracy of the data, which they contain. The Company carries out an annual closed tendering competition to select an auditing organization in compliance with the requirements of internal documents. The Company's Central Procurement Commission decides the winner of the competition based on consideration of the applications, which are submitted, and through assessment and comparison of the applications based on the criteria and procedure indicated in the competition announcement and the tendering documentation, and also taking account of technical assessment of the project and the level of remuneration, which applicants request in return for their services. Notification of holding of a closed competition for selection of auditing organizations, with information about the conditions of the competition (the assessment procedure, object of the contract, volume of the services to be provided, and short description of the services), is published on a special Internet site of Bashneft ([www.zakupki.bashneft.ru](http://www.zakupki.bashneft.ru)) and in an official printed periodical. Candidacy of the winner of the annual tendering competition for auditing services is submitted for approval to the Budget and Audit Committee of the Board of Directors of Bashneft.

In accordance with Clause 2.1.4. of the Regulation on the Budget and Audit Committee of the Board of Directors of Bashneft, assessment of candidates to act as the Company's external auditor is the exclusive function of the Budget and Audit Committee. Based on the recommendation of the Committee, the Board of Directors takes a decision on proposal of the auditor's candidacy for approval by the Annual General Meeting of Shareholders. The auditor's remuneration is set on the basis of planned working time and the auditor's hourly rates, as declared in the commercial proposal submitted to the Procurement Commission.

Based on the recommendation of the Budget and Audit Committee, cost of the services of LLC FinExpertiza for auditing of the annual financial accounts of Bashneft for 2010, prepared in accordance with Russian Accounting Standards, were approved by the Board of Directors in the amount of 2,406,560 rubles including VAT.

**CJSC Deloitte & Touche CIS**

CJSC Deloitte & Touche CIS carries out audit of the annual financial accounts of Bashneft, prepared in accordance with US GAAP as well as review of interim (quarterly) US GAAP accounting by the Company.

**Procedure for choice of auditor**

The auditor is selected by conduct of a closed tendering competition among the 'Big-4' accounting firms. A choice is made based on all-round analysis of applications to assess their compliance with Company requirements. The candidate for the role of auditor of the Company's annual financial accounts prepared in accordance with US GAAP is assessed and approved by the Budget and Audit Committee. Approval of the candidacy by the General Meeting of Shareholders is not required. Based on the results of analysis of applications by the Budget and Audit Committee it was decided to appoint CJSC Deloitte & Touche CIS as auditor of the annual financial accounts of Bashneft for 2010, prepared in accordance with US GAAP.

<sup>1</sup> The 'Big 4' are the four leading international providers of audit and consulting services: PricewaterhouseCoopers, Ernst&Young, Deloitte, and KPMG.

**SHARE CAPITAL**

**Shares**

The Company has Charter Capital of 204,792,440 (two hundred and four million, seven hundred and ninety two thousand, four hundred and forty) rubles.

A total of 204,792,440 (two hundred and four million, seven hundred and ninety two thousand, four hundred and forty) shares have been placed to the value of Charter Capital, consisting of:

- 170,169,754 (one hundred and seventy million, one hundred and sixty nine thousand, seven hundred and fifty four) ordinary shares with nominal value of 1 (one) ruble per share, having total value of 170,169,754 (one hundred and seventy million, one hundred and sixty nine thousand, seven hundred and fifty four) rubles, representing 83.09% of Charter Capital of the Company;
- 34,622,686 (thirty four million, six hundred and twenty two thousand, six hundred and eighty six) type-A preferred shares with nominal value of 1 (one) ruble per share, having total value of 34,622,686 (thirty four million, six hundred and twenty two thousand, six hundred and eighty six) rubles, representing 16.91% of Charter Capital of the Company. Type-A preferred shares are not subject to conversion to common shares when they are resold.

In accordance with its Charter, Bashneft has the right to place new authorized preferred and ordinary shares with nominal value of 1 (one) ruble to a total of 6,000,000,000 (six billion) shares, having value of 6,000,000,000 (six billion) rubles, consisting of:

- 4,985,626,051 (four billion, nine hundred and eighty five million, six hundred and twenty six thousand, and fifty one) common shares with nominal value of 1 (one) ruble per share, having total value of 4,985,626,051 (four billion, nine hundred and eighty five million, six hundred and twenty six thousand, and fifty one) rubles (authorized common shares);
- 1,014,373,949 (one billion, fourteen million, three hundred and seventy three thousand, nine hundred and forty nine) type-A preferred shares with nominal value of 1 (one) ruble per share, having total value of 1,014,373,949 (one billion, fourteen million, three hundred and seventy three thousand, nine hundred and forty nine) rubles (authorized preferred shares).

Authorized shares offer the same rights under the Company Charter as shares of the respective category that have already been placed. Ordinary shares of Bashneft have state registration number 1-01-00013-A and registration date on April 7, 2004.

Preferred shares of Bashneft have state registration number 2-01-00013-A and registration date on April 7, 2004.

There were no issues or placements of new shares of Bashneft in the course of 2010.

As of December 31, 2010 there were 10,976 shareholders recorded in the register of shareholders of Bashneft (including 8 nominees).

Shares of Bashneft are traded on an organized market in Russia: the Russian Trading System (RTS).

The rights of shareholders who own ordinary and type-A preferred shares of Bashneft are listed in Articles 23 and 24 of the Company Charter, which can be viewed on the Company's Internet site.

**Main shareholders of Bashneft**

Shareholders	Shareholders as of December 31, 2010	
	Stake in ordinary share capital, %	Stake in Charter capital, %
Sistema Corporation	61.3	52.1
Sistema Invest	25.0	20.9
Other legal entities, including individuals	12.2	23.9
Individuals	1.5	3.1

## DIVIDEND PAYMENT

It is of crucial importance for Bashneft that shareholders should participate in distribution of Company income. The Company's policy in distribution of dividends is based on rational principals, which take account of both the interests of shareholders and development needs of the Company.

Decisions on payment of dividends, the amount to be paid, and the form of payment is taken by the General Meeting of Shareholders based on recommendations of the Company's Board of Directors.

In accordance with acting Russian legislation, dividends on ordinary and preferred shares are paid from Company's net income.

Bashneft is implementing a strategy of consistent increase in the level of dividend payouts.

### Bashneft dividend history

Period	Category (type) of share		total sum, (thousand rubles)
	common shares (rubles per share)	type-A preferred shares (rubles per share)	
1995	–	0.50	17,311.3
1996	0.20	1.11	72,326.6
1997	0.10	0.55	35,915.4
1998	0.05	0.50	24,363.0
1999	0.08	1.00	45,341.2
2000	0.17	1.00	60,061.1
2001	0.17	1.00	63,551.5
2002	0.20	1.00	68,656.6
2003	0.22	1.00	72,060.0
2004	0.25	1.25	85,820.8
2005	1.14	5.67	390,304.1
2006	25.80	25.80	5,283,644.9
2007	16.31	16.31	3,340,164.7
2008	48.82	48.82	9,997,966.9
2009	109.65	109.65	22,455,471.2
9 months 2010	104.50	104.50	21,400,791.1
Q4 2010*	131.27	131.27	26,883,103.6

\* recommended by the Company Board of Directors, subject to approval by the Annual General Meeting of Shareholders

## PROTECTING THE RIGHTS OF MINORITY SHAREHOLDERS, INFORMATION DISCLOSURE

Bashneft has put in place an efficient mechanism for interaction with shareholders, based on full compliance with current legal requirements and the recommendations of share market regulators.

Information disclosure by Bashneft is governed by the Federal Laws on the Securities Market and on Joint-Stock Companies, and the Regulation on Disclosure of Information by Securities Issuers, approved by Decree №06-117 of the Federal Service for Financial Markets, dated October 10, 2006.

The company is also guided by requirements of stock exchanges, at which its securities are traded, and by other requirements and statutes.

Bashneft policy for information disclosure is based on principles of regularity, punctuality, accessibility, accuracy, and content. The Company ensures timely and full disclosure of information about all aspects of its business to interested parties.

The Company discloses information using all modern media in order to maximize transparency, and provide the most comprehensible and accessible information to shareholders and other interested parties concerning all aspects of its business.

In order to enable access to Company documents for various groups of shareholders, the Bashneft does all it can to ensure that such documents can be viewed at its offices in cities, where the company has presence: at the Company's address in the city of Ufa (30 Karl Marx street) and at the Company's Moscow office (5 First Tverskaya-Yamskaya street). Documents can also be viewed on the Company's Internet sites ([www.bashneft.ru](http://www.bashneft.ru); [www.bn-rb.ru](http://www.bn-rb.ru)).

The main channel for information disclosure is the corporate Internet site of Bashneft, which presents information on material facts, events, management structure, and the Company's business results. The Charter and other internal documents, as well as annual reports, quarterly financial reporting to Russian Accounting Standards, quarterly financial reporting to International Accounting Standards, press-releases, presentations, the corporate newspaper, information on related parties, and other information, which may exert influence on the share price of Bashneft, are available for viewing on the site. The corporate Internet site is updated regularly.

The Internet site also has a Questions & Answer section for shareholders. Qualified consultations for shareholders are also available over the phone.

The Company provides access for shareholders to all material information ahead of General Meetings of Shareholders, and provides adequate information for assessment of Company business during the year in the Company's annual reports.

The Company also carries out regular meetings with shareholders, and telephone- and press-conferences. Bashneft can provide copies of internal documents, as well as documents and materials connected with holding of the General Meeting of Shareholders, lists of related parties, and other documents, in accordance with requirements of the Federal Law on Joint-Stock Companies.

# FINANCIAL STATEMENTS

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## STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

The following statement, which should be read in conjunction with the independent auditors' report set out on page 2, is made with a view to distinguish the respective responsibilities of management and those of the independent auditors in relation to the consolidated financial statements of Joint Stock Oil Company Bashneft (the "Company"), its subsidiaries and its special purpose entities (the "Group").

Management is responsible for the preparation of consolidated financial statements that presents fairly in all material respects the consolidated financial position of the Group as at 31 December 2010, the results of its operations, cash flows and changes in equity for the year then ended, in accordance with the International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance;
- Making judgements and estimates that are reasonable and prudent;
- Stating whether IFRS have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with legislation and accounting standards in the Russian Federation;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements for the year ended 31 December 2010 were approved by:

A.L. Korsik  
President



A.Y. Lisovenko  
Chief Accountant



Ufa, Russian Federation

22 April 2011

## REPORT OF THE INDEPENDENT AUDITORS

To the shareholders of Joint Stock Oil Company Bashneft:

We have audited the accompanying consolidated financial statements of Joint Stock Oil Company Bashneft, its subsidiaries and its special purpose entities (the "Group") which comprise the consolidated statement of financial position at 31 December 2010, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2010, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

*Deloitte & Touche*

Moscow, Russia

22 April 2011

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2010

### Millions of US Dollars

	Notes	Year ended 31 December 2010	Year ended 31 December 2009
Revenue	7	13,341	6,775
Cost of purchased crude oil, gas and petroleum products		(2,882)	(933)
Export tariffs and excise		(2,753)	(793)
Production and operating expenses		(2,665)	(2,132)
Taxes other than income tax	9	(1,421)	(913)
Depletion and depreciation		(711)	(631)
Transportation expenses		(538)	(190)
Selling, general and administrative expenses		(470)	(487)
Exploration expenses		(9)	(15)
Gain on reclassification of available-for-sale investments to investments in associates	13	477	-
Other operating expenses, net		(99)	(63)
<b>Operating profit</b>		<b>2,270</b>	<b>618</b>
Finance income	10	67	41
Finance costs	10	(357)	(21)
Foreign exchange (loss)/gain, net		(2)	5
Share of profit of associates	13	36	-
<b>Profit before income tax</b>		<b>2,014</b>	<b>643</b>
Income tax	11	(468)	(170)
<b>PROFIT FOR THE YEAR</b>		<b>1,546</b>	<b>473</b>
<b>OTHER COMPREHENSIVE LOSS</b>			
Effect of translation to presentation currency		(93)	(254)
<b>Other comprehensive loss for the year, net of income tax</b>		<b>(93)</b>	<b>(254)</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b>1,453</b>	<b>219</b>
Profit for the year attributable to:			
Owners of the Company		1,429	420
Non-controlling interests		117	53
		<b>1,546</b>	<b>473</b>
Total comprehensive income for the year attributable to:			
Owners of the Company		1,356	276
Non-controlling interests		97	(57)
		<b>1,453</b>	<b>219</b>
<b>EARNINGS PER SHARE</b>			
Weighted average number of ordinary shares in issue during the year	19	162,295,807	170,169,754
Basic and diluted earnings per share (US Dollars per share)		7.26	2.05

The accompanying notes on pages 93-135 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 DECEMBER 2010

Millions of US Dollars

	Notes	31 December 2010	31 December 2009	1 January 2009
<b>ASSETS</b>				
<b>Non-current assets</b>				
Property, plant and equipment	12	9,552	9,867	10,066
Advances paid for acquisition of property, plant and equipment		120	160	261
Advance payment for acquisition of license for Trebs and Titov deposit		597	-	-
Intangible assets		33	6	3
Financial assets	14	217	65	154
Investments in associates	13	667	-	-
Long-term inventories	15	50	57	77
Other non-current assets	16	3	3	2
		<b>11,239</b>	<b>10,158</b>	<b>10,563</b>
<b>Current assets</b>				
Inventories	15	625	385	393
Financial assets	14	676	230	70
Trade and other receivables	17	523	227	176
Advances to suppliers and prepaid expenses		157	96	160
Income tax prepaid		11	16	44
Other taxes receivable	23	685	410	203
Cash and cash equivalents	18	1,067	1,166	826
Other current assets		8	1	3
		<b>3,752</b>	<b>2,531</b>	<b>1,875</b>
<b>TOTAL ASSETS</b>		<b>14,991</b>	<b>12,689</b>	<b>12,438</b>

The accompanying notes on pages 93-135 form an integral part of these consolidated financial statements.

Millions of US Dollars

	Notes	31 December 2010	31 December 2009	1 January 2009
<b>EQUITY AND LIABILITIES</b>				
<b>Capital and reserves</b>				
Share capital	19	77	77	77
Treasury shares	5	(252)	-	-
Additional paid-in capital		1,160	1,170	2,429
Foreign currency translation reserve		(155)	(104)	-
Retained earnings		4,445	4,162	3,838
<b>Equity attributable to owners of the Company</b>		<b>5,275</b>	<b>5,305</b>	<b>6,344</b>
Non-controlling interests		2,717	3,135	3,356
		<b>7,992</b>	<b>8,440</b>	<b>9,700</b>
<b>Non-current liabilities</b>				
Borrowings	20	3,118	1,676	51
Decommissioning provision	12	217	231	79
Deferred tax liabilities	11	1,099	1,051	1,119
Other non-current liabilities	21	49	31	31
		<b>4,483</b>	<b>2,989</b>	<b>1,280</b>
<b>Current liabilities</b>				
Borrowings	20	795	63	66
Trade and other payables	22	659	398	410
Dividends payable		73	3	487
Advances received		553	343	168
Provisions	24	97	24	32
Income tax payable		21	27	8
Other taxes payable	23	318	402	287
		<b>2,516</b>	<b>1,260</b>	<b>1,458</b>
<b>TOTAL LIABILITIES</b>		<b>6,999</b>	<b>4,249</b>	<b>2,738</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>14,991</b>	<b>12,689</b>	<b>12,438</b>

The accompanying notes on pages 93-135 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2010

Millions of US Dollars

	Year ended 31 December 2010	Year ended 31 December 2009
<b>OPERATING ACTIVITIES</b>		
Profit before income tax	2,014	643
Adjustments for:		
Depletion and depreciation	711	631
Loss on disposal of property, plant and equipment	66	52
Finance income	(67)	(41)
Finance costs	357	21
Share of profit of associates	(36)	-
Gain on reclassification of available-for-sale investment to investment in associates	(477)	-
Impairment of investment in associate	17	-
Foreign exchange loss/(gain), net	2	(5)
Change in other provisions and allowances	50	33
Other	10	(4)
<b>Operating cash flows before working capital changes</b>	<b>2,647</b>	<b>1,330</b>
Movements in working capital:		
Inventories	(236)	14
Trade and other receivables	(335)	(70)
Advances to suppliers and prepaid expenses	(62)	52
Other taxes receivable	(263)	(211)
Trade and other payables	232	36
Advances received	213	173
Other taxes payable	(80)	143
<b>Cash generated from operations</b>	<b>2,116</b>	<b>1,467</b>
Interest paid	(312)	(14)
Income tax paid	(404)	(204)
<b>NET CASH GENERATED FROM OPERATING ACTIVITIES</b>	<b>1,400</b>	<b>1,249</b>

The accompanying notes on pages 93-135 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 31 DECEMBER 2010 (CONTINUED)

Millions of US Dollars

	Year ended 31 December 2010	Year ended 31 December 2009
<b>INVESTING ACTIVITIES</b>		
Payments to controlling shareholder relating to the formation of the Group	-	(1,360)
Payments for acquisition of property, plant and equipment	(492)	(589)
Advance payment for acquisition of license for Trebs and Titov deposit	(597)	-
Proceeds from disposal of property, plant and equipment	10	11
Payment for acquisition of associate	(123)	-
Payments for acquisition of intangible assets	(32)	(3)
Payments for acquisition of financial assets	(2,326)	(210)
Proceeds from disposal of financial assets	1,510	135
Interest received	55	39
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(1,995)</b>	<b>(1,977)</b>
<b>FINANCING ACTIVITIES</b>		
Payment for acquisition of Sistema-invest, net of cash acquired	(201)	-
Payments for acquisition of non-controlling interests	(142)	-
Proceeds from borrowings	3,044	2,345
Repayments of borrowings	(899)	(727)
Dividends paid by the Company	(1,290)	(316)
Dividends paid by subsidiaries	(24)	(229)
<b>NET CASH GENERATED FROM FINANCING ACTIVITIES</b>	<b>488</b>	<b>1,073</b>
<b>Net (decrease)/increase in cash and cash equivalents</b>	<b>(107)</b>	<b>345</b>
<b>Cash and cash equivalents at beginning of the year</b>	<b>1,166</b>	<b>826</b>
Effect of translating reporting currency to presentation currency and exchange rate changes on the balance of cash and cash equivalents held in foreign currencies	8	(5)
<b>Cash and cash equivalents at end of the year</b>	<b>1,067</b>	<b>1,166</b>

The accompanying notes on pages 93-135 form an integral part of these consolidated financial statements.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2010

Millions of US Dollars

	Notes	Share capital	Treasury shares	Additional paid-in capital	Foreign currency translation reserve	Retained earnings	Equity attributable to owners of the Company	Non-controlling interests	Total
Balance at 1 January 2009		77	-	2,429	-	3,838	6,344	3,356	9,700
Profit for the year		-	-	-	-	420	420	53	473
Other comprehensive loss for the year		-	-	-	(144)	-	(144)	(110)	(254)
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		-	-	-	(144)	420	276	(57)	219
Distribution to controlling shareholder relating to the formation of the Group	1	-	-	(1,400)	40	-	(1,360)	-	(1,360)
Increase of ownership in subsidiaries due to change in controlling shareholder		-	-	141	-	-	141	(141)	-
Dividends to equity holders		-	-	-	-	(96)	(96)	(23)	(119)
Balance at 31 December 2009		77	-	1,170	(104)	4,162	5,305	3,135	8,440
Profit for the year		-	-	-	-	1,429	1,429	117	1,546
Other comprehensive loss for the year		-	-	-	(73)	-	(73)	(20)	(93)
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		-	-	-	(73)	1,429	1,356	97	1,453
Acquisition of Sistema-invest	5	-	(252)	-	-	163	(89)	(307)	(396)
Dividends to equity holders		-	-	-	22	(1,360)	(1,338)	(23)	(1,361)
Acquisition of additional interests in subsidiaries	5	-	-	-	-	49	49	(178)	(129)
Other equity transactions		-	-	(10)	-	2	(8)	(7)	(15)
Balance at 31 December 2010		77	(252)	1,160	(155)	4,445	5,275	2,717	7,992

The accompanying notes on pages 93-135 form an integral part of these consolidated financial statements.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

### 1. GENERAL INFORMATION

#### Organisation and operations

Joint Stock Oil Company Bashneft (the "Company" or "Bashneft"), its subsidiaries and special purpose entities (together referred to as the "Group" or the "Bashneft Group") are primarily involved in oil production, refining, marketing and distribution of petroleum products and electricity and heat generation in the Bashkortostan region of the Russian Federation. Bashneft is the parent company of a vertically integrated group of oil and gas and energy companies.

The Company was incorporated as an open joint stock company on 13 January 1995, following the privatisation of Bashkir Petrochemical Enterprise ("Bashneftekombinat"). The Company's registered office is located at Ufa, Bashkortostan Republic, 450045, Russian Federation.

The Group's oil production, refining, marketing and distribution base includes 167 oilfields, 4 refineries and 319 petrol stations. The Group's electricity and heat generation base includes 30 electricity generation stations with 4,248 megawatts ("MW") and 13,264 gigacalories/hour ("Gcal/h") of electricity and heat generation capacity, respectively.

The following principal subsidiaries incorporated in the Russian Federation were included in the scope of consolidation at 31 December 2010 and 2009, and at 1 January 2009:

Company	Principal activities	Group's effective interest		
		31 December 2010	31 December 2009	1 January 2009
OJSC Ufimsky refinery plant	Crude oil processing	63%	56%	54%
OJSC Novoil	Crude oil processing	69%	62%	60%
OJSC Ufaneftekhim	Crude oil processing	60%	47%	42%
OJSC Ufaorgsintez	Production of petrochemicals	63%	51%	50%
OJSC Bashkirenergo	Electricity and heat generation	35%	31%	30%
OJSC Bashkirnefteproduct	Petroleum products trading	62%	56%	48%
LLC Bashneft-dobycha	Production of crude oil and gas	100%	100%	n/a
LLC Bashneft-Bureniye	Construction services	100%	100%	100%

At 31 December 2010, the Group included 93 special purpose entities ("SPEs") (31 December 2009: 105 SPEs; 1 January 2009: 115 SPEs) which were established to provide supporting services to the Company and its subsidiaries engaged in the production and refining of crude oil and the generation of electricity and heat.

#### Group formation

From 1 January 2009 to April 2009, the Company, OJSC Ufimsky refinery plant ("Ufimsky refinery plant"), OJSC Novoil ("Novoil"), OJSC Ufaneftekhim ("Ufaneftekhim"), OJSC Ufaorgsintez ("Ufaorgsintez") and OJSC Bashkirnefteproduct ("Bashkirnefteproduct") (together referred to as the "Group") were under common control of LLC Aguidel-Invest, LLC Yuruzan-Invest, LLC Inzer-Invest and LLC Ural-Invest (hereinafter refer to as "the previous shareholder"). The previous shareholder also owned OJSC Bashkirenergo ("Bashkirenergo") through its controlling interest in these companies.

In April 2009, OJSC JSFC Sistema ("JSFC Sistema") acquired controlling interests in the Company, Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct from the previous shareholder. Because of these acquisitions, JSFC Sistema also obtained control over Bashkirenergo. From 1 April 2009, these companies were under common control of JSFC Sistema.

On 31 December 2009, as part of the reorganisation of JSFC Sistema's oil and gas assets, the Company acquired controlling interests in Ufimsky refinery plant, Novoil, Ufaneftekhim and Ufaorgsintez from JSFC Sistema and on 22 January 2010 the Company acquired a controlling interest in Bashkirnefteproduct and thereby became the holding company of the Group, including Bashkirenergo.



## 1. GENERAL INFORMATION (CONTINUED)

As all the companies of the Group were a single economic entity and were under common control during the year ended 31 December 2009, the change in the Group structure has been accounted for retrospectively and these consolidated financial statements have been prepared as if the reorganisation had occurred on 1 January 2009.

The net assets of Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez, Bashkirnefteproduct and Bashkirenergo as of 1 January 2009 attributable to the previous shareholder in the amount of USD 2,429 million have been accounted for as additional paid-in capital in these consolidated financial statements. Payments made by the Company to JSFC Sistema relating to the acquisition of Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct in the amount of USD 1,360 million were accounted for as distributions to shareholders.

Equity attributable to owners of the Group as of 1 January 2009 and during the period from 1 January 2009 to 1 April 2009 represents the previous shareholder's controlling interests in the Company, Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct during this period. Equity attributable to owners of the Group during the period from 1 April 2009 to 31 December 2009 represents the previous shareholder's controlling interests in the Company, Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct that was acquired by JSFC Sistema on 1 April 2009 and JSFC Sistema's existing shareholding in the Group as of 1 April 2009.

### Business environment

Emerging markets such as Russia are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. As has happened in the past, actual or perceived financial problems or an increase in the perceived risks associated with investing in emerging economies could adversely affect the investment climate in Russia and the Russian economy in general.

The global financial turmoil that has negatively affected Russian financial and capital markets in 2008 and 2009 has receded and Russian economy returned to growth in 2010. However significant economic uncertainties remain. Adverse changes arising from systemic risks in global financial systems, including any tightening of the credit environment or Russia, could slow or disrupt the economy, adversely affect the Group's access to capital and cost of capital for the Group and, more generally, its business, results of operations, financial condition and prospects.

## 2. BASIS OF PREPARATION

### Conversion to International Financial Reporting Standards

The consolidated financial statements have been prepared in accordance with the requirements of IFRS 1 First-time Adoption of International Financial Reporting Standards, as a part of the Group's conversion to International Financial Reporting Standards ("IFRS").

The Group applied IFRS 1 in the preparation of the consolidated statement of financial position at 1 January 2009, the Group's transition date to IFRS. Management has elected to apply the exemption under IFRS 1, which allows accounting for property, plant and equipment of the Group at their fair values which represent their deemed cost. Fair values have been determined by an independent valuation at 1 January 2009.

The Group applied all IFRS Standards and Interpretations effective for the annual periods ending 31 December 2010.

Specific disclosures required by IFRS 1 in respect of the Group's transition from Russian accounting standards ("RAS") to IFRS are presented in Note 29.

### Standards and Interpretations in issue but not yet adopted

At the date of authorisation of these consolidated financial statements, the following Standards and Interpretations were in issue but not yet effective:

Standards and Interpretations	Effective for annual periods beginning on or after
IFRS 3 Business Combinations (amendments)	1 July 2010
IFRS 7 Financial Instruments: Disclosures (amendments)	1 January 2011
IFRS 9 Financial Instruments: Classification and Measurement	1 January 2013
IAS 1 Presentation of Financial Statements (amendments)	1 January 2011
IAS 12 Income Taxes (amendments)	1 January 2012
IAS 24 Related Party Disclosures (revised)	1 January 2011
IAS 27 Consolidated and Separate Financial Statements (amendments)	1 July 2010
IAS 32 Financial Instruments: Presentation (amendments)	1 February 2010
IAS 34 Interim Financial Reporting (amendments)	1 January 2011
IFRIC 13 Customer Loyalty Programmes (amendments)	1 January 2011
IFRIC 14 IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (amendments)	1 January 2011
IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments	1 July 2010

The impact of adoption of these Standards and Interpretations in the preparation of the consolidated financial statements in future periods is currently being assessed by management. Management anticipates that, except for IFRS 9 Financial Instruments: Classification and Measurement ("IFRS 9"), the adoption of these Standards and Interpretations will have no material impact on the consolidated financial statements of the Group in the period of initial adoption. IFRS 9 introduces new requirements for the classification and measurement of financial assets.

All recognised financial assets that are currently within the scope of IAS 39 Financial Instruments: Recognition and Measurement, will be measured at either amortised cost or fair value.

### Functional and presentation currency

The national currency of the Russian Federation is the Russian Rouble ("RUB"), which is the Group's functional currency as it reflects the economic substance of the Group's operations.

Management of the Group has selected US Dollar ("USD") as presentation currency for the convenience of the shareholders and users of the consolidated financial statements. All financial information presented in USD has been rounded to the nearest million.

The translation from functional currency into presentation currency is performed as follows:

- Assets and liabilities are expressed in USD using exchange rates prevailing at the end of the reporting period;
- Income and expenses items are translated at the average exchange rates for the period, unless exchange rate fluctuated significantly during that period, in which case the exchange rate at the dates of the transactions is used;
- Exchange differences, if any, are presented in the foreign currency translation reserve recognised as a separate component in other comprehensive income;
- All equity items are translated at their historical exchange rates; and
- In the consolidated statement of cash flows, cash balances at beginning and end of each period presented are translated at exchange rates at the respective dates. All cash flows are translated at the average exchange rate for the period, unless exchange rates fluctuated significantly during that period, in which case the exchange rate at the dates of the transactions is used. Resulting exchange differences, if any, are presented as Effect of translating reporting currency to presentation currency and exchange rate changes on the balance of cash and cash equivalents held in foreign currencies.

### 3. SIGNIFICANT ACCOUNTING POLICIES

#### Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards.

#### Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis except for fair value of the Company's property, plant and equipment measured at fair value at 1 January 2009, the date of transition to IFRS.

#### Basis of consolidation

The consolidated financial statements incorporate financial statements of the Company and entities (including special purpose entities) controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

All intra-group transactions, balances, income and expenses and any unrealised profits or losses are eliminated in full on consolidation.

Income and expenses of subsidiaries acquired or disposed of during the year are included in the consolidated statement of comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate. Total comprehensive income of subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by the Group.

#### Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are generally recognised in profit or loss as incurred. At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value at the acquisition date.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after reassessment, the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognised immediately in profit or loss as a bargain purchase gain.

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis. Other types of non-controlling interests are measured at fair value or, when applicable, on the basis specified in another IFRS.

When a business combination is achieved in stages, the Group's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Group obtains control) and the resulting gain or loss, if any, is recognised in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognised in other

comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest were disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period (which cannot exceed one year from the acquisition date), or additional assets or liabilities are recognised, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognised at that date.

#### Changes in the Group's ownership interests in existing subsidiaries

Changes in the Group's interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions. The carrying amount of the Group's interest and the non-controlling interests are adjusted to reflect the changes in their relative interest in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to owners of the Company.

When the Group loses control over a subsidiary, the profit or loss on disposal is calculated as the difference between:

- The aggregate of the fair value of the consideration received and the fair value of any retained interest; and
- The previous carrying amount of the assets and liabilities of the subsidiary and any non-controlling interests.

Amounts previously recognised in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred to retained earnings) in the same manner as would be required if the relevant assets or liabilities were disposed of. The fair value of any investment retained in the former subsidiary at the date when control is lost is regarded as the fair value on initial recognition for subsequent accounting under IAS 39 Financial Instruments: Recognition and Measurement or, when applicable, the cost on initial recognition of investments in an associate.

#### Special purpose entities

Special purpose entities are those undertakings that are created to satisfy specific business needs of the Group and the Group has the right to the majority of the benefits of the SPEs, or is exposed to risks associated with the activities of the SPEs. SPEs are consolidated in the same manner as subsidiaries.

#### Common control transactions

The assets and liabilities of subsidiaries acquired from entities under common control are recorded at the carrying values recognised by the transferor. Any difference between the carrying value of the net assets of subsidiaries acquired, and the consideration paid by the Group is accounted for as an adjustment to shareholders' equity. The net assets of the subsidiaries and their results are recognised prospectively from the date on which control of the subsidiaries was obtained by the transferor.

The cost of assets acquired from entities under common control is measured as the carrying value of the asset given up by the transferor at the date of the transaction. Any difference between the carrying value of the assets acquired, and the consideration paid by the Group is accounted for as an adjustment to shareholders' equity.

#### Foreign currencies

In preparing financial information of the individual entities, transactions in currencies other than the Russian Rouble are recorded at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date.

Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

**3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**Property, plant and equipment**

**Recognition and measurement**

The Group has utilised the exemption available to first-time adopters under IFRS 1 with regard to determining the carrying value of property, plant and equipment at the transition date. Property, plant and equipment of the Company and its subsidiaries acquired or constructed before 1 January 2009 are recorded at amounts determined by an independent valuation at 1 January 2009. The basis of valuation was fair value. In some instances, when items of property plant and equipment are of a specialised nature, they were valued at depreciated replacement cost. For each item of property plant and equipment the replacement cost was estimated as the current cost to replace the assets with a functionally equivalent asset. The estimated replacement cost was adjusted for accrued depreciation, including physical depreciation and functional and economic obsolescence. The result of this valuation comprised deemed cost at 1 January 2009.

Items of property, plant and equipment acquired after 1 January 2009 are measured at historic acquisition or construction cost.

Oil and gas exploration and evaluation expenditures are accounted for using the “successful efforts” method of accounting. Costs are accumulated on a field-by-field basis. Geological and geophysical costs are expensed as incurred. Costs directly associated with an exploration well, and exploration and property leasehold acquisition cost are capitalised until the determination of reserves is evaluated. If it is determined that commercial discovery has not been achieved, these costs are recognised in profit or loss. Capitalisation is made within property, plant and equipment. Once commercial reserves are found, exploration and evaluation assets are tested for impairment and transferred to development assets. No depreciation or amortisation is recognised during the exploration and evaluation phase. Expenditure on the construction, installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of commercially proven development wells, is capitalised within property, plant and equipment and intangible assets according to nature. When development is completed on a specific field, it is transferred to production or intangible assets. No depreciation or amortisation is charged during the exploration and evaluation phase. Extraction assets are aggregated exploration and evaluation tangible assets, and development expenditures associated with the production of proved reserves.

Property, plant and equipment include the initial estimate of the cost of conservation and liquidation of wells, pipelines, other oil and gas facilities and site restoration. Construction cost includes expenditure that is directly attributable to the acquisition of the asset.

The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the asset to a working condition for its intended use, and the costs of dismantling and removing the items and restoring the site on which they are located. Purchased software that is integral to the functionality of the related equipment is capitalised as part of that equipment. Borrowing costs that are directly attributable to the acquisition or construction of assets, that necessarily takes a substantial period of time to get ready for its intended use, are capitalised as part of the cost of that asset.

The cost of replacing a part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised in profit or loss as incurred.

When parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment, and are recognised in profit or loss.

**Depletion and depreciation**

Property, plant and equipment related to oil production activities are depreciated using the unit-of-production method. Unit-of-production rates are based on proved developed reserves, which are oil, gas and other mineral reserves estimated to be recovered from existing facilities using current operating methods except for assets whose useful lives are shorter than the lifetime of the field, in which case the straight-line method is applied. Where individually insignificant, unproved oil and gas properties may be grouped and amortised based on factors such as the average concession term and past experience of recognising proved reserves. Acquisition costs of proved properties are depleted using the unit-of-production method based upon total proved reserves. For this purpose, the oil and gas reserves of the Group have been determined based on estimates of hydrocarbon reserves in accordance with internationally recognised definitions by internationally recognised petroleum engineers to the extent that the reserves will be extracted by the end of the expected useful life of the field reserves.

Assets which are not directly associated with oil production activities are depreciated on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term. Land is not depreciated.

The estimated useful lives of major classes of property, plant and equipment for the current year are as follows:

Buildings and constructions	2-100 years
Machinery and equipment	2-39 years
Transport	1-57 years

Depreciation methods, useful lives and residual values are reviewed at each reporting date, with the effect of any changes in estimates being accounted for on a prospective basis.

**Intangible assets**

Intangible assets are measured at cost less accumulated amortisation and impairment losses. Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of intangible assets.

The estimated useful life for the software for the current year is two years. Amortisation methods and useful lives are reviewed annually, with the effect of any changes in estimate being accounted for on a prospective basis.

**Investments in associates**

An associate is an entity over which the Group has significant influence and that is neither a subsidiary nor an interest in a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

The results and assets and liabilities of associates are incorporated in these consolidated financial statements using the equity method of accounting. Under the equity method, an investment in an associate is initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate. When the Group's share of losses of an associate exceeds the Group's interest in that associate (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate), the Group discontinues recognising its share of further losses. Additional losses are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate.

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Any excess of the cost of acquisition over the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities of an associate recognised at the date of acquisition is recognised as goodwill, which is included within the carrying amount of the investment. Any excess of the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities over the cost of acquisition, after reassessment, is recognised immediately in profit or loss.

The requirements of IAS 39 are applied to determine whether it is necessary to recognise any impairment loss with respect to the Group's investment in an associate. When necessary, the entire carrying amount of the investment (including goodwill) is tested for impairment in accordance with IAS 36 Impairment of Assets as a single asset by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount, any impairment loss recognised forms part of the carrying amount of the investment. Any reversal of that impairment loss is recognised in accordance with IAS 36 to the extent that the recoverable amount of the investment subsequently increases.

When a group entity transacts with its associate, profits and losses resulting from the transactions with the associate are recognised in the Group's consolidated financial statements only to the extent of interests in the associate that are not related to the Group.

#### Impairment of tangible and intangible assets

At the end of each reporting period, the Group reviews the carrying amounts of its tangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

The recoverable amount is the higher of fair value less cost to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

#### Financial instruments

Financial assets and financial liabilities are recognised when a Group entity becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

#### Financial assets

Financial assets are recognised and derecognised on a trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value plus transaction costs.

Financial assets of the Group are classified into the following specified categories: available-for-sale ("AFS") financial assets, held-to-maturity investments and loans and receivables.

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition.

#### Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset, or, where appropriate, a shorter period, to the carrying amount on initial recognition.

#### AFS financial assets

Listed and unlisted shares held by the Group that are traded in an active market are classified as AFS and are stated at fair value, except for investments in shares for which there are no available market quotations and whose fair value cannot be reliably measured, which are accounted at cost.

Fair value of AFS financial assets with standard terms and conditions and traded in active markets is determined with reference to quoted market prices.

Gains and losses arising from changes in fair value are recognised in other comprehensive income and accumulated in the investments revaluation reserve. Where the investment is derecognised, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss, except for derecognition due to transactions under common control, where the respective cumulative gain or loss is reclassified within the consolidated statement of changes in equity.

#### Held-to-maturity investments

Promissory notes and debentures with fixed or determinable payments and fixed maturity dates which the Group has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are recorded at amortised cost less impairment, if any. Interest income is recognised using the effective interest method.

#### Loans and receivables

Trade receivables, loans, and other receivables that have fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortised cost using the effective interest method less any impairment. Interest income is recognised by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

#### Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Equity securities classified as AFS, a significant and prolonged decline in the fair value of the securities below its costs is considered to be objective evidence of impairment.

For other financial assets objective evidence of impairment could include:

- Significant financial difficulty of the counterparty; or
- Default or delinquency in interest or principle payments; or
- It is becoming probable that the counterparty will enter bankruptcy or financial re-organisation.

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of an allowance account. When a trade receivable is uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognised in other comprehensive income are reclassified to profit or loss in the period.

With the exception of AFS equity securities, if, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

In respect of AFS equity securities, impairment losses previously recognised in profit or loss are not reversed through profit or loss. Any increase in fair value subsequent to an impairment loss is recognised in other comprehensive income.

#### Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial assets and substantially all the risk and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risk and rewards of ownership and continues to control the transferred asset, the Group recognises its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognise the financial asset and also recognises a collateralised borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in profit or loss.

#### Inventories

Inventories are stated at the lower of cost and net realisable value. The cost of inventories is based on the weighted average principle, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and costs necessary to make the sale.

#### Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, current accounts and cash deposits with banks and highly liquid investments with maturities of three months or less, that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

#### Financial liabilities

Financial liabilities of the Group are classified into the following specified categories: financial guarantee contract liabilities and other financial liabilities.

#### Financial guarantee contract liabilities

Financial guarantee contract liabilities are measured initially at their fair values and are subsequently measured at the higher of:

- The amount of the obligation under the contract, as determined in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets; and
- The amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with the revenue recognition policies set out below.

#### Other financial liabilities

Other financial liabilities, including trade and other payables, loans and borrowings, are initially measured at fair value, net of transaction costs. Financial liabilities are subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

#### Provisions and contingencies

##### Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows.

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, the receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

##### Contingencies

Contingent liabilities are not recognised in the consolidated financial statements unless they arise as a result of a business combination. Contingencies attributable to specific events are disclosed unless the probability of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognised in the consolidated financial statements but are disclosed when an inflow of economic benefits is probable.

#### Decommissioning provision

Decommissioning provision relates primarily to the conservation and liquidation of wells, pipelines, other oil and gas facilities and site restoration. Management estimates the obligation related to these costs based on internally generated engineering estimates, current statutory requirements and industry practices. Future decommissioning costs, discounted to net present value, are capitalised and a corresponding obligation is recognised as soon as a constructive obligation to incur such costs arises and the amount can be reliably estimated. The unwinding of the discount is recognised as finance cost. Oil and gas properties related to decommissioning are depreciated using the unit-of-production method based on proved developed reserves.

The adequacy of the decommissioning provision is periodically reviewed in the light of current laws and regulations, and adjustments are made as necessary. Changes in the estimated expenditure are reflected as an adjustment to the provision and the corresponding asset.

#### Employee benefit obligations

Remuneration to employees in respect of services rendered during the reporting period, including accrual for unused vacation and bonuses and related social taxes, is recognised as an expense in the period when it is earned.

#### Defined contribution plan

Subsidiaries registered in the Russian Federation are legally obliged to make defined contributions to the State Pension Fund. This defined contribution plan is financed on a pay-as-you-earn basis.

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Defined benefit plans

For defined benefit retirement plans, the cost of providing benefits is determined using the Projected Unit Credit Method, with actuarial valuations being carried out at the end of each reporting period and with immediate recognition of all actuarial gains and losses in the income statement. Past service cost is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the statement of financial position represents the present value of the defined benefit obligation as adjusted for unrecognised past service cost.

#### Share-based payment arrangements

For cash-settled share-based payments, a liability is recognised for the goods or services acquired, measured initially at the fair value of the liability. At the end of each reporting period until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with any changes in fair value recognised in profit or loss for the year.

#### Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminating sales within the Group.

The Group recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the entity and when specific criteria have been met for each of the Group's activities as described below. The Group bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Cash received in advance from customers is not included in current year revenue, and is recognised within advances received.

#### Sales of crude oil and petroleum products

Revenue from the sales of crude oil and petroleum products ("goods") is recognised when all the following conditions are satisfied:

- The Group has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the entity; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

#### Sales of electricity and heat

Revenues from sales of electricity and heat are recognised when electricity and heat are supplied to customers. Revenue from services on transmission of electricity and heat energy is recognised in the period when occurred.

#### Rendering of services

Revenue from a contract to provide services is recognised by reference to the stage of completion of the contract.

Revenue from time and material contracts is recognised at the contractual rates as labour hours are delivered and direct expenses are incurred.

#### Construction contracts

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognised in profit or loss in proportion to the stage of completion of the contract. Contract expenses are recognised as incurred unless they create an asset related to future contract activity.

The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

#### Interest income

Interest income is recognised using the effective interest method. When a loan and receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loan and receivables are recognised using the original effective interest rate.

#### Dividend income

Dividend income is recognised when the right to receive payment is established.

#### Rental income

Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised on a straight-line basis over the lease term.

#### Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time when the assets are substantially ready for their intended use or sale. Investment income earned on temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the finance costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

#### Leasing — the Group as lessee

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are initially recognised as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments.

The corresponding liability to the lessor is included in the consolidated statement of financial position as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognised immediately in profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs (see above). Contingent rentals are recognised as expenses in the periods in which they are incurred.

Operating lease payments are recognised as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognised as an expense in the period in which they are incurred.

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### Income tax

Income tax expense comprises current and deferred tax.

#### Current tax

Current tax is based on taxable profit for the year. Taxable profit differs from profit as reported in the consolidated statement of comprehensive income because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

#### Deferred tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is expected to be settled or assets realised, based on tax rates that have been enacted or substantially enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

#### Earnings per share

The Group presents basic and diluted earnings per share ("EPS") data for its ordinary shares.

Profit for the year attributable to owners of the Company is allocated between the Company's ordinary and preference shares based on the two-class method. Under the two-class method, profit for the year attributable to each class of share is allocated according to their participation rights in the undistributed earnings of the Company. Basic EPS is calculated by dividing profit or loss attributable to ordinary shares of the Company by the weighted average number of ordinary shares outstanding during the period adjusted for shares purchased by the Group and held as treasury shares. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding.

### 4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group's accounting policies, described in note 3, management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities and recognised amounts of income and expenses that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

The most significant areas requiring the use of management estimates and assumptions relate to:

- Control over SPEs;
- Useful economic lives of property, plant and equipment;
- Impairment of property, plant and equipment;
- Decommissioning provision;
- Allowances for doubtful receivables;
- Allowances for obsolete and slow-moving inventories;
- Legal contingencies; and
- Taxation.

#### Control over special purpose entities

Management judgement is involved in the assessment of control and the consolidation of certain SPEs in the Group's financial statements. The Group does not have any direct or indirect shareholdings in these SPEs and management periodically reviews the status of each of these entities.

An SPE is consolidated if, based on an evaluation of the substance of its relationship with the Group and the SPE's risks and rewards, the Group concludes that it controls the SPE. SPEs controlled by the Group were established under terms that impose strict limitations on the decision-making powers of the SPEs' management and that result in the Group receiving the majority of the benefits related to the SPEs' operations and net assets, being exposed to the majority of risks incident to the SPEs' activities, and retaining the majority of the residual or ownership risks related to the SPEs or their assets.

#### Useful economic lives of property, plant and equipment

The estimation of the useful life of an item of property, plant and equipment is a matter of management judgement based upon experience with similar assets. In determining the useful life of an asset, management considers the expected usage based on production and reserve estimates, estimated technical obsolescence, physical wear and tear and the physical environment in which the asset is operated. Changes in any of these conditions or estimates may result in adjustments to future depreciation rates.

Based on the terms included in the licences and past experience, management believes oil production licences will be extended past their current expiration dates at insignificant additional costs. Because of the anticipated licence extensions, the assets are depreciated over their useful lives beyond the end of the current licence term.

Other property, plant and equipment are depreciated on a straight-line basis over their useful economic lives. Management periodically, at the end of each reporting period, reviews the appropriateness of the assets useful economic lives and residual values. The review is based on the current condition of the assets, the estimated period during which they will continue to bring economic benefit to the Group and the estimated residual value.

#### 4. CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY (CONTINUED)

##### Impairment of property, plant and equipment

At the end of each reporting period, the Group reviews the carrying amounts of its property, plant and equipment to determine whether there is any indication that those assets are impaired. In making the assessment for impairment, assets that do not generate independent cash flows are allocated to an appropriate cash-generating unit. Management necessarily applies its judgement in allocating assets that do not generate independent cash flows to appropriate cash-generating units, and also in estimating the timing and value of underlying cash flows within the value in use calculation. In determining the value in use calculation, future cash flows are estimated at each cash-generating unit based on a cash flows projection utilising the latest budgeted information available.

##### Decommissioning provision

The Group's oil and gas activities are subject to various laws and regulations governing the protection of the environment. The Group estimates environmental obligations based on management's understanding of the current legal requirements in the various jurisdictions, terms of the licence agreements and internally generated engineering estimates. Provision is made, based on net present values, for decommissioning costs as soon as the obligation arises. Actual costs incurred in future periods could differ materially from the amounts provided. Additionally, future changes to environmental laws and regulations, life of oil and gas reserves estimates and discount rates could affect the carrying amount of this provision.

##### Allowances for doubtful receivables

The Group creates an allowance for doubtful receivables to account for estimated losses resulting from the inability of customers to make required payments. When evaluating the adequacy of the allowance for doubtful receivables, management bases its estimates on the current overall economic conditions, the ageing of accounts receivable balances, historical write-off experience, customer creditworthiness and changes in payment terms. Changes in the economy, industry or specific customer conditions may require adjustments to the estimated allowance for doubtful receivables.

##### Allowances for obsolete and slow-moving inventories

The Group creates an allowance for obsolete and slow-moving inventories. Estimates of net realisable value of inventories are based on the most reliable evidence available at the time the estimates are made. These estimates take into consideration fluctuations of prices or costs directly relating to events occurring subsequent to the reporting date to the extent that such events confirm conditions existing at the end of the reporting period. Changes in the supply and demand for the products, any subsequent changes to prices or costs may require adjustments to the estimated allowance for obsolete and slow-moving inventories.

##### Legal contingencies

Legal proceedings covering a wide range of matters are pending or threatened against the Group. Periodically, the status of each significant loss contingency is reviewed to assess the potential financial exposure of the Group. The Group records provisions for pending litigation when it determines that an unfavourable outcome is probable and the amount of loss can be reasonably estimated. Due to the inherent uncertain nature of litigation, the ultimate outcome or actual cost of settlement may materially vary from estimates. Provisions are based on the best information available at the time. As additional information becomes available, the potential liability related to pending claims and litigation is reassessed and, if required, estimates are revised. Such revisions in estimates could have a material impact on the future of the Group's results.

##### Taxation

Significant judgement is required in determining the provision for taxation in the Russian Federation. There are many transactions and calculations for which the ultimate tax determination is uncertain.

The Group recognises liabilities for anticipated additional tax assessments as a result of tax audits based on estimates of whether it is probable that additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax provisions in the period in which such determinations are made.

Deferred tax assets are reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilised. The estimation of that probability includes judgements based on the expected performance of the Group. Various factors are considered to assess the probability of the future utilisation of deferred tax assets, including past operating results, operational plans, expiration of tax losses carried forward, and tax planning strategies. If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be negatively affected.

#### 5. BUSINESS COMBINATIONS AND INCREASE OF OWNERSHIP IN SUBSIDIARIES

##### OJSC "Sistema-invest"

On 9 April 2010, the Group acquired 25% interest in OJSC "Sistema-invest" ("Sistema-invest") from a third party for a cash consideration of USD 202 million.

As a result of this transaction, the shareholding structure of Sistema-invest was as follows:

	Interest
JSFC "Sistema"	65%
Bashneft	25%
Third party	10%
<b>TOTAL</b>	<b>100%</b>

Sistema-invest is a special purpose entity controlled by JSFC "Sistema" that owns equity interests in the Company, Ufimsky refinery plant, Novoil, Ufaneftekhim, Ufaorgsintez and Bashkirnefteproduct.

The other assets and liabilities of Sistema-invest at the date of the transaction comprised mainly a loan from VTB. The transaction, in substance, represents an acquisition of the Company's own shares and additional interests in subsidiaries. The Group accounts for assets, liabilities, equity, revenues and expenses of Sistema-invest to the extent of its interest in Sistema-invest. The Company's proportionate interest in its own shares was accounted for as treasury shares and the proportionate increase in the Company's interest in subsidiaries was accounted for as an increase in ownership in subsidiaries acquired by the Group.

At the date of acquisition, Group's proportionate interest in the fair value of Sistema-invest's net assets amounted to USD 621 million. The excess of the Group's proportionate interest in the net assets acquired over the consideration paid was recognised in the Group's consolidated statement of changes in equity as an increase in treasury shares and retained earnings in the amounts of USD 267 million and USD 152 million, respectively. The transaction resulted in a decrease in non-controlling interests in the amount of USD 277 million.

On 3 December 2010, Sistema-invest acquired 10% of its own shares from a third party for a cash consideration of USD 120 million. As a result of this transaction, the Group's proportionate interest in Sistema-invest increased from 25% to 27.78%. The excess of the Group's proportionate interest in the fair value of Sistema-invest's net assets over the Group's proportionate interest in the consideration paid by Sistema-invest for its own shares was recognised in the Group's consolidated statement of changes in equity as an increase in treasury shares and retained earnings in the amounts of USD 19 million and USD 11 million, respectively. The transaction resulted in a decrease in non-controlling interests in the amount of USD 30 million.



**5. BUSINESS COMBINATIONS  
AND INCREASE OF OWNERSHIP IN SUBSIDIARIES (CONTINUED)**

As a result of this transaction, the shareholding structure of Sistema-invest was as follows:

	Interest
JSFC "Sistema"	72.22%
Bashneft	27.78%
<b>TOTAL</b>	<b>100%</b>

At 31 December 2010, the carrying value of treasury shares held by the Company was as follows:

	Treasury shares acquired on 9 April 2010	Treasury shares acquired on 3 December 2010	Total
Fair value	486	52	538
Excess of the Group's proportionate interest in the net assets acquired over the consideration paid attributable to treasury shares	(267)	(19)	(286)
<b>TOTAL</b>	<b>219</b>	<b>33</b>	<b>252</b>

The increase in the Group's interest in the Company and its subsidiaries as a result of the acquisition of 25% interest in Sistema-invest and Sistema-invest's acquisition of 10% of its own shares was as follows:

	Effective ownership acquired on 9 April 2010	Effective ownership acquired on 3 December 2010	Total
Bashneft (treasury shares)	5.19%	0.58%	5.77%
Ufimsky refinery plant	5.62%	0.62%	6.24%
Novoil	6.40%	0.71%	7.11%
Ufaneftekhim	4.55%	0.51%	5.06%
Ufaorgsintez	5.38%	0.60%	5.98%
Bashkirnefteproduct	4.30%	0.48%	4.78%
Bashkirenergo*	1.99%	0.22%	2.21%

\* The Company controls Bashkirenergo through its controlling interests in Ufimsky refinery plant, Novoil and Ufaneftekhim.

**Increase of ownership in subsidiaries**

In June 2010, the Group acquired additional interests in subsidiaries as follows: 7.7% in Ufaneftekhim, 0.2% in Novoil, 0.7% in Ufimsky refinery plant, 5.0% in Ufaorgsintez and 0.8% in Bashkirnefteproduct for a total cash consideration of USD 129 million. As a result of these acquisitions, the Group's effective interest in Bashkirenergo increased by 1.5%. The excess of the Group's share in net assets acquired over the consideration paid of USD 49 million was recognised directly in the consolidated statement of changes in equity as an increase in retained earnings. As a result of these acquisitions, the Group recognised a decrease in net assets attributable to non-controlling interests of USD 178 million.

**6. SEGMENT INFORMATION**

For management purposes the Group is organised into three segments: Extraction, Refining and Marketing. Reports reviewed by the Board of Directors of the Group that are used to allocate resources to segments and to assess their performance are prepared on the same basis.

The operations of each of the Group's reportable segments are as follows:

- Extraction: The Extraction segment comprises subsidiaries and business units of the Company engaged in exploration and production of crude oil;
- Refining: The Refining segment comprises subsidiaries and business units of the Company engaged in processing crude oil and oil products; and
- Marketing: The Marketing segment comprises subsidiaries and business units of the Company engaged in wholesale and retail of oil and oil products.

Subsidiaries and business units of the Company engaged in electricity and heat generation are not included within the reportable operating segments, as they are not included in the reports provided to the Board of Directors. The results of these operations are included in the "Other segment" column below.

There are varying levels of integration between the Extraction, Refining and Marketing reportable segments. This integration includes transfers of crude oil from the Extraction segment to the Refining segment for processing into petroleum products.

Information regarding the results of each reportable segment is reviewed by the Board of Directors. Segment Profit before tax is used to measure segment performance, as management believes that such information is the most relevant in evaluating the results of certain segments relative to other entities that operate within these industries.

The significant accounting policies of the reportable segments are the same as the Group's accounting policies described in Note 3.

Inter-segment pricing is determined on an arm's length basis.

Information about reportable segments for the year ended 31 December 2010 is as follows:

	Extraction	Refining	Marketing	Other segment	Eliminations	Total
External revenues	10,900	29	734	1,678	-	13,341
Inter-segment revenues	679	1,461	123	412	(2,675)	-
Finance income	42	21	4	-	-	67
Finance costs	(350)	(6)	-	(1)	-	(357)
Depletion and depreciation	(180)	(398)	(18)	(115)	-	(711)
Share of profit of associates	34	-	2	-	-	36
Other non-cash income/(expenses), net	431	(57)	(56)	(4)	-	314
Capital expenditure	326	144	5	133	-	608
Income tax (expense)/benefit	(379)	(49)	2	(42)	-	(468)
Profit/(loss) before tax	1,732	172	(24)	134	-	2,014

**6. SEGMENT INFORMATION (CONTINUED)**

Information about reportable segments for the year ended 31 December 2009 is as follows:

	Extraction	Refining	Marketing	Other segment	Eliminations	Total
External revenues	4,113	820	585	1,257	-	6,775
Inter-segment revenues	334	463	52	345	(1,194)	-
Finance income	10	23	7	1	-	41
Finance costs	(17)	(3)	-	(1)	-	(21)
Depletion and depreciation	(159)	(349)	(17)	(106)	-	(631)
Other non-cash (expenses)/ income, net	(33)	1	-	(10)	-	(42)
Capital expenditure	379	215	36	154	-	784
Income tax expense	(108)	(22)	(11)	(29)	-	(170)
Profit/(loss) before tax	531	(28)	43	97	-	643

For the purpose of monitoring segment performance and allocating resources between segments all assets are allocated to reportable segments. The following tables present assets and liabilities of the Group reportable segments at 31 December 2010:

	Extraction	Refining	Marketing	Other segment	Eliminations	Total
Investments in associates	560	-	107	-	-	667
Segment assets	6,986	5,015	429	1,894	-	14,324
Inter-segment assets and eliminations	70	118	24	3	(215)	-
<b>TOTAL SEGMENT ASSETS</b>	<b>7,616</b>	<b>5,133</b>	<b>560</b>	<b>1,897</b>	<b>(215)</b>	<b>14,991</b>
Segment liabilities	(5,782)	(869)	(115)	(233)	-	(6,999)
Inter-segment liabilities and eliminations	(116)	(72)	(7)	(20)	215	-
<b>TOTAL SEGMENT LIABILITIES</b>	<b>(5,898)</b>	<b>(941)</b>	<b>(122)</b>	<b>(253)</b>	<b>215</b>	<b>(6,999)</b>

The following tables present assets and liabilities of the Group reportable segments at 31 December 2009:

	Extraction	Refining	Marketing	Other segment	Eliminations	Total
Segment assets	5,212	5,088	453	1,936	-	12,689
Inter-segment assets and eliminations	85	22	21	1	(129)	-
<b>TOTAL SEGMENT ASSETS</b>	<b>5,297</b>	<b>5,110</b>	<b>474</b>	<b>1,937</b>	<b>(129)</b>	<b>12,689</b>
Segment liabilities	(2,904)	(975)	(73)	(297)	-	(4,249)
Inter-segment liabilities and eliminations	(10)	(36)	(58)	(25)	129	-
<b>TOTAL SEGMENT LIABILITIES</b>	<b>(2,914)</b>	<b>(1,011)</b>	<b>(131)</b>	<b>(322)</b>	<b>129</b>	<b>(4,249)</b>

The following tables present assets and liabilities of the Group reportable segments at 1 January 2009:

	Extraction	Refining	Marketing	Other segment	Eliminations	Total
Segment assets	4,330	5,629	446	2,033	-	12,438
Inter-segment assets and eliminations	27	34	8	2	(71)	-
<b>TOTAL SEGMENT ASSETS</b>	<b>4,357</b>	<b>5,663</b>	<b>454</b>	<b>2,035</b>	<b>(71)</b>	<b>12,438</b>
Segment liabilities	(839)	(1,411)	(104)	(384)	-	(2,738)
Inter-segment liabilities and eliminations	-	(30)	(22)	(19)	71	-
<b>TOTAL SEGMENT LIABILITIES</b>	<b>(839)</b>	<b>(1,441)</b>	<b>(126)</b>	<b>(403)</b>	<b>71</b>	<b>(2,738)</b>

Substantially all of the Group's operations are conducted in the Russian Federation. The geographical regions within the Russian Federation have substantially similar economic and regulatory conditions. Therefore, the Group has not presented any separate geographical disclosure about its non-current assets by geographical area.

The Group's revenue from external customers by geographical location is as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Russian Federation	7,306	4,849
European Union	5,309	1,646
CIS	726	280
<b>TOTAL</b>	<b>13,341</b>	<b>6,775</b>

The following counterparties relating to the Extraction segment comprise each more than 10% of the total revenue of the Group:

	Year ended 31 December 2010		Year ended 31 December 2009	
	Revenue	% of the total Revenue	Revenue	% of the total Revenue
Litasco SA	1,634	12%	160	2%
STAR Oil (FZE)	1,522	11%	815	12%

**7. REVENUE**

	Year ended 31 December 2010	Year ended 31 December 2009
Petroleum products	9,342	2,828
Crude oil	1,995	1,687
Other revenue	2,004	2,260
<b>TOTAL</b>	<b>13,341</b>	<b>6,775</b>

Other revenue includes electricity and heat sales in the amount of USD 1,678 million (year ended 31 December 2009: USD 1,257 million).

**NOTES TO THE CONSOLIDATED  
FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**  
MILLIONS OF US DOLLARS

**8. EMPLOYEE BENEFIT EXPENSES**

	Year ended 31 December 2010	Year ended 31 December 2009
Wages and salaries	1,073	954
Social tax	214	148
Defined benefit plans (refer to Note 21)	11	7
Other employee benefits	13	-
<b>TOTAL</b>	<b>1,311</b>	<b>1,109</b>

Employee benefit expenses are included in profit and loss within production and operating expenses and selling, general and administrative expenses.

**9. TAXES OTHER THAN INCOME TAX**

	Year ended 31 December 2010	Year ended 31 December 2009
Mineral extraction tax	1,108	687
Social taxes	214	148
Property tax	71	65
Other taxes	28	13
<b>TOTAL</b>	<b>1,421</b>	<b>913</b>

**10. FINANCE INCOME AND FINANCE COSTS**

	Year ended 31 December 2010	Year ended 31 December 2009
<b>FINANCE INCOME</b>		
Interest income on loans and promissory notes	36	2
Interest income on cash and deposits	31	39
<b>TOTAL</b>	<b>67</b>	<b>41</b>
<b>FINANCE COSTS</b>		
Interest expense on borrowings	326	8
Unwinding of discount	29	11
Interest expense on defined benefit obligations	2	2
<b>TOTAL</b>	<b>357</b>	<b>21</b>

**11. INCOME TAX**

**Income tax expense**

	Year ended 31 December 2010	Year ended 31 December 2009
Current year income tax expense	393	200
Adjustments relating to current income tax of prior years	19	5
<b>Current income tax expense</b>	<b>412</b>	<b>205</b>
<b>Deferred tax expense/(benefit)</b>	<b>56</b>	<b>(35)</b>
<b>Income tax expense</b>	<b>468</b>	<b>170</b>

Reconciliation of statutory income tax to income tax expense is as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
<b>Profit before tax</b>	<b>2,014</b>	<b>643</b>
Income tax at statutory rate	403	129
Non-deductible and non-taxable items	46	31
Adjustments relating to current income tax of prior years	19	5
Current year losses for which no deferred tax asset was recognised	-	5
<b>Income tax expense</b>	<b>468</b>	<b>170</b>

**Deferred income tax**

Movements in deferred income tax are as follows:

	1 January 2010	Recognised in profit or loss	Effect of translation to presentation currency	31 December 2010
Property, plant and equipment	1,127	(60)	(8)	1,059
Investments	(3)	95	-	92
Inventories	(7)	16	-	9
Trade and other receivables	-	25	-	25
Decommissioning provision	(46)	(2)	-	(48)
Provisions	(1)	(14)	-	(15)
Trade and other payables	(9)	(4)	-	(13)
Other	(10)	-	-	(10)
<b>TOTAL</b>	<b>1,051</b>	<b>56</b>	<b>(8)</b>	<b>1,099</b>

	1 January 2009	Recognised in profit or loss	Effect of translation to presentation currency	31 December 2009
Property, plant and equipment	1,190	(29)	(34)	1,127
Investments	(4)	1	-	(3)
Inventories	(5)	(2)	-	(7)
Trade and other receivables	(16)	15	1	-
Decommissioning provision	(18)	(27)	(1)	(46)
Provisions	1	(2)	-	(1)
Trade and other payables	(5)	(4)	-	(9)
Other	(24)	13	1	(10)
<b>TOTAL</b>	<b>1,119</b>	<b>(35)</b>	<b>(33)</b>	<b>1,051</b>

**12. PROPERTY, PLANT AND EQUIPMENT**

	Oil and gas properties	Refining	Marketing	Other	Total
<b>COST / DEEMED COST</b>					
Balance at 1 January 2009	3,354	4,765	368	1,579	10,066
Additions	386	215	36	154	791
Disposals	(13)	(36)	(4)	(13)	(66)
Effect of translation to presentation currency	(84)	(125)	(9)	(38)	(256)
Balance at 31 December 2009	3,643	4,819	391	1,682	10,535
Additions	297	139	5	132	573
Disposals	(24)	(50)	(2)	(13)	(89)
Impairment	(12)	(3)	(2)	-	(17)
Effect of translation to presentation currency	(28)	(37)	(3)	(13)	(81)
Balance at 31 December 2010	3,876	4,868	389	1,788	10,921
<b>ACCUMULATED DEPLETION AND DEPRECIATION</b>					
Balance at 1 January 2009	-	-	-	-	-
Charge for the year	(165)	(349)	(20)	(106)	(640)
Disposals	-	3	-	-	3
Effect of translation to presentation currency	(8)	(17)	(1)	(5)	(31)
Balance at 31 December 2009	(173)	(363)	(21)	(111)	(668)
Charge for the year	(188)	(397)	(22)	(115)	(722)
Disposals	3	9	-	1	13
Effect of translation to presentation currency	2	4	1	1	8
Balance at 31 December 2010	(356)	(747)	(42)	(224)	(1,369)
<b>NET BOOK VALUE</b>					
At 1 January 2009	3,354	4,765	368	1,579	10,066
At 31 December 2009	3,470	4,456	370	1,571	9,867
At 31 December 2010	3,520	4,121	347	1,564	9,552

Property, plant and equipment of subsidiaries and business units of the Company engaged in electricity and heat generation is included in "other" above.

At 31 December 2010, properties with a carrying amount of USD 214 million (31 December 2009: USD 407 million; 1 January 2009: USD 182 million) are pledged as security for the Group's bank loans.

**Decommissioning provision**

Balance at 1 January 2009	79
Unwinding of discount	11
New obligations	1
Changes in estimates of existing obligations	135
Effect of translation to presentation currency	5
Balance at 31 December 2009	231
Unwinding of discount	29
New obligations	3
Changes in estimates of existing obligations	(29)
Effect of translation to presentation currency	(3)
Balance at 31 December 2010	231

Current and non-current portions of decommissioning provision are as follows:

	31 December 2010	31 December 2009	1 January 2009
Current portion	14	-	-
Non-current portion	217	231	79
<b>TOTAL</b>	<b>231</b>	<b>231</b>	<b>79</b>

The Group's decommissioning provision relates primarily to the conservation and liquidation of wells, pipelines and other oil and gas facilities and site restoration. Key assumptions used for evaluation of decommissioning provision were as follows:

	31 December 2010	31 December 2009	1 January 2009
Discount rate	12.38%	10.69%	14.96%
Inflation rate	2.25%-10.81%	2.33%-10.42%	2.64%-6.20%

The Group has estimated the costs to be incurred using the cost of technology and materials that are currently available.

### 13. INVESTMENTS IN ASSOCIATES

	Year ended 31 December 2010
Balance at beginning of the year	-
Reclassified from available-for-sale investments	545
Acquired during the year	123
Share of post-acquisition profits	36
Impairment	(17)
Effect of translation to presentation currency	(20)
<b>Balance at end of the year</b>	<b>667</b>

The Group holds 38.5% interest in OJSC "Belkamneft" ("Belkamneft"), a company engaged in the production of crude oil. At 31 December 2009 and 1 January 2009, the Group's 38.5% interest in Belkamneft was classified as an available-for-sale investment as the Group was not able to exercise significant influence over the operating and financing activities of the investee. On 23 April 2010,

JSFC Sistema (the Group's parent company) acquired 49.9% interest in OJSC "Russneft" (Belkamneft's parent Company). As a result of this transaction, the Group obtained significant influence over Belkamneft and reclassified the investment in Belkamneft from available-for-sale to investments in associates. The excess of the fair value of the investment over the carrying value in amount of USD 477 million was recognised in profit and loss as gain on reclassification of available-for-sale investments to investments in associates.

On 31 July 2010, the Group acquired 49.99% interest in OJSC "Aspec" from a related party for a cash consideration of USD 123 million. OJSC "Aspec" is the holding company of the Aspec Group ("Aspec"). Aspec is engaged in wholesale and retail of oil products, real estate development and also owns

an automotive retail business. Aspec's petrol stations and storage depots are located throughout the Russian Federation, with its headquarter located in the Republic of Udmurtia. As at 31 December 2010, the Group recognised an impairment loss in the amount of USD 17 million on its investment in Aspec.

The following is a summary of the financial information of associates:

	Year ended 31 December 2010
Total assets	2,903
Total liabilities	567
<b>Net assets</b>	<b>2,336</b>
<b>Group's share of net assets of associates</b>	<b>923</b>

	Year ended 31 December 2010
Total revenue	1,514
Total profit for the year	138
<b>Group's share of profit of associates</b>	<b>36</b>

### 14. FINANCIAL ASSETS

	31 December 2010	31 December 2009	1 January 2009
<b>NON-CURRENT INVESTMENTS</b>			
Held-to-maturity investments	217	-	-
Available-for-sale investments, at cost	-	65	66
Loans given, at amortised cost	-	-	1
Deposits	-	-	87
<b>TOTAL</b>	<b>217</b>	<b>65</b>	<b>154</b>
<b>CURRENT INVESTMENTS</b>			
Held-to-maturity investments	547	4	2
Loans given, at amortised cost	118	1	20
Deposits	11	225	48
<b>TOTAL</b>	<b>676</b>	<b>230</b>	<b>70</b>

At 31 December 2010, current and non-current held-to-maturity investments represent promissory notes which bear interest at rates varying from 3.5% to 5.0% per annum and mature in 2011 and 2012, respectively.

Available-for-sale investments at cost at 1 January 2009 and 31 December 2009 represent a 38.5% investment in Belkamneft (refer to Note 13). The Group accounted for this investment at cost as the fair value of the investment could not be reliably measured.

Loans given at amortised cost at 31 December 2010 is unsecured and bear interest at rates varying from 5.0% to 8.3% per annum.

At 31 December 2010, current deposits represent bank deposits which bear interest at rates varying from 7.5% to 14.5% (31 December 2009: 5.0% to 15.0%; 1 January 2009: 5.0% to 15.0%) per annum. Non-current deposits at 1 January 2009 represents bank deposits which bore interest at rates varying from 7.0% to 14.8% per annum.

## 15. INVENTORIES

	31 December 2010	31 December 2009	1 January 2009
<b>INVENTORIES EXPECTED TO BE RECOVERED AFTER TWELVE MONTHS</b>			
Catalytic agents	44	51	70
Raw materials and other inventories	6	6	7
<b>TOTAL</b>	<b>50</b>	<b>57</b>	<b>77</b>
<b>INVENTORIES EXPECTED TO BE RECOVERED IN THE NEXT TWELVE MONTHS</b>			
Petroleum products	333	121	51
Crude oil	7	16	7
Raw materials and other inventories	335	295	380
<b>TOTAL</b>	<b>675</b>	<b>432</b>	<b>438</b>
Less: allowance for obsolete and slow-moving items	(50)	(47)	(45)
<b>TOTAL</b>	<b>625</b>	<b>385</b>	<b>393</b>

The cost of inventories (excluding crude oil) recognised as expense during the year ended 31 December 2010 amounted to USD 1,637 million (year ended 31 December 2009:

USD 1,304 million). At 31 December 2010, none of the Group's inventories were stated at net realisable value (31 December 2009: USD 17 million; 1 January 2009: USD 8 million).

## 16. OTHER NON-CURRENT ASSETS

At 31 December 2010, other non-current assets included long-term accounts receivable in the amount of USD 3 million (31 December 2009: USD 3 million; 1 January 2009: USD 2 million), net of allowance for doubtful receivables in the amount of USD 24 million (31 December 2009: USD 26 million; 1 January 2009: USD 3 million).

## 17. TRADE AND OTHER RECEIVABLES

	31 December 2010	31 December 2009	1 January 2009
Trade receivables	545	255	211
Other receivables	72	44	47
<b>TOTAL</b>	<b>617</b>	<b>299</b>	<b>258</b>
Less: allowance for doubtful receivables	(94)	(72)	(82)
<b>TOTAL</b>	<b>523</b>	<b>227</b>	<b>176</b>

The average credit period for the Group's customers is 30 days. During this period no interest is charged on the outstanding balances. Before accepting any new customer, the Group uses an internal credit system to assess the potential customer's credit quality and defines credit limits separately for each individual customer. At 31 December 2010, the Group's five largest customers represent 67.9% (31 December 2009: 37.9%; 1 January 2009: 25.7%) of the outstanding trade receivables balance. Creditworthiness of the existing customers is also periodically evaluated based on internal and external information regarding the history of settlements with these customers. The Group regularly analyses accounts receivable turnover ratios, maturity dates and takes appropriate measures on collection of debts due.

Allowances for doubtful receivables are recognised against trade and other receivables older than 30 days based on estimated irrecoverable amounts, determined by reference to past experience and are regularly reassessed based on the facts and circumstances existing at each reporting date.

Ageing of trade and other receivables was as follows:

	31 December 2010		31 December 2009		1 January 2009	
	Gross	Impairment provision	Gross	Impairment provision	Gross	Impairment provision
Not past due	444	-	184	-	102	-
Past due up to 30 days	25	-	3	-	1	-
Past due from 31 to 90 days	26	(6)	15	(3)	49	(6)
Past due from 91 to 180 days	13	(5)	12	(6)	16	(4)
Past due from 181 to 365 days	27	(24)	11	(8)	11	(2)
Past due over 365 days	82	(59)	74	(55)	79	(70)
<b>TOTAL</b>	<b>617</b>	<b>(94)</b>	<b>299</b>	<b>(72)</b>	<b>258</b>	<b>(82)</b>

Movement in the allowance for doubtful receivables in respect of trade and other receivables was as follows:

	31 December 2010	31 December 2009
Balance at the beginning of the year	72	82
Recognised in profit or loss	27	(6)
Amounts written-off as uncollected	(5)	(2)
Effect of translation to presentation currency	-	(2)
<b>Balance at the end of the year</b>	<b>94</b>	<b>72</b>

## 18. CASH AND CASH EQUIVALENTS

	31 December 2010	31 December 2009	1 January 2009
Call deposits	549	668	56
Bank balances	164	497	769
Other cash and cash equivalents	354	1	1
<b>TOTAL</b>	<b>1,067</b>	<b>1,166</b>	<b>826</b>

## 18. CASH AND CASH EQUIVALENTS (CONTINUED)

Call deposits mostly represent overnight bank deposits and are denominated in USD and in RUB. USD-denominated deposits bear interest at rates varying from 0.1% to 0.2% per annum. RUB-denominated deposits bear interest at rates varying from 0.5% to 2.7% (31 December 2009: 5.0% to 15.0%; 1 January 2009: 5.0% to 15.0%) per annum. Maturity dates for these deposits are within 3 months from the date they originated.

As part of its cash and credit risk management function, the Group regularly evaluates the creditworthiness of financial and banking institutions where it deposits cash and cash equivalents. Banking relationships are with large Russian banks with external credit ratings of at least B+.

## 19. SHARE CAPITAL

### Authorised, issued and outstanding share capital

	31 December 2010	31 December 2009	1 January 2009
170,169,754 ordinary shares with a par value of RUB 1.00	64	64	64
34,622,686 preferred shares with a par value of RUB 1.00	13	13	13
<b>TOTAL</b>	<b>77</b>	<b>77</b>	<b>77</b>

The nominal value of share capital was adjusted for hyperinflation from the actual dates of share issuance to 31 December 2002.

### Dividends and retained earnings

The holders of the Company's ordinary shares are entitled to one vote per share at shareholders' meetings and a right to dividends, as declared periodically.

The holders of the Company's preferred shares receive a non-cumulative dividend at the Company's discretion or whenever dividends to ordinary shareholders are declared. They do not have the right to vote at shareholders' meetings if dividends are declared but carrying one vote per share if dividends are not declared.

Ordinary and preferred shares rank equally with regard to the Company's residual assets in the event of liquidation.

At 1 January 2009, the Company had an outstanding balance of USD 240 million of dividends payable, which were declared in prior years and were paid to shareholders during 2009. On 30 June 2009, the Company declared a dividend of USD 0.468 per share amounting to USD 96 million which was fully paid during the period from 30 June 2009 to 31 December 2009.

On 29 June 2010, the Company declared a dividend of USD 3.54 per share amounting to USD 725 million which was fully paid during the period from 29 June 2010 to 31 December 2010.

On 17 December 2010, the Company declared a dividend of USD 3.40 per share amounting to USD 696 million, out of which USD 73 million remained unpaid as of 31 December 2010.

The statutory financial statements of the Company are the basis for the profit distribution and other appropriations.

## Earnings per share

Earnings per share ("EPS") is calculated by dividing profit for the year attributable to ordinary shares of the Company by the weighted average number of ordinary shares outstanding during the year adjusted for shares purchased by the Group and held as treasury shares. Profit for the year attributable to owners of the Company is allocated between the Company's ordinary and preference shares at a ratio of 1:1 in accordance with their participation rights as described in the Company's charter. Profit attributable to ordinary shareholders of the Company for the year ended 31 December 2010 was USD 1,429 million (year ended 31 December 2009: USD 420 million). The weighted average number of ordinary shares outstanding during the year ended 31 December 2010 was 162,295,807 (31 December 2009: 170,169,754). Reciprocal interests relating to Sistema-invest's ownership in the Group are deducted from the total outstanding shares in computing the weighted average number of outstanding ordinary shares.

## 20. BORROWINGS

	31 December 2010		31 December 2009		1 January 2009	
	Rate, %	Outstanding balance	Rate, %	Outstanding balance	Rate, %	Outstanding balance
<b>NON-CURRENT LIABILITIES</b>						
Unsecured non-convertible bonds	12.5%	1,633	12.5%	1,642	8.3%	51
Unsecured borrowings	11.9%-12.0%	1,466	-	-	-	-
Secured borrowings	16.0%	19	16.0%	34	-	-
<b>TOTAL</b>		<b>3,118</b>		<b>1,676</b>		<b>51</b>
<b>CURRENT LIABILITIES</b>						
Short-term unsecured borrowings	3.6% - 7.2%	773	9.5% - 12.5%	16	13.0% - 15.5%	37
Current portion of secured borrowings	16.0%	14	16.0%	12	-	-
Short-term secured borrowings	4.5% - 20.0%	8	13.0% - 18.0%	35	13.0% - 18.0%	29
<b>TOTAL</b>		<b>795</b>		<b>63</b>		<b>66</b>

### Unsecured non-convertible bonds

On 22 December 2009, the Company issued 50,000,000 non-convertible RUB-denominated bonds at a par value of USD 32. The bonds have a coupon rate of 12.5% per annum, payable semi-annually. The Group has the right to modify the coupon rate annually from 21 December 2012 at which point bondholders have the right to redeem the bonds at par value.

### Unsecured borrowings

At 31 December 2010, unsecured borrowings are denominated in RUB and USD and were obtained from a variety of lenders. The borrowings mature from 2011 through 2017 (31 December 2009: 2010) and bear interest at fixed rates.

**21. OTHER NON-CURRENT LIABILITIES**

	31 December 2010	31 December 2009	1 January 2009
Defined benefit obligation	37	29	25
Non-current portion of phantom share plan	9	-	-
Other non-current liabilities	3	2	6
<b>TOTAL</b>	<b>49</b>	<b>31</b>	<b>31</b>

**Defined benefit plans**

The Group operates a number of unfunded defined benefit plans for its employees. In accordance with these plans, the employees are entitled to certain benefits in accordance with the terms of collective agreements (such as retirement bonus, jubilee bonus, reimbursement of funeral costs).

The valuation of the Group's defined benefit obligation was performed by an independent actuary.

The principal assumptions used for the purpose of the actuarial valuations were as follows:

	31 December 2010	31 December 2009	1 January 2009
Discount rate	7.8%	8.5%	8.5%
Expected rate of salary increase	5.0%	5.0%	5.0%
Expected benefit increase	5.0%	5.0%	5.0%
Average life expectancy of employees from the date of retirement	19	19	19

Amounts recognised in profit or loss in respect of these defined benefit plans are as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Current service cost	3	2
Interest cost	2	2
Actuarial losses	6	3
<b>TOTAL</b>	<b>11</b>	<b>7</b>

Movements in the present value of the defined obligation were as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Defined benefit obligation at the beginning of the year	29	25
Actuarial losses	6	3
Current service cost	3	2
Interest cost	2	2
Benefits paid	(3)	(2)
Effect of translation to presentation currency	-	(1)
Defined benefit obligation at the end of the year	37	29

**Phantom share plan**

In 2010, the Company granted share appreciation rights to key management personnel of the Group. In accordance with the terms of the plan, the eligible employees are entitled to a cash payment based on a number of vested phantom shares, the value of which is to be determined by an independent appraiser at each vesting date. The program has 3 stages and is effective during the period from 2010 to 2012. Liabilities under the phantom share plan were as follows:

	Year ended 31 December 2010
Balance at the beginning of the year	-
Granted during the year	13
Balance at the end of the year	13

At 31 December 2010, the Group recognised USD 4 million as a current liability and USD 9 million as non-current liability under the phantom share plan.

**22. TRADE AND OTHER PAYABLES**

	31 December 2010	31 December 2009	1 January 2009
Trade payables	424	269	200
Other payables and accrued expenses	235	129	210
<b>TOTAL</b>	<b>659</b>	<b>398</b>	<b>410</b>

The average credit period on purchase of the majority of inventories and services consumed is 35 days (31 December 2009: 45 days; 1 January 2009: 45 days). No interest is charged on the outstanding balance of trade and other payables during this period.



### 23. TAXES

	31 December 2010	31 December 2009	1 January 2009
<b>OTHER TAXES RECEIVABLE</b>			
VAT recoverable	285	180	117
Custom duties prepaid	252	105	27
Other taxes	148	125	59
<b>TOTAL</b>	<b>685</b>	<b>410</b>	<b>203</b>
<b>OTHER TAXES PAYABLE</b>			
VAT	120	161	122
Mineral extraction tax	103	80	24
Excise tax	51	105	86
Other taxes	44	56	55
<b>TOTAL</b>	<b>318</b>	<b>402</b>	<b>287</b>

### 24. PROVISIONS

Provisions at 31 December 2010 include an amount of USD 83 million in relation to legal claims brought against the Group. The provision charge is recognised in profit or loss within other operating expenses. The balance at 31 December 2010 is expected to be settled in 2011. In management's opinion the outcome of these legal claims will not give rise to any significant loss beyond the amounts provided at 31 December 2010.

### 25. RELATED PARTIES

At 31 December 2010, 2009 and 1 January 2009, the Group had the following outstanding balances with related parties:

	31 December 2010	31 December 2009	1 January 2009
<b>SISTEMA-INVEST</b>			
Other Sistema Group companies	786	1	-
Total	118	161	26
<b>SISTEMA-INVEST</b>	<b>904</b>	<b>162</b>	<b>26</b>
<b>OTHER SISTEMA GROUP COMPANIES</b>			
LLC Aguidel-Invest, LLC Yuruzan-Invest,	-	3	81
LLC Inzer-Invest, LLC Ural-Invest	44	1	3
Other related parties	-	-	234
Total	16	-	-
<b>TOTAL</b>	<b>60</b>	<b>4</b>	<b>318</b>

The amounts outstanding were unsecured and are expected to be net settled or settled in cash.

The Group does not create an allowance for doubtful receivables in respect of outstanding balances of related parties. No balances owed by related parties were past due but not impaired.

No expense has been recognised in the current year for bad debts in respect of amounts owed by related parties.

The Group entered into the following transactions with related parties:

	31 December 2010	31 December 2009
<b>SISTEMA-INVEST</b>		
Dividends paid	275	65
Loans issued	1,661	-
Proceeds from repayment of loans issued	607	-
Sale of goods and services	-	2
Purchase of goods and services	-	36
Interest income	29	-
<b>OTHER SISTEMA GROUP COMPANIES</b>		
Dividends paid	753	54
Loans issued	290	-
Proceeds from repayment of loans issued	290	-
Sale of goods and services	32	1
Purchase of goods and services	26	-
Purchase of property	55	-
Interest income	10	2
<b>LLC AGUIDEL-INVEST, LLC YURUZAN-INVEST, LLC INZER-INVEST, LLC URAL-INVEST</b>		
Dividends paid	-	121
<b>ASSOCIATES OF THE GROUP</b>		
Sale of goods and services	425	-
<b>KEY MANAGEMENT PERSONNEL</b>		
Acquisition of investments	123	-
<b>OTHER RELATED PARTIES</b>		
Sale of goods and services	323	-

During the year ended 31 December 2010, the Group transferred USD 19 million (year ended 31 December 2009: USD 14 million) as a donation to Charity Fund Sistema, a related party of the Group.

## 25. RELATED PARTIES (CONTINUED)

### Compensation of key management personnel

The remuneration of directors and other key management personnel was as follows:

	Year ended 31 December 2010	Year ended 31 December 2009
Wages and salaries	45	20
Share-based payments	4	-
<b>TOTAL</b>	<b>49</b>	<b>20</b>

At 31 December 2010, outstanding balances in respect of wages and salaries of key management personnel were USD 34 million (31 December 2009: USD 11 million; 1 January 2009: USD 2 million).

### Terms and conditions of transactions with related parties

Sales and purchases of goods and services to and from related parties were made on market terms. Interest rates on loans issued and promissory notes acquired reflect market terms.

## 26. FINANCIAL RISK MANAGEMENT

### Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Board of Directors' policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. The Group may adjust the amount of dividends paid to shareholders and return on capital to shareholders, issue new shares or sell assets to reduce debt, maintain or adjust the capital structure.

The Board of Directors monitors the return on capital, which the Group defines OIBDA divided by total net borrowings. The Group defines OIBDA as operating profit adjusted for depletion, depreciation and amortisation and total net borrowings as total borrowings minus cash and cash equivalents. Since OIBDA is not a standard IFRS measure, the Group's definition of OIBDA may differ from that of other companies.

The Group's gearing ratio was as follows:

	31 December 2010	31 December 2009
OIBDA	2,981	1,249
Total net borrowings	2,846	573
<b>OIBDA TO NET BORROWINGS RATIO</b>	<b>1.05</b>	<b>2.18</b>

### Major categories of financial instruments

	31 December 2010	31 December 2009	1 January 2009
<b>FINANCIAL ASSETS</b>			
Trade and other receivables, excluding prepayments	523	227	176
Available-for-sale investments	-	65	66
Loans given	118	1	20
Held-to-maturity investments	764	4	2
Deposits	11	225	135
Cash and cash equivalents	1,067	1,166	826
<b>TOTAL FINANCIAL ASSETS</b>	<b>2,483</b>	<b>1,688</b>	<b>1,225</b>
<b>FINANCIAL LIABILITIES</b>			
Borrowings	3,913	1,739	117
Trade and other payables, including dividends payable	732	401	897
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>4,645</b>	<b>2,140</b>	<b>1,014</b>

The main risks arising from the Group's financial instruments are foreign currency, commodity price and liquidity risks.

### Foreign currency risk

Currency risk is the risk that the financial results of the Group will be adversely impacted by changes in exchange rates to which the Group is exposed. The Group undertakes certain transactions denominated in foreign currencies and is exposed primarily with respect to the US Dollar.

The Group manages its net exposure to foreign exchange risk by balancing both financial assets and financial liabilities denominated in Russian Rouble and US Dollar. The Group does not use derivatives to manage its foreign currency risk exposure.

The carrying amount of the Group's US-dollar denominated monetary assets and liabilities at 31 December 2010, 2009 and 1 January 2009 were as follows:

	31 December 2010	31 December 2009	1 January 2009
<b>ASSETS</b>			
Trade and other receivables, excluding prepayments	293	108	17
Cash and cash equivalents	430	311	159
<b>TOTAL ASSETS</b>	<b>723</b>	<b>419</b>	<b>176</b>
<b>LIABILITIES</b>			
Trade and other payables	3	3	4
Loans and borrowings	201	-	-
<b>TOTAL LIABILITIES</b>	<b>204</b>	<b>3</b>	<b>4</b>

## 26. FINANCIAL RISK MANAGEMENT (CONTINUED)

The table below details the Group's sensitivity to the strengthening of the US Dollar against the Russian Rouble by 10%. This analysis assumes that all other variables, in particular interest rates, remain constant. This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis was applied to monetary items at the end of the period denominated in the respective currencies.

	Year ended 31 December 2010	Year ended 31 December 2009
Increase in profit before tax	52	42

The effect of a corresponding strengthening of the Russian Rouble against the US Dollar is approximately equal and opposite.

### Commodity price risk

Commodity price risk is the risk or uncertainty arising from possible movements in prices for crude oil and related products, and their impact on the Group's future performance and results of the Group's operations. A decline in the prices could result in a decrease in net income and cash flows. An extended period of low prices could precipitate a decrease in development activities and could cause a decrease in the volume of reserves available for transportation and processing through the Group's systems or facilities and ultimately impact the Group's ability to deliver under its contractual obligations.

The Group's overall strategy in production and sales of crude oil and related products is centrally managed. As of 31 December 2010, if the average crude oil price and petroleum products had weakened by 10% with all other variables held constant, profit before tax would have been lower by USD 460 million for the year ended 31 December 2010. As of 31 December 2009, if the average crude oil price and petroleum products had weakened by 10% with all other variables held constant, profit before tax would have been lower by USD 210 million for the year ended 31 December 2009.

### Liquidity risk

Liquidity risk is the risk that the Group will not be able to settle all its liabilities as they fall due. The Group's liquidity position is carefully monitored and managed. The Group has a detailed budgeting and cash forecasting process to help ensure that it has adequate cash available to meet its payment obligations.

The following tables detail the Group's remaining contractual maturity for its financial liabilities and net-settled financial liabilities at 31 December 2010. The tables include both interest and principal cash flows. The contractual maturity is based on the earliest date on which the Group may be required to pay or net-settle its financial liabilities.

	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-5 years	Over 5 years
Unsecured borrowings	2,239	3,430	111	874	704	1,741
Secured borrowings	41	46	9	9	28	-
Unsecured non-convertible bonds	1,633	2,051	103	103	1,845	-
Dividends payable	73	73	73	-	-	-
Trade and other payables	659	659	659	-	-	-
<b>TOTAL</b>	<b>4,645</b>	<b>6,259</b>	<b>955</b>	<b>986</b>	<b>2,577</b>	<b>1,741</b>

The following tables detail the Group's remaining contractual maturity for its financial liabilities and net-settled financial liabilities at 31 December 2009. The tables include both interest and principal cash flows. The contractual maturity is based on the earliest date on which the Group may be required to pay or net-settle its financial liabilities.

	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-5 years	Over 5 years
Unsecured borrowings	16	17	6	11	-	-
Secured borrowings	81	93	10	45	38	-
Unsecured non-convertible bonds	1,642	2,272	103	103	2,066	-
Dividends payable	3	3	3	-	-	-
Trade and other payables	398	398	398	-	-	-
<b>TOTAL</b>	<b>2,140</b>	<b>2,783</b>	<b>520</b>	<b>159</b>	<b>2,104</b>	<b>-</b>

The following tables detail the Group's remaining contractual maturity for its financial liabilities and net-settled financial liabilities at 1 January 2009. The tables include both interest and principal cash flows. The contractual maturity is based on the earliest date on which the Group may be required to pay or net-settle its financial liabilities.

	Carrying amount	Contractual cash flows	0-6 months	6-12 months	1-5 years	Over 5 years
Unsecured borrowings	37	41	41	-	-	-
Secured borrowings	29	35	17	2	16	-
Unsecured non-convertible bonds	51	60	2	2	56	-
Dividends payable	487	487	487	-	-	-
Trade and other payables	410	410	410	-	-	-
<b>TOTAL</b>	<b>1,014</b>	<b>1,033</b>	<b>957</b>	<b>4</b>	<b>72</b>	<b>-</b>

For the management of its day to day liquidity requirements the management had following financing facilities.

	31 December 2010	31 December 2009	1 January 2009
Committed credit facilities	948	228	242
Less: amounts withdrawn	(56)	(101)	(61)
<b>TOTAL UNUSED CREDIT FACILITIES</b>	<b>892</b>	<b>127</b>	<b>181</b>

### Interest rate risk

The Group's exposure to interest rate risk is limited as the Group's loans and borrowings have fixed interest rates.

## 27. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial assets and liabilities is determined as follows:

- The fair value of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices; and
- The fair value of other financial assets and financial liabilities are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions.

As at 31 December 2010, 2009 and 1 January 2009, management believes that the carrying values of all significant financial assets and financial liabilities recorded at amortised cost in the consolidated financial statements approximated their fair values, except for the unsecured non-convertible bonds with carrying value of USD 1,633 million and fair value USD 1,518 million.

Management believes that the carrying value of financial assets and liabilities approximated their fair values due to (i) their short-term nature for current financial assets and liabilities, (ii) the fact that interest rates on loans receivable approximate current market rates for similar debt instruments, and (iii) the fact that the interest rates on long-term liabilities approximate the current market rates for similar instruments as the majority of loans and borrowings were obtained in 2009 and 2010.

The Group do not have any financial instruments that are measured subsequent to initial recognition at fair value.

## 28. COMMITMENTS AND CONTINGENCIES

### Capital commitments

At 31 December 2010, contractual capital commitments of the Group amounted to USD 176 million (31 December 2009: USD 136 million; 1 January 2009: USD 358 million). These commitments are expected to be settled during 2011.

### Operating leases: Group as a lessee

The Group leases certain production equipment, transport and office premises. The leases typically run for periods varying from 1 to 10 years with no renewal option at the end of the lease term. In addition to the above, the Group's extraction, refining, marketing and distribution and other facilities are located under operating leases, which expire in various years through 2060.

Future minimum rental expenses under non-cancellable operating leases are as follows:

	31 December 2010	31 December 2009	1 January 2009
Due in one year	37	32	33
Due from one to five years	105	113	127
Thereafter	514	457	485
<b>TOTAL</b>	<b>656</b>	<b>602</b>	<b>645</b>

### Taxation contingencies in the Russian Federation

The taxation system in the Russian Federation is at a relatively early stage of development, and is characterised by numerous taxes, frequent changes and inconsistent enforcement at federal, regional and local levels.

The government of the Russian Federation has commenced a revision of the Russian tax system and passed certain laws implementing tax reform. The new laws reduce the number of taxes and overall tax burden on businesses and simplify tax litigation. However, these new tax laws continue to rely heavily on the interpretation of local tax officials and fail to address many existing problems. Many issues associated with practical implication of new legislation are unclear and complicate the Group's tax planning and related business decisions.

In terms of Russian tax legislation, authorities have a period of up to three years to re-open tax declarations for further inspection. Changes in the tax system that may be applied retrospectively by authorities could affect the Group's previously submitted and assessed tax declarations.

While management believes that it has adequately provided for tax liabilities based on its interpretation of current and previous legislation, the risk remains that tax authorities in the Russian Federation could take differing positions with regard to interpretive issues. This uncertainty may expose the Group to additional taxation, fines and penalties that could be significant.

With regard to matters where practice concerning payment of taxes is unclear, management estimated possible tax exposure at 31 December 2010, to be approximately of USD 184 million (31 December 2009: USD 121 million; 1 January 2009: USD 14 million).

### Legal contingencies

At 31 December 2010, unresolved legal claims against the Group amounted to USD 50 million. Management estimates the unfavourable outcome of the legal claims to be possible.

### Insurance

The Russian Federation is in a developing stage and many forms of insurance protection common in developed markets are not generally available.

The Group does not have full coverage for property damage, for business interruption and third party liabilities in respect of environmental damage arising from accidents on the Group's property or relating to the Group's operations. Until the Group obtains adequate insurance coverage, there is a risk that the losses could have a material adverse effect on the Group's operations and financial position.

**29. RECONCILIATIONS REQUIRED BY IFRS 1 FIRST TIME ADOPTION  
OF INTERNATIONAL FINANCIAL REPORTING STANDARD (UNAUDITED)**

The Company's transition date to IFRS is 1 January 2009, when the opening consolidated IFRS statement of financial position was prepared.

Reconciliation of equity at the date of the transition to IFRS and at the reporting dates is as follows:

	31 December 2010 (unaudited)	31 December 2009 (unaudited)	1 January 2009 (unaudited)
<b>Equity in accordance with RAS (unaudited)</b>	<b>3,305</b>	<b>3,234</b>	<b>2,797</b>
Recognition of non-controlling interests on consolidation of the Group	2,717	3,135	3,356
Effect of acquisition of subsidiaries from entities under common control	1,160	1,170	2,429
Valuation of other non-current assets under IFRS 1	(2)	(87)	(100)
Valuation of property, plant and equipment under IFRS 1	1,732	1,852	1,652
Valuation of investments	(407)	(398)	(233)
Valuation of trade and other receivables	38	(32)	(33)
Valuation of inventory	(110)	(90)	(36)
Derecognition of income tax and other taxes payable	(19)	-	29
Recognition of decommissioning provision	(231)	(231)	(79)
Deferred tax	(343)	(262)	(238)
Other IFRS adjustments	152	149	156
<b>Equity in accordance with IFRS</b>	<b>7,992</b>	<b>8,440</b>	<b>9,700</b>

Reconciliation of profit for the years ended 31 December 2010 and 2009 is as follows:

	Year ended 31 December 2010 (unaudited)	Year ended 31 December 2009 (unaudited)
<b>Profit for the year in accordance with RAS (unaudited)</b>	<b>1,449</b>	<b>493</b>
Consolidation of subsidiaries of the Company	208	86
Reversal of available-for-sale investments revaluation calculated under RAS	(393)	(50)
Gain on reclassification of available-for-sale investments to investments in associates	477	-
Valuation of inventory	(43)	(11)
Unwinding of discount on decommissioning provision	(28)	(12)
Effect of differences in deferred tax recognition criteria under IFRS	(97)	12
Effects of other IFRS adjustments	(27)	(45)
<b>Profit for the year in accordance with IFRS</b>	<b>1,546</b>	<b>473</b>
Effect of translation to presentation currency	(93)	(254)
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<b>1,453</b>	<b>219</b>

**30. EVENTS SUBSEQUENT TO THE REPORTING PERIOD**

**Orenburgnefteproduct**

On 4 April 2011, the Group acquired 94% interest in OJSC "Orenburgnefteproduct" ("ONP") from OJSC NK "Russneft". ONP is engaged in wholesale and retail of oil products in the Orenburg region of the Russian Federation. The purchase consideration included a fixed payment of USD 90 million and an additional payment equal to ONP's net working capital at the date of the transaction. According to the purchase agreement, the additional payment should be defined within 30 days after the acquisition.

**Trebs and Titov**

On 8 February 2011, the license for the development of the Trebs and Titov oil fields was granted to the Group. The total consideration paid to acquire the license amounted to USD 629 million.

On 15 April 2011, the Group entered into an agreement with OJSC "Lukoil", a major Russian oil company, for the joint development of the Trebs and Titov oil fields. Under the terms of the agreement, the Group is required to transfer the license to its subsidiary, 25% stake of which will be acquired by OJSC "Lukoil".

**Key management changes**

On 6 April 2011, the Board of Directors of the Company appointed Alexander Korsik as President of the Company. Prior to his appointment, Mr. Korsik has held the position of Senior Vice-President of JSFC Sistema and Head of its Oil and Energy Business Unit.

## APPENDIX 1 MAIN FACTORS OF RISK

At the end of 2009 the Board of Directors of Joint-Stock Oil Company Bashneft (hereinafter 'Bashneft') began installation of an enterprise risk management (ERM) system at the Company, and at its subsidiaries and affiliates. In 2010 the Company's Executive Board set up a Committee on Risk and guiding documents for risk management were approved, which comply with the ERM Integrated Framework, designed by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

Bashneft carries out systematic monitoring of risk events that may arise in the course of everyday business and during implementation of investment projects, and uses various methods for management of risks, which are identified.

Occurrence of any of the risks described below could have adverse effect on business of the Company and, ultimately, on the Company's financial results. Probabilities of the occurrence of risks, and the fact that they are beyond the Company's control, entail that Bashneft cannot fully guarantee that risk management measures will completely exclude such adverse effect. The Company therefore draws the attention of all those who use Bashneft Company accounts as a source of reference that the business of Bashneft includes various circumstances, described below, which may lead to deterioration of its business results. Bashneft will take all possible measures to monitor and prevent occurrence of these events and, in case of their occurrence, will do all it can to ensure that their consequences are eliminated rapidly and with the minimum of damage to the Company.

### SECTOR RISKS

The principal businesses of Bashneft are production of crude oil and natural gas, refining of crude oil, and sales of crude oil and petroleum products.

The Russian economy remained under the influence of the global financial crisis during 2010 and was therefore subject to instability. Rates of economic growth in Russia during 2010 were not substantial: GDP expansion compared with 2009 was 4.0%, including 4.8% in the mineral extraction sector and 13.4% in processing industries.

The situation is not expected to worsen in the medium term, thanks to stabilization of demand for crude oil and petroleum products on domestic and export markets.

#### Risks associated with price changes for crude oil and petroleum products

Prices for crude oil, gas and petroleum products are the main factor determining financial and, indirectly, operational indicators of Bashneft's business. The Company has limited means to control prices for its production, which depend for the most part on the state of the world market, and on the balance of supply and demand in specific regions of Russia. Fall in prices for crude oil, gas or petroleum products may have unfavorable impact on the business results and financial position of Bashneft. Price falls may lead to decline in volumes of crude oil and gas, which the Company can produce profitably, and this in turn will lead to reduction in the volume of Bashneft's hydrocarbon reserves, which can be efficiently developed, and to lower economic efficiency of exploration programs and technical interventions to enhance production levels.

In order to reduce negative impact of the above-mentioned risks, the Company has:

- designed a set of measures to reduce per-unit lifting costs;
- introduced a flexible system for allocation of its outputs, enabling rapid and timely reallocation of goods in case of significant price divergence for crude oil and petroleum products between export and domestic markets;

- put in place a system of flexible business planning, based on a scenario approach for calculation of key business indicators by reference to the level of crude oil prices on world markets. Such an approach reduces expenses, partly through reduction of investment programs or their postponement to future periods.

These measures lower risks to an acceptable level and help the Company to deliver on its commitments.

#### Risks associated with dependence on monopolistic providers of services for transportation of crude oil and petroleum products, and on electricity suppliers, and on their tariffs

Bashneft depends on monopolistic providers of services for transportation of oil and oil products, and has no control over the infrastructure, which they use, and the tariffs, which they charge. OJSC Transneft (hereinafter 'Transneft') is a government monopoly operating oil pipelines. No serious breakdowns of the Transneft pipeline system have occurred to date and Bashneft has not incurred any serious losses due to failure of or leakages from the Transneft system. However, any serious disruption in operation of the Transneft pipeline system or restriction on access to its capacities could interrupt transportation of crude oil, with adverse effect on Bashneft's operating results and financial position.

Bashneft, like other Russian oil producers, is obliged to pay for the transportation services provided by Transneft. The level of tariffs charged by Transneft is regulated by the Federal Tariff Service (hereinafter 'FTS'). Transneft periodically raises the level of tariffs for use of its system, increasing Bashneft's expenses, and this has adverse effect on business results and financial position of the Company.

Similar risks may arise from use of the pipeline system of OJSC Transnefteprodukt (hereinafter 'Transnefteprodukt'). A significant share of Bashneft's petroleum product output is transported via the Transnefteprodukt pipeline system, and any serious interruptions in operation of that system, and periodic increase of charges for use of the system may have adverse effect on the business results and financial position of Bashneft.

The Company also depends on railways for transportation of its petroleum products. OJSC Russian Railways (hereinafter 'RZhD') is a government monopoly providing railway transportation services. Use of railway services exposes Bashneft to risks, such as potential failure of deliveries due to deterioration of Russian railway infrastructure, and to risk of accidents during transportation. Although RZhD tariffs are subject to antimonopoly control, they have traditionally tended to increase. Further tariff increases will entail higher expenses for crude oil and petroleum product transportation, and may have adverse effect on the Company's business results and financial position.

The Company also depends on supplies of electricity, tariffs for which are regulated by the FTS. Growth of power tariffs and interruptions of electricity supply may disrupt Company business, causing interruptions in the production process and detriment to financial results.

Bashneft implements a range of actions to reduce these risks to an acceptable level and to ensure that its business operates smoothly.

### **Competition risks**

#### **Risks associated with access to new mineral resources**

Competition with major Russian and transnational companies for access to new sources of raw hydrocarbons could mean that the Company will not be able to obtain access in the future to new, highly prospective hydrocarbon fields.

This risk could entail reduction in volume of the Company's proved reserves and, as a result, lowering of its capitalization.

#### **Risks associated with access to transport infrastructure**

Bashneft depends on the government transport monopolies, Transneft, Transnefteprodukt and RZhD for transportation of its production. The Company's dependence on government monopolies for transportation of its production may lead to significant adverse consequences.

#### **Risks on the refining market and in marketing of petroleum products**

Competition and regulatory risks on oil refining markets and in marketing of crude oil and petroleum products may cause non-receipt of revenue or growth in expenses of Bashneft, which will ultimately have negative effect on cash flow in the respective business segments.

In order to minimize these risks the Company is working to build new facilities and modernize existing ones in order to achieve greater refining depth and output of high-quality products, which meet Euro-4 and Euro-5 standards for fuels.

#### **Risks associated with geological exploration**

The key strategic task for the Company is quantitative and qualitative expansion of its hydrocarbon resource base in order to achieve a satisfactory level of production, and achievement of this task depends to a significant extent on successful conduct of geological exploration work.

Main risks for Bashneft in conduct of geological exploration work arise from uncertainty and probabilistic evaluations of quantitative and qualitative characteristics of crude oil reservoirs, structure and features of hydrocarbon pools, and production prospects.

It is important to note that geological exploration work is carried out in various geographical regions, including territories with unfavorable climates, which often leads to a risk of cost increases.

Bashneft has considerable experience in conduct of geological exploration and makes use of the most up-to-date geophysical methods for hydrocarbon prospecting and exploration, as well as the latest drilling and field construction technologies, which lowers probability of occurrence of the above-mentioned risks.

#### **Risk of shortage of qualified personnel**

The growing international shortage of technical specialists and rise in the average age of workers in the oil & gas sector are causing foreign companies to consider sourcing personnel from Russia. This increases the risk of high demand for specialists in Russia and growth of wage levels. This could lead to higher payroll expenses and the need for rapid modernization of production in order to reduce the number of personnel required, which could have negative impact on financial results of Company business.

### **COUNTRY AND REGIONAL RISKS**

#### **Country risks**

The political situation in Russia at the present time is stable, and characterized by durability of the executive branch of government at federal and regional levels. Bashneft is a registered tax payer in the city of Ufa, which is one of the principal cities of the Russian Federation, with significant natural resource potential, developed industry (including oil refining and petrochemicals) and a good transport network.

Bashneft has subsidiaries and affiliates in the Urals, Volga and Central Federal Districts of the Russian Federation.

The Company believe that the political situation in the country is stable and does not foresee any risk of negative developments at the present time.

#### **Regional risks**

Most of the Bashneft's production and marketing business is concentrated in the Republic of Bashkortostan, where the economy has strong industrial and agricultural sectors, as well as considerable natural resource wealth of various kinds. The most serious obstacles to socio-economic development in the Republic of Bashkortostan are environmental problems and high risk of industrial accidents in various districts and cities of the Republic, due to extensive presence of environmentally dangerous oil production, oil refining and petrochemical facilities, as well as the fact that a number of oil & gas pipelines pass through the Republic.

Bashkortostan has a 2B rating from Expert RA rating agency, which denotes average potential and moderate risk. The Republic takes 15th place among Russian regions by investment potential. Among the components of investments risk, the economic component is lowest and the environmental component is highest. Greatest potential is in the consumer sector.

### **FINANCIAL RISKS**

Bashneft is rapidly expanding its business, using both internal and loan financing. The Company is subject to risks associated with changes in interest rates, currency exchange rates, and rates of inflation. In order to minimize these risks at present and in each particular situation, company staff at various levels make use of internal mechanisms and reserves for financial risk management.

#### **Currency risks**

More than 50% of Bashneft's gross revenue is generated from export of crude oil and petroleum products. Consequently, fluctuations in exchange rates of currencies against the ruble have impact on the Company's business results, which represents a source of risk.

The Company's currency risk is substantially reduced by existence of expenses that are denominated in foreign currency. The Company makes a large part of its borrowings in US dollars on the international lending market. Current liabilities for servicing of these loans are also denominated in dollars. This revenue and liability structure acts as a hedging mechanism, where factors act in opposite directions and compensate each other. A balanced structure of claims and liabilities in foreign currency minimizes impact of currency risk on the Company's business results. The Company manages risk arising from the share of foreign currency claims and liabilities, which are not balanced, by entering into forward agreements for sale of foreign currency.

### **Interest rate risk**

As a major borrower, Bashneft is exposed to risks associated with changes in interest rates. A small part of the Company's debt portfolio consists of loans denominated in US dollars. Interest rates on some Company loans (their share is not fixed and may vary) is based on the London interbank offered rate (LIBOR), and increase of this rate may lead to rise in the Company's debt-servicing costs. Growth of Bashneft's cost of borrowing may have adverse impact on solvency and liquidity indicators. However, at present the LIBOR rate is relatively low in comparison with historical levels and has a stable medium-term trend. These facts and the low share of Company loans, which are LIBOR-based, mean that Bashneft is not seriously exposed to interest-rate risk.

Bashneft's policy is to maintain a balance between internal and loan financing. Increase of the Company's credit-worthiness and structuring of the credit portfolio between various lenders enables selection of the best interest rates, which helps to lower the cost of borrowing.

### **Inflation risks**

Change in the consumer price index has some impact on the Company's financial position. Inflation risk has particularly large impact on capital expenditures, and may threaten successful implementation of various investment projects.

The Company does its best to limit growth of costs and to evaluate inflation risks when designing investment projects and making investment decisions.

The rate of inflation in 2009 was 8.8% compared with 13.3% in 2008. Inflation in 2010 was also at a level of 8.8% and the Ministry of Economic Development has set a forecast of 7-7.5% for 2011. Current and forecast rates of inflation are well below critical levels for the Company and the sector, so significant impact of inflationary factors on the Company's financial sustainability is unlikely in future periods.

### **LEGAL RISKS**

At the present time there is a risk of tightening of antimonopoly legislation and enforcement with respect to oil companies. The Russian Government has initiated a number of changes to legislation, which substantially simplify the procedure for establishing anti-monopoly violations and provide additional powers to regulatory bodies.

The Russian Government has also recently taken steps to regulate petroleum product pricing on the domestic market proportionately to changes in international prices, and to alter the basis for calculation of export duties that are levied on crude oil and petroleum products.

These actions by Government may lead to reduction of petroleum product margins in Russia, with adverse effect on Company business results.

### **Risks associated with changes to foreign-currency regulation**

Bashneft is an active participant in foreign economic relations. Part of the Company's assets and liabilities are denominated in foreign currency. So the Government mechanism of currency regulation has impact on Company business

Consistent liberalization of Russian currency legislation has created a stable mechanism for Government regulation of currency operations using market instruments and methods. The trend towards liberalization of foreign currency regulation reduces the risk of adverse effects for Bashneft as a result of future changes in such regulation.

Bashneft constantly monitors changes to legislation in respect of currency regulation and control, strictly adheres to established rules and carries out the lawful recommendations of supervisory bodies.

So changes to currency regulation will not entail risks of the Company being held to account for violations.

### **Risks associated with changes to tax legislation**

Bashneft is one of the largest tax payers in Russia, and its relationship with tax authorities is based on principles of good faith and transparency.

The Company is required to pay valued-added tax, income tax, mineral extraction tax, property tax, land tax and other taxes, as provided for by acting tax legislation.

The outcome of tax reform in the Russian Federation has been positive: the system of taxation has been structured, mechanisms and rules for levying of taxes have been simplified, and tax rates have been lowered. Court practice in cases heard by the Russian Constitutional Court has shown that basic provisions of law have impact on the tax rights of business agents and protect tax payers from unjustified and sudden increases of the tax burden. Changes in force since the 2009 tax year include increase of the threshold price per barrel of crude oil, above which mineral extraction tax is payable, from USD 9 to USD 15, increase of the amortization premium for new fixed assets, and shortening of the period for write-down of licence payments to two years. Amortization periods for various types of oil & gas industry equipment and facilities (including oil production wells) have been reduced since 2009, and amortization periods for drilling equipment and some other industry facilities have been reduced since 2010.

These developments show that the Russian tax system is becoming more stable and that tax implications of the business of companies in the Russian Federation is becoming more predictable.

However, possibility of increase of the tax burden levied by Government on tax payers through changes to various aspects of taxation, cancelation of tax privileges, raising of duty rates, etc., cannot be excluded.

In the course of its business, Bashneft carries out timely monitoring of changes to tax legislation, and changes to law-enforcement practice. The Company assesses and forecasts possible adverse impact of changes to tax legislation and makes efforts to minimize any risks arising from such changes. As a result, the management of Bashneft believes that the Company's tax positions are sustainable and will not have substantial impact on the state of its consolidated finances and on business results.

### **Risks associated with changes in customs rules and duties**

Bashneft is involved in foreign economic relations, and is therefore subject to various risks that arise from changes to legislation governing foreign economic relations, and to customs legislation governing procedures for transportation of goods across the customs border, establishment and application of customs regimes, and establishment, introduction and levying of customs charges.

Customs regulation is carried out in accordance with international customs agreements entered into by the Russian Federation, provisions of the Russian Customs Code, the Russian Federal Law on Customs Tariffs and other federal laws regarding Government regulation of foreign economic activity, as well as legal acts, which have been adopted in compliance with those laws.

At the present time, in accordance with the Federal Law № 164 on Principles of Government Regulation of Foreign Trade Activity, crude oil can be exported without quantitative limitations or export licensing.

Quantitative limitations on exports can only be introduced by decision of the Government of the Russian Federation in exceptional cases, established by the afore-mentioned Federal Law.

The trend and character of changes, which have been made to customs legislation during the period of operation of the Russian Customs Code (since January 1, 2004), justifies the conclusion that customs law is among the most stable spheres of legislation in the Russian Federation.

There is a risk that the Government of the Russian Federation may introduce changes to customs duties (both import and export duties) on specific goods, with which Bashneft carries out foreign-trade transactions. In case such a risk occurs, the main adverse consequence would be increase of costs and lowering of the efficiency of exports.

The Company carries out the requirements of customs control and prepares all documentation that is needed for execution of export and import operations in a timely fashion, and has sufficient financial and staff resources to ensure observance of standards and rules in the sphere of customs regulation.



Bashneft constantly monitors changes to acting legislation, assesses the character of such changes and takes account of them in its business, thus ensuring that legal risks associated with changes to rules for customs control and the procedure for making customs payments are kept to a minimum.

**Risks associated with changes to antimonopoly legislation**

Bashneft has a significant share of wholesale markets in the Russian Federation for automotive gasoline, diesel fuel, and fuel oil, so Company business in this sphere is subject to additional requirements designed to protect competition, entailing risks associated with changes to antimonopoly legislation.

Antimonopoly regulation is carried out in accordance with Russian federal laws and legal acts adopted in compliance with these laws.

The principal law governing antimonopoly regulation is the Federal Law on Protection of Competition.

The Company takes all necessary measures in its business selling petroleum products on the domestic market to minimize risks of violation of antimonopoly legislation, constantly monitoring the levels of market prices, and Bashneft is increasing the share of its petroleum product sales, which use the transparent market mechanism of commodity exchanges, and also implementing recommendations of antimonopoly bodies to ensure economically justified price formation for petroleum products.

A working group has been set up inside the Company for cooperation with Government bodies in the sphere of antimonopoly regulation in order to clarify in detail the position of Bashneft with respect to this issue and any risks associated with actions proposed by the Government of the Russian Federation.

**Risks associated with changes to requirements for licensing of core business**

Bashneft carries out its operations at licence areas with due account for Russian laws governing mineral resources, ensuring that licence agreement are kept in compliance with changes to acting legislation.

The acting Russian Federal Law on Mineral Resources is supplemented by a list of permissible grounds for transfer of rights for use of mineral areas and of reissue of licences for use of a mineral area.

The right to use of a mineral area can now be transferred from a parent company to its subsidiary and from a subsidiary to its parent and also between subsidiaries of one and the same parent. The legal entity, to which the usage right is transferred, must satisfy requirements for mineral users that are set out in Russian law.

The above-mentioned changes are generally positive, since provisions have been introduced on transfer of a licence within a group, and this enables Bashneft to optimize its system of licence management.

Bashneft analyzes and assesses law-making initiatives by relevant ministries and government departments in the spheres of mineral resource legislation and licensing of various activities.

Amendments to existing legislation, which have been proposed and are being discussed, will have generally positive effect on the regime for mineral use in the Russian Federation and on conduct of forms of business that are subject to licensing.

Bashneft is confident that it is not subject to legal risks associated with loss of mineral usage rights or violation of existing legislation as a result of the above-mentioned changes.

**Risks associated with changes in court practice on issues associated with Company business**

Bashneft regularly monitors verdicts by higher courts and assesses trends in legal practice at the level of district arbitration courts, applying the results of this monitoring for defense of its rights and lawful interests in courts and for resolution of legal questions that arise in the course of Company business. Risks associated with change in court practice are therefore viewed as negligible.

**Risks associated with inability to extend validity of licenses for particular types of business or for use of objects of licensing, supply of which is limited (including natural resources)**

The licensing regime for geological study, exploration and production of oil & gas is regulated by Russian Federal Law № 2395-1 on Mineral Resources, dated February 21, 1992 with amendments and additions, and also by normative acts passed in compliance with that Law. Bashneft operates on the basis of numerous licenses for geological study, exploration and production of hydrocarbons. Bashneft is also obliged to obtain and extend the validity of other licenses, permits, agreements, and rights to land use and approvals for development of its fields. Bashneft carried out work to secure extension of licences, which represent interest for the Company and which expired in 2010. In view of company practice of observing the conditions of licence agreements, monitoring such agreements, and taking actions to keep licences up to date, Bashneft views risks of early termination of its mineral usage rights as minimal.

However, any suspension, restriction or termination of Bashneft's licenses could have adverse effect on the Company's business results and its financial position.

**PRODUCTION RISKS**

**Environmental risks**

In its environmental policy Bashneft strives to ensure compliance with the requirements of existing environmental legislation by investing substantial amounts of money in measures to protect the environment, including use of technologies, which minimize adverse environmental impacts.

Probability of the occurrence of risks involving pollution of the environment have been significantly reduced as a result of these activities.

**Risks of accidents in the process of crude oil production, refining of hydrocarbons and marketing of petroleum products**

Bashneft carries out its production operations using complex technical equipment. Occurrence of risks of malfunctioning of production equipment could lead to production stoppages and failure to achieve operating and financial targets, which were set earlier.

Bashneft employs an integrated system of insurance, covering property liability, etc., in order to minimize the consequences of such risks. The Company views this system as a key mechanism for its stable strategic development in the long term, affording protection from uncompensated financial losses as a result of accidents and other extraordinary situations that may arise in the course of production.

Bashneft's insurance arrangements are based on unified principles and methodology for organization of the insurance process, and have an integrated character. The arrangements include a system for monitoring of insurance risks, insurance contracts and quality of insurance protection, based on a list of requirements and criteria for assessment of the quality (reliability) of specific insurance companies and the services, which they offer. During 2010 the specialized international company Crawford (through RusSurvey) carried out a technical survey of engineering risks at Bashneft and its subsidiaries and affiliates, as a result of which it was established that risks of destruction of Company property are not higher overall than the average level for enterprises in the international oil production, refining and petrochemical industries.

Steps taken for management of the above-mentioned risks have provided Bashneft with high-quality insurance protection, enabling full and efficient protection of the rights and property interests of Company shareholders with respect to safe-keeping of property and avoidance of uncompensated losses due to accidents in the course of production. The Company also has a system of industrial safety, which ensures constant monitoring of the state of technical facilities, conducts a program of equipment renewal, and carries out preventative measures to avoid production accidents and to achieve further reduction in levels of risk.

**Risk of non-fulfilment of targets for production of crude oil, oil refining, and marketing of petroleum products**

Company business includes an inherent risk of non-fulfilment of production targets due to various circumstances relating to productive, economic and administrative factors.

Bashneft takes account of such risk and makes efforts to reduce it to a minimum, planning its business in a way that prevents substantial impact of this risk on key efficiency indicators of the Company.

**Construction risks**

The Company is subject to a risk of late commissioning of production facilities when implementing investment projects for development of oil fields, modernization of refinery capacities, construction of filling stations, etc. Principal factors with impact on this type of risk are planning errors, actions by sub-contractors, and risks that arise from the state of infrastructure.

Bashneft does all it can to manage such risk by careful preparation of projects, selection of the most reliable partners and sub-contractors, and by obtaining guarantees of fulfilment of obligations by such partners and sub-contractors, as well as by developing partnership relations with infrastructure operators (Government monopolies and executive Government in administrative regions of the Russian Federation).

**APPENDIX 2**  
**SHORT BIOGRAPHIES OF MEMBERS**  
**OF THE BOARD OF DIRECTORS**  
**AND EXECUTIVE BOARD OF BASHNEFT**

**Short biographies of members of the Board of Directors and their shares in Charter Capital of Bashneft (as of 31.12.2010)**

<b>Alexander Yurievich GONCHARUK</b> Chairman of the Board of Directors of Bashneft	Born in 1956. Graduated in 1978 from the Sevastopol Higher Naval Engineering Institute and in 1987 from the A.A. Grechko Naval Academy. 07.2003-11.2005 — General Director of Scientific Center Concern. 11.2005-02.2006 — General Director of Sitronics Concern. 02.2006-05.2008 — President of Sistema Corporation. 05.2008-08.2009 — First Deputy Chairman of the Board of Directors of Sistema Corporation. 09.2009-present — Managing Director of Bashneft. Member of the Board of Directors of Sistema Corporation, Chairman of the Board of Directors of Polief. Does not own shares in the Company.
<b>Anton Vladimirovich ABUGOV</b> Member of the Board of Directors of Bashneft	Born in 1976. Graduated in 1998 from the Economics Academy of the Government of the Russian Federation; completed post-graduate studies at the Moscow State Forestry Institute in 2003. 09.2003-08.2006 — Managing Director, Head of the Corporate Finance Section of the Investment Banking Department at Rosbank. 08.2006-present — First Vice-President, Head of the Strategy and Development Division of Sistema Corporation. Member of the Boards of Directors of MTS, SkyLink, Bashkirenergo, and Russneft Oil Company. Member of the Executive Board of Sistema Corporation. Does not own shares in the Company.
<b>Ruslan Fedorovich ALMAKAEV</b> Member of the Board of Directors of Bashneft	Born in 1963. Graduated in 1994 from Kharkov State Pedagogical Institute and in 2003 from Krasnodar State University. 06.2003-03.2004 — General Director of Sistemny Project. 04.2004-08.2004 — Vice-President of Sistema Corporation for Regional Relations. 08.2004-04.2005 — Vice-President of Sistema Corporation for Regional and Venture Projects. 04.2005-present — Vice-President of Sistema Corporation, Head of the Administrative Division. Chairman of the Boards of Directors of NTR Region and AB-Safeti LLC, Member of the Executive Board of Sistema Corporation. Does not own shares in the Company.
<b>Alexei Nikolayevich BUYANOV</b> Member of the Board of Directors of Bashneft	Born in 1969. Graduated in 1992 from the Moscow Institute of Physics and Technology. 09.2002-04.2005 — First Vice-President of Sistema Corporation, Head of the Financial and Investment Division. 04.2005-present — Senior Vice-President of Sistema Corporation, Head of the Financial and Investment Division. Chairman of the Board of Directors of the Moscow Stock Exchange, Deputy Chairman of the Board of Directors of MTS. Member of the Board of Directors of MBRR Commercial Bank, Intourist, ECU GEST HOLDING S.A. Member of the Executive Board of Sistema Corporation. Director of SISTEMA FINANCE S.A. and Sistema Holdings Ltd. Does not own shares in the Company.
<b>Anna GOLDIN</b> Member of the Board of Directors of Bashneft	Born in 1963. Graduated from the University of California (Berkeley) Boalt Hall. 1999-2007 — Partner, Managing Partner of Latham&Watkins. 2007-present — Vice-President of Sistema Corporation for Legal Issues, Head of the Legal Division. Member of the Executive Board of Sistema Corporation. Does not own shares in the Company.
<b>Sergei Alexeyevich DROZDOV</b> Member of the Board of Directors of Bashneft	Born in 1970. Graduated in 1993 from the Ordzhonikidze State Academy of Management. Candidate of Economic Sciences. 09.2002-03.2005 — First Vice-President of Sistema Corporation, Head of the Property Division. 04.2005-present — Senior Vice-President of Sistema Corporation, Head of the Property Division. Chairman of the Board of Directors of Reestr, member of the Boards of Directors of Sistema-Hals, MTS, SMM, NTR Region, Premier-Avia, AB-Safeti LLC, Moscow Stock Exchange, Russneft Oil Company, and ZETA GmbH. Member of the Executive Board of Sistema Corporation. Does not own shares in the Company.

**APPENDIX 2  
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**Short biographies of members of the Board of Directors  
and their shares in Charter Capital of Bashneft (as of 31.12.2010)**

<b>Alexander Leonidovich KORSIK</b> Member of the Board of Directors of Bashneft	Born in 1956. Graduated in 1979 from the Bauman Higher Technical Institute (Moscow). 1999-12.2005 — First Vice-President of Siberian Oil Company. 01.2006-09.2006 — Managing Director of Renaissance Capital Financial Consultant LLC. 10.2006-08.2007 — Executive Director of ITERA Oil & Gas Company LLC. 05.2009-present — Senior Vice-President of Sistema Corporation, Head of the Fuel & Energy Business Unit. Member of the Board of Directors of Bashkirenergo, member of the Executive Board of Sistema Corporation. Does not own shares in the Company.
<b>Igor Valentinovich MARCHENKO</b> Member of the Board of Directors of Bashneft	Born in 1968. Graduated in 1994 from the Moscow State Institute of Radio Technology, Electronics and Automation, and in 1998 from the Higher School of International Business of the Economics Academy of the Government of the Russian Federation. 02.1997-02.2006 — Head of the Strategic Development Department of Sibneft. 02.2006-10.2006 — Director for Financial Consulting of the Financial Consulting Department of Renaissance Capital Financial Consultant LLC. 11.2006-11.2007 — Development Director of ITERA Oil Company LLC. 11.2007-07.2009 — Vice-President for Development of Russneft Oil Company. 07.2009-present — Executive Vice-President of Sistema Corporation, Director of the Strategy Department of the Fuel & Energy Business Unit. Does not own shares in the Company.
<b>Leonid Adolfovich MELAMED</b> Member of the Board of Directors of Bashneft	Born in 1967. Graduated in 1992 from the Sechenov Moscow Medical Academy and in 2006 from the Moscow Medical Academy, Doctor of Medical Science. 09.2003-04.2006 — General Director of ROSNO. 04.2006-05.2008 — President of MTS. 05.2008-present — President of Sistema Corporation. Member of the Board of Directors, Chairman of the Executive Board of Sistema Corporation. Chairman of the Board of Directors of Russneft Oil Company. Member of the collegiate executive body of InternationalCellHoldingLtd. Does not own shares in the Company.
<b>Yury Leonidovich PUSTOVGAROV</b> Member of the Board of Directors of Bashneft	Born in 1964. Graduated in 1986 from Magnitogorsk Mining Institute. 06.1993-03.2006 — Head of Foundry, then successively Head of the Planning and Economics Department, Deputy General Director for Economics, for Marketing, Technical Director, and General Director of the Ufa Engine Plant 03.2006-11.2006 — Deputy Premier and Minister for Economic Development and Industry of the Government of the Republic of Bashkortostan. 12.2006-03.2009 — Deputy Premier and Minister for Industry, Investment and Innovation Policy of the Government of the Republic of Bashkortostan. 03.2009-08.2010 — Deputy Premier and Minister for Industry and External Economic Relations of the Government of the Republic of Bashkortostan. 08.2010-present — Deputy Premier of the Government of the Republic of Bashkortostan. Member of the Boards of Directors of the companies Bashkirsky Tractor, Premium, Soda, Ufa Engine Plant, and Bashkirskaya Venture Company. Does not own shares in the Company.
<b>Murtaza Gubaidullovich RAKHIMOV</b> Member of the Board of Directors of Bashneft	Born in 1934. Graduated from Ufa State Oil Institute. 12.1993-07.2010 — President of the Republic of Bashkortostan. Does not own shares in the Company.
<b>Viktor Gennadievich KHOROSHAVTSEV</b> Member of the Board of Directors of Bashneft, Chairman of the Executive Board of Bashneft	Born in 1953. Graduated in 1976 from Izhevsk Mechanical Institute. 05.2003-01.2009 — Member of the Council of the Federation of the Federal Assembly of the Russian Federation. 01.2009-09.2009 — General Director of Sistema-Invest. 09.2009-01.2010 — General Director of Bashneft. 02.2010-present — President of Bashneft. Chairman of the Boards of Directors of Novoil, Ufa Oil Refinery, Ufaneftekhim, Ufaorgsintez, Bashkirnefteprodukt, and Bashneft-Dobycha LLC. Does not own shares in the Company.
<b>David Mikhailovich YAKOBASHVILI</b> Member of the Board of Directors of Bashneft	Born in 1957. Graduated from the Polytechnical Institute of Georgia (Tbilisi). 2001-07.2010 — Chairman of the Board of Directors of Wimm-Bill-Dann Food Products. 07.2010-present — Advisor to the Chairman of the Executive Board of Wimm-Bill-Dann Food Products. Chairman of the Boards of Directors of Wimm-Bill-Dann, Milling Combine №4, and Metelitsa Club LLC. Chairman of the Supervisory Board of Wimm-Bill-Dann Ukraine. Member of the Boards of Directors of Gorki-2 Agrocomplex and Kolmogorovskaya Pit LLC. Does not own shares in the Company.

**Short biographies of members of the Executive Board  
and their shares in Charter Capital of Bashneft (as of 31.12.2010)**

<b>Viktor Gennadievich KHOROSHAVTSEV</b> Chairman of the Executive Board of Bashneft	Born in 1953. Graduated in 1976 from Izhevsk Mechanical Institute. 05.2003-01.2009 — Member of the Council of the Federation of the Federal Assembly of the Russian Federation. 01.2009-09.2009 — General Director of Sistema-Invest. 09.2009-01.2010 — General Director of Bashneft. 02.2010-present — President of Bashneft. Chairman of the Boards of Directors of Novoil, Ufa Oil Refinery, Ufaneftekhim, Ufaorgsintez, Bashkirnefteprodukt, and Bashneft-Dobycha LLC. Does not own shares in the Company.
<b>Kirill Igorievich ANDREICHENKO</b> Member of the Executive Board	Born in 1975. Graduated in 1997 from Moscow State Industrial University. 2005-2006 — Director of the Legal Department of Sistema Telecom. 2005-2009 — General Director of United Telesystems (concurrently with the above post). 2006-2007 — Deputy General Manager for Corporate Management of Sistema Telecom. 2007-2008 — Director for Corporate Management and Legal Issues of COMSTAR-OTS. 2008-2009 — Vice-President for Corporate Management and Legal Issues of COMSTAR-OTS. 2009-present — Vice-President for Corporate Management and Legal Issues of Bashneft. Members of the Boards of Directors of Bashneft-Dobycha LLC, Belkamneft, ASPEC, Bashneft-Trans LLC, Bashneft-Polyus LLC, and Bashneft-Service Assets LLC. Does not own shares in the Company.
<b>Viktor Alexandrovich GANTSEV</b> Member of the Executive Board	Born in 1957. Graduated in 1986 from Ufa Oil Institute . 2006-2009 — General Director of Ufaneftekhim. 2009-2009 — First Deputy General Director of Sistema-Invest for Oil Refining and Petrochemicals. 2009-present — Senior Vice-President of Bashneft for Oil Refining and Petrochemicals. Member of the Board of Directors of Ufaneftekhim. Does not own shares in the Company.
<b>Ruslan Nedimovich GENSH</b> Member of the Executive Board	Born in 1965. Graduated in 1987 from the Moscow Mining Institute. 2005-2008 — Head of Organization of Lukoil-Personnel LLC. 2008-2009 — First Deputy General Director for Marketing of Lukoil-Resource LLC. 2009-2009 — First Deputy General Director of Lukoil-Reservenefteprodukt LLC. 2009-2009 — Executive Vice-President of Sistema-Invest, Head of the Export Project Office. 2009-present — Vice-President of Bashneft for Export. Does not own shares in the Company.
<b>DASHEVSKY Alexander Vladimirovich</b> Member of the Executive Board	Born in 1968. Graduated in 1990 from Grozny Oil Institute and in 2003 from Gubkin State Oil & Gas University. 2005-2008 — Director of the Department of Strategic Planning and Preparation of Investment Projects, Director of the Oil & Gas Department of Rosneft. 2008-2009 — General Director of Vankorneft. 2010-present — Senior Vice-President of Bashneft for Oil & Gas Dobycha. Member of the Boards of Directors of Bashneft-Dobycha LLC, Bashneft-Polyus LLC, BashNIPIneft LLC, and Bashneft-Burenie LLC. Does not own shares in the Company.
<b>Elvira Rifovna KAMALOVA</b> Member of the Executive Board	Born in 1966. Graduated in 1989 from Bashkiria State Medical Institute, MBA. 2005-2007 — Executive Director of Premium-ART LLC. 2007-2008 — Deputy General Director of Sistema Invest for External Relations. 2008-2009 — Deputy General Director of Sistema Invest for Corporate Communications. 2009-present — Vice-President of Bashneft for Corporate Communications. Does not own shares in the Company.
<b>Igor Olegovich KALYUZHNY</b> Member of the Executive Board	Born in 1966. Graduated in 1995 from Moscow State University. 2005-2007 — Director of the IT Infrastructure Development Section at the Corporate Center of MTS. 2007-2009 — Director of the IT Operating Control Department at the Corporate Center of MTS. 2009-2009 — Deputy General Director of Sistema-Invest for Information Technologies. 2009-present — Vice-President of Bashneft for Information Technologies. Does not own shares in the Company.
<b>Alexei Valerievich KURACH</b> Member of the Executive Board	Born in 1980. Graduated in 2003 from Loughborough University. 2005-2006 — Head of the Investor Relations Department of Sistema Corporation. 2006-2009 — Deputy General Director of Detsky Mir Center. 2009-2009 — Deputy General Director of Sistema-Invest for Economics and Finance. 2009-present — Vice-President of Bashneft for Economics and Finance, Financial Director. Member of the Boards of Directors of Bashneft-Dobycha LLC, Bashneft-Trans LLC, Bashneft-Polyus LLC, ASPEC, Bashneft-Service Assets LLC. Does not own shares in the Company.

**APPENDIX 2  
SHORT BIOGRAPHIES OF MEMBERS  
OF THE BOARD OF DIRECTORS  
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**Short biographies of members of the Executive Board  
and their shares in Charter Capital of Bashneft (as of 31.12.2010)**

<b>Valeriy Rafgatovich NURGUTDINOV</b> Member of the Executive Board	Born in 1969. Graduated in 1994 from Ufa Aviation Institute and in 2001 from Bashkiria Presidential State Academy for Civil Service and Management. 1999-2008 — Head of the Department for Financial and Economic Analysis, Head of Personnel of Bashkirenergo. 2008-2009 — First Deputy General Director for Economics of BashUral EnergoStroy. 2009-2009 — Director of the Administrative and Social Department of Sistema-Invest. 2009-present — Director of the Administrative and Social Department of Bashneft. Does not own shares in the Company.
<b>Oleg Yurievich SIDOMONIDZE</b> Member of the Executive Board	Born in 1960. Graduated in 1983 from Moscow State Pedagogical Institute of Foreign Languages, in 2001 from Belarus State University, and in 2005 from The Open University. 2005-2007 — Personnel Director of Schlumberger Logelco Inc. (Panama), Project Manager. 2007-2007 — Personnel Manager at the Representative Office of Shell Exploration and Dobycha Services (RF) B.V. 2007-2008 — Head of Personnel of Gazprom Neft. 2008-2009 — Deputy Director for Organizational Issues of Gazprom Neft Trading GmbH LLC (Austria). 2009-2009 — Director of the Personnel Department of Sistema-Invest. 2009-present — Director of the Personnel Department of Bashneft. Member of the Boards of Directors of Bashneft-Polyus LLC and Bashneft-Burenie LLC. Does not own shares in the Company.
<b>Dmitry Stanislavovich PANKRATOV</b> Member of the Executive Board	Born in 1967. Graduated in 1991 from Timiryazev Agricultural Academy (Moscow). 2004-2006 — Executive Director of Prodo Management LLC. 2006-2006 — Executive Director of Cherkizovo Group. 2007-2008 — Executive Director of ASPEC Management Company LLC. 2008-2009 — General Director of ASPEC-Lesprom. 2009-2009 — Director of the Wholesale Department of Sistema-Invest. 2009-present — Vice-President of Bashneft for Petroleum Product Sales and Raw Material Procurement. Does not own shares in the Company.
<b>Ali Mussayevich UZDENOV</b> Member of the Executive Board	Born in 1962. Graduated in 1985 from Rostov Railway Engineering Institute. 2001-2007 — Chairman of the Board of Directors of Kormmash. 2007-2009 — General Director of Rostovregiongaz LLC, Rostovoblgaz, Rostovgorgaz, Novocherkasskgorgaz. 2009-present — Senior Vice-President of Bashneft for Marketing. Member of the Boards of Directors of ASPEC, Bashneft-Trans LLC and Bashneft-Dobycha LLC. Does not own shares in the Company.
<b>Roman Anatolievich KHOMENKO</b> Member of the Executive Board	Born in 1967. Graduated in 1991 from Moscow State Pedagogical University, MBA. 2001-2006 — Executive Vice-President of YUKOS Refining and Marketing, Executive Vice-President for Retail, Vice-President for Retail. 2008-2008 — General Director of Arbat Prestige. 2009-2009 — Deputy General Director of Sistema Invest for Marketing. 2009-present — Vice-President of Bashneft for Retail Sales and Logistics. Member of the Board of Directors of Bashneft-Trans LLC. Does not own shares in the Company.

**APPENDIX 3  
OBSERVANCE OF THE CODE  
OF CORPORATE CONDUCT**

No	Provision of the Code of Corporate Conduct	Observed / Not observed	Notes
<b>GENERAL MEETING OF SHAREHOLDERS</b>			
1.	Shareholders are notified about any general meeting of shareholders at least 30 days before it is held, unless legislation permits a longer notification period	Observed	This provision is included in the Company Charter
2.	The procedure for giving notification of holding of a general meeting of shareholders must give shareholders the opportunity to make appropriate preparations for participation in the meeting	Observed	Notification of the meeting is sent by post and published in the newspapers, Republic of Bashkortostan and Bashkortostan
3.	Shareholders included in the list of shareholders and controlling no less than 1 percent of votes should have the right to acquaint themselves with the list of persons who have the right to take part in a general meeting of shareholders	Observed	Shareholders have the right to acquaint themselves with the list of persons, who have the right to take part in a general meeting of shareholders. This right is envisaged by the Statute on the General Meeting of Shareholders.
4.	Shareholders should have the opportunity to acquaint themselves with information (materials), which are required to be provided in preparation for holding of a general meeting of shareholders.	Observed	Shareholders have the right to acquaint themselves with information (materials), that has to be provided in preparation for a General Meeting of Shareholders at the premises of the Company's executive body at addresses, which are indicated in the meeting notification, and shareholders also have the right to obtain copies of all materials at these addresses.
5.	A shareholder can place a question on the agenda of a general meeting of shareholders or request convocation of a general meeting of shareholders without providing an extract from the register of shareholders if his right to shares is accounted via the register, and, if his right to shares is via a depo account, he can exercise the above-mentioned rights after presenting an extract from his depo account.	Observed	There is no requirement to confirm rights in document form other than by an extract from a depo account. This is envisaged by the Statute on the General Meeting of Shareholders of Bashneft (approved by the General Meeting of Shareholders of Bashneft, Minutes № 23, dated 29.06.2010)
6.	Internal documents of the company should set out the procedure for registration of participants of the general meeting of shareholders	Observed	Regulated by the Statute on the General Meeting of Shareholders
<b>WORK BY THE BOARD OF DIRECTORS</b>			
1.	The charter of the company should ensure the right of the BoD to carry out annual approval of the company's financial and business plan.	Observed	Competence of the Board of Directors in accordance with the Company Charter includes: 'Definition of Company business priorities and development strategy, approval of the Company's annual budgets (financial plans), and review of business and strategic development of subsidiaries.'
2.	The charter should allow the BoD to decide requirements for qualifications and level of remuneration of the CEO and heads of main sub-divisions of the company.	Observed	Competence of the Board of Directors includes the following issues: appointment of the Company President; defining the number of members of the Executive Board and election of its members; approval of the conditions of contracts with the President and members of the Executive Board; early termination of the authorities of the Company President and members of the Executive Board; approval of principles for evaluation of performance of senior managers who are directly subordinate to the Company President, as well as the system for their remuneration and monitoring of their performance.

**APPENDIX 3  
OBSERVANCE OF THE CODE  
OF CORPORATE CONDUCT**

No	Provision of the Code of Corporate Conduct	Observed / Not observed	Notes
3.	The charter should allow the BoD to approve the conditions of contracts with the CEO and executive board members.	Observed	In accordance with the Company Charter, terms of contracts with the President and members of the Executive Board of the Company are approved by the Board of Directors
4.	The BoD should not include any person who has been judged guilty of economic crimes or crimes against government authority, government services or local government services, or has been subject to administrative sanctions for violations in the entrepreneurial, financial, fiscal or securities market sectors.	Observed	The Company has made efforts to investigate this issue and does not have any information of any such violations by members of the Board of Directors
5.	The BoD of the company should not include any person who is a stakeholder, CEO (manager), member of a management body or employee of any legal entity, which is in competition with the company.	Observed	
6.	Internal documents should require holding of BoD meetings at least once every six weeks.	Observed	The Statute on the Board of Directors states that its meetings should as a rule be held at least once a month. A total of 24 meetings of the Board of Directors were held during the reporting period
7.	BoD meetings in the year, for which the annual report is prepared, should be held at least once every six weeks.	Observed	24 meetings of the Board of Directors were held during the reporting period
8.	Internal documents should set out the procedure for conduct of BoD meetings.	Observed	The procedure for conduct of meetings of the Board of Directors is set out in the Rules for Work by the Board of Directors of Bashneft
9.	Internal documents should allow BoD members to obtain information, which is necessary for carrying out their functions in the BoD, from executive bodies and heads of main structural sub-divisions of the company	Observed	Provided for in the Statute on the Board of Directors. Information provision is ensured by participation in Board meetings by vice-presidents and other Company officials.
10.	The company should have a BoD committee on strategic planning	Observed	A Strategy Committee of the Board of Directors has been set up at the Company.
11.	The company should have a BoD committee (the audit committee), which recommends an auditor for the company to the BoD and collaborates with the auditor and the company audit commission.	Observed	A Budget and Audit Committee of the Board of Directors has been set up at the Company
12.	The company should have a BoD committee (the personnel and remunerations committee), whose function is to define criteria for choice of BoD candidates and to design company remuneration policy.	Observed	An Appointments and Remuneration Committee of the Board of Directors has been set up at the Company. Functions of the Committee are defined in the Statute on the Appointments and Remuneration Committee.
13.	The personnel and remunerations committee should be headed by an independent director.	Not observed	
14.	The company should have internal documents, approved by the BoD, which regulate the procedure for formation and operation of BoD committees.	Observed	The Company has approved a Regulation on the Board of Directors, defining the competence of Board committees, procedure for their creation, and their activity.
15.	The company charter should define a BoD quorum in such a way that participation of independent directors in BoD meetings is essential.	Not observed	A quorum of the Board of Directors is defined according to the number of members of the Board participating in a meeting, regardless of their status as independent or non-executive.

No	Provision of the Code of Corporate Conduct	Observed / Not observed	Notes
16.	Internal documents of the issuer should contain requirements for members of the Board of Directors, members of the collegiate executive body, and the person exercising the function of one-person executive body, including any management organization and its officials, to disclose information about their ownership of securities of the issuer, and about sales and (or) purchase of securities of the issuer.	Observed	This requirements is reflected in the Statute on the Board of Directors, Statute on the Executive Board and Statute on the President.
<b>EXECUTIVE BODIES</b>			
1.	The company should have a collegiate executive body (board).	Observed	The Company has a collegiate executive body: the Executive Board of the Company.
2.	Executive bodies should not include any person who is a stakeholder, CEO (manager), member of an executive body or worker of an legal entity, which is in competition with the company.	Observed	
3.	Executive bodies should not include any person who has been judged guilty of economic crimes or crimes against government authority, government services or local government services, or has been subject to administrative sanctions for violations in the entrepreneurial, financial, fiscal or securities market sectors.	Observed	
4.	The Charter or internal documents should forbid any managing organization or manager to carry out analogous functions for a competing company or to be in any ownership relationship with the company apart from provision of the services of managing organization (manager).	Observed	Provided for by the Company Charter
5.	Internal documents should require executive bodies to refrain from any actions, which will or might lead to a conflict between their own interests and interests of the company and, if such a conflict arises, they should be required to disclose the conflict to the BoD.	Observed	Such requirements are contained in Regulations on the Board of Directors, on the Executive Board and on the President of the Company
6.	Executive bodies should submit monthly reports on their work to the company BoD.	Observed	The Board of Directors reviews financial results each quarter.
7.	Internal documents of the issuer should contain requirements for members of the Board of Directors, members of the collegiate executive body, and the person exercising the function of one-person executive body, including any management organization and its officials, to disclose information about their ownership of securities of the issuer, and about sales and (or) purchase of securities of the issuer.	Observed	This requirement is currently reflected in the Statute on the Board of Directors. For executive bodies this requirements is reflected in the Statute on the President and the Statute on the Executive Board.
8.	Contracts between the company and the CEO (managing organization, manager) and executive bodies should assign responsibility for violation of regulations on use of confidential or official information	Observed	The requirement for observance of confidentiality is contained in contracts with the President and members of the Executive Board.

**APPENDIX 3  
OBSERVANCE OF THE CODE  
OF CORPORATE CONDUCT**

No	Provision of the Code of Corporate Conduct	Observed / Not observed	Notes
<b>CORPORATE SECRETARY</b>			
1.	The company should have a special officer (the corporate secretary), whose function is to ensure observation by company bodies and officers of procedural requirements that guarantee implementation of rights and lawful interests of company shareholders.	Observed	The Company has appointed a Corporate Secretary.
2.	The charter or internal documents should specify a procedure for nominating (electing) the corporate secretary and the responsibilities of the corporate secretary.	Observed	Provided for by the Company Charter, the Statute on the Board of Directors, and the Statute on the Corporate Secretary.
3.	The Charter should specify criteria for candidates to serve as corporate secretary.	Observed in part	These requirements are contained in the Statute on the Board of Directors, and the Statute on the Corporate Secretary.
<b>SUBSTANTIAL CORPORATE ACTIONS</b>			
1.	The Charter or internal documents should include requirements for approval of major transactions prior to their implementation	Observed in part	This rule is not contained in the Company Charter, but is observed in practice.
2.	An independent appraiser should be engaged for appraisal of market value of property, which is the object of a major transaction.	Observed	
3.	The charter should forbid any actions by the company's executive bodies (members of executive bodies) or BoD members, which are intended to protect their own interests or which tend to worsen the situation of shareholders when large share stakes in the company are being acquired (takeover). In particular the charter should forbid any decision by the BoD on additional share issue, issue of securities convertible into shares or securities offering the right to purchase company shares until the period of acquisition of the large stake has expired, even if such a decision is the right of the BoD in accordance with the Charter.	Not observed	Such actions are improbable, since the Company has a controlling shareholder.
4.	The charter should not release the buyer in a takeover from the obligation to offer to buy common shares (securities convertible into common shares) from other shareholders.	Observed	
<b>INFORMATION DISCLOSURE</b>			
1.	The company should have an internal document approved by the BoD defining rules and approaches to information disclosure (statute on information policy).	Not observed	
2.	Internal documents should provide a full list of information, documents and materials, which must be supplied to shareholders for resolution of issues raised at general meetings of shareholders	Observed	A list of additionally provided information is given in the Statute on the General Meeting of Shareholders.
3.	Disclosure of financial information about company business	Observed	Financial reporting to Russian Accounting Standards is provided annually. Financial reporting to International Accounting Standards is provided quarterly.
4.	Use of additional forms and means of information disclosure.	Observed	

No	Provision of the Code of Corporate Conduct	Observed / Not observed	Notes
5.	The issuer should provide information on the amount of remuneration received by members of the BoD, members of collegiate executive bodies, and by the person exercising the function of one-person executive body, including any managing organization and manager.	Observed	Such information is disclosed in the annual report, quarterly issuer's report and securities issue prospectus.
6.	The company should have a corporate web site in the Internet and should regularly disclose company information on that web site.	Observed	Internet address: <a href="http://www.bn-rb.ru/">http://www.bn-rb.ru/</a>
7.	Internal documents should require disclosure of information about company transactions with persons whom the company charter categorizes as senior company officials, and also about company transactions with organizations, in which senior officials of the company directly or indirectly own 20 or more percent of share capital or over which such officials can exert significant influence by other means.	Observed in part	Observed in compliance with requirements of law regarding related-party transactions.
8.	Internal documents should require disclosure of information about all transactions, which can have serious impact on market value of company shares.	Observed in part	Observed in compliance with requirements of the Russian Federal Service for Financial Markets concerning information disclosure.
14.	The company should have an internal document, approved by the BoD, setting out rules for use of material information on company business, its shares and other securities and transactions with them in cases where such information is not generally available and where its disclosure may have significant impact on market value of shares and other securities of the company.	Not observed	
<b>SUPERVISION OF FINANCIAL AND BUSINESS OPERATIONS</b>			
1.	The company should have procedures, approved by the BoD, for internal control of its financial and business operations.	Observed	The Company has approved a Statute on Internal Audit, a Statute on the Department of Internal Control and Audit, and Rules for organization and conduct of audit procedures.
2.	The company should have a special sub-division for supervising internal control procedures (a control and audit service).	Observed	A Department of Internal Control and Audit operates at the Company
3.	The control and audit service should not include any person who has been judged guilty of economic crimes or crimes against government authority, government services or local government services, or has been subject to administrative sanctions for violations in the entrepreneurial, financial, fiscal or securities market sectors.	Observed	Personal data and information about candidates to posts in the Department of Internal Control is checked, subject to preliminary written agreements by the candidates, before they are admitted to the post.
4.	The control and audit service should not include any person who is a member of other executive bodies of the company or who is a stakeholder, CEO (manager), member of a management body or worker of any legal entity, which is in competition with the company.	Observed	

**APPENDIX 3  
OBSERVANCE OF THE CODE  
OF CORPORATE CONDUCT**

No	Provision of the Code of Corporate Conduct	Observed / Not observed	Notes
5.	Internal documents should oblige the control and audit commission to inform the BoD audit committee of any violations, which are discovered, or to inform the BoD directly in case the company does not have an audit committee.	Observed	In accordance with the Statute on the Budget and Audit Committee, the Department reports to the Budget and Audit Committee on the results of its audits.
6.	The charter should require prior assessment by the control and audit commission of the advisability of carrying out any operations, which were not envisaged by the company's financial and business plan (non-standard operations).	Observed in part	This function is exercised by the Company's financial service.
7.	The BoD audit committee should give an assessment of the auditor's report prior to its presentation to shareholders at the general meeting of shareholders.	Observed	In compliance with the Statute on the Budget and Audit Committee.

**DIVIDENDS**

1.	The company should have an internal document, approved by the BoD, which the BoD uses for guidance when making decisions on dividend recommendations (statute on dividend policy).	Not observed	
2.	Company dividend policy and amendments to that policy should be published in a periodical publication, which is indicated by the company charter as the place for announcement of shareholder meetings, and should also be placed on the company's web site in the Internet.	Not observed	

**APPENDIX 4  
GENERAL INFORMATION  
ABOUT BASHNEFT**

Date of registration of JSOC Bashneft and registration number:

- Date of state registration of the Company as a legal entity: January 13, 1995;
- Number of act of state registration: 60;
- Date when an entry was made in the Unified State Register of Legal Persons as a legal person, registered before July 1, 2002: October 15, 2002.
- Series and number of certificate of making of an entry in the Unified State Register of Legal Persons as a legal person, registered before July 1, 2002: Series 02, № 004176539
- Main state registration number, under which an entry was made in the Unified State Register of Legal Persons regarding creation of the Company: 1020202555240

Main types of activity of the Company:

- production of crude oil and natural gas, providing services in these spheres;
- production of oil (secondary) gas and gas condensate;
- production and enrichment of manganese ores;
- production of turf and other minerals;
- production of oil refining, petrochemical and chemical outputs;
- refining of oil and natural gas, production and sale of petroleum products;
- trading and procurement (including through creation of the Company's own trading outlets) of products (including crude oil, refined products and petrochemicals), vehicles, other means of transport, and also spare parts and components;
- organization, maintenance and operation of filling stations and gas filling stations.

# CONTACT INFORMATION

**FULL NAME OF THE COMPANY:**

Joint-Stock Oil Company Bashneft

**SHORT NAME:**

Bashneft

**LOCATION:**

30 Karl Marx Street, Ufa,  
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**INFORMATION SERVICE****FOR SHAREHOLDERS:**

Department of Corporate Relations

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**Company registrar:**

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**Company web-site:**

[www.bashneft.ru](http://www.bashneft.ru)



