

## 6. Tatneft: Genghis can

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Tatneft, the oil company of the Republic of Tatarstan, is the fifth-largest Russian oil company in terms of crude oil production (after Rosneft, LUKOIL, Gazprom Neft and Surgutneftegas). It is also the only major Russian oil company with an ethnic identity. The Tatars are a distinctive Turkic-speaking, predominantly Muslim people who make up 53% of the population of Tatarstan. The republic was once seen as one of the more independently minded subjects of the Russian Federation, and this is reflected in the way Tatneft operates. Tatneft struggles valiantly with its depleting resource base and has been maintaining oil output levels by optimizing production, raising efficiency, promoting technological innovation and investing in extra-viscous crude. It is the only Russian oil company that has built a major new refinery since the collapse of the USSR; it is also one of the few that has a strong petrochemical arm. Tatneft has done well concerning import substitution and support for domestic producers as well as avoiding Western sanctions, mainly because the company was not thought to be as closely connected with the Kremlin as some other Russian oil companies. Tatneft has partnered with foreign companies within Russia; however, it has not been particularly successful in its attempts at investing abroad.

As of early 2019, the proved hydrocarbon reserves of Tatneft amounted to 971 million tonnes, while oil production in 2018 reached almost 30 million tonnes (Tatneft Press-Tsentr 2019). Tatneft accounts for over 80% of the oil produced in the Republic of Tatarstan and some 8% of Russia's crude output.

Tatneft is a fully vertically integrated company with refining, petrochemicals and gas-processing facilities. It has a network of 692 fuel stations, including 111 stations in Ukraine and 15 in Belarus. Tatneft is also a major producer of tyres, with three tyre-manufacturing plants based in the town of Nizhnekamsk in Tatarstan (Tatneft 2018a). Tatneft also has its own research institute, TatNIPIneft, located in Bugulma, Tatarstan.

Tatneft mainly operates in the Republic of Tatarstan, but it also has investments in the Samara, Orenburg and Ulyanovsk regions as well as the Republic of Kalmykia and Nenets Autonomous District. Tatneft's minimal presence abroad is in Belarus, Turkmenistan and Ukraine.

The General Director of Tatneft is Nayl Maganov. Like most other Russian oil and gas companies, except LUKOIL and Surgutneftegas, Tatneft's leadership has changed numerous times since the Soviet era. Maganov has been the

company's general director since November 2013, taking over from Shafagat Takhautdinov. Maganov previously served in senior management positions in Tatneft when the company was privatized in 1994. Prior to that, he had worked for NGDU Elkhovneft, part of the Tatneft Production Association.

As of May 2015, the company's key shareholders were the National Settlement Depository (59.55%) and OJSC Central Depository of Republic of Tatarstan (30.45%). Tatneft's depository receipts are listed on the London Stock Exchange and are traded in the Xetra system within Deutsche Börse (Tatneft 2018b).

## CORPORATE HISTORY

Commercial oil production in Tatarstan commenced in 1943, making it one of Russia's oldest petroleum provinces. The super-giant Romashkinskoye field is among the top ten oilfields in world history and was discovered in 1948, transforming Tatarstan into the most oil-rich region in the USSR. At the time, Tatarstan's reserves amounted to 2.3 billion tonnes, including recoverable reserves of 1.4 billion tonnes. Most of Tatarstan's crude is of low quality, with medium to high viscosity and an average sulphur content of 2.5%.

Tatneft's predecessor, the Tatneft Production Association, was established in January 1949. In 1956, Tatneft extracted 18 million tonnes of oil, becoming the number one crude producer in the Soviet Union. Tatarstan demonstrated high petroleum output growth rates with the volume of oil production rising from 43 million tonnes in 1960 to 104 million tonnes in 1975. By 1981, the accumulated hydrocarbon production in Tatarstan had reached 2 billion tonnes of oil and over 70 billion cubic metres of gas. However, 1975 was the last year that witnessed a rise in crude production. It subsequently began to decline steadily, mainly because of ageing fields, and reached a low of 24 million tonnes in 1994.

Because of its complex reserve base, Tatneft has always focused on innovation and new technology. For example, as early as 1984 and 1985, Tatneft introduced improved reservoir management techniques, which helped arrest the rapidly growing proportion of water in the oil it extracted (Lazard Capital Markets 1996, p. 13). During the 1980s, Tatneft's employees worked on several fields in Western Siberia on a fly-in, fly-out basis (Tatneft 2018c).

### **The 1990s**

When market reforms began in Russia, the Republic of Tatarstan was in a different position from other Russian regions because the Kremlin was particularly keen to secure the loyalty of this ethnic Turkic, Muslim republic located in the centre of the country. To this end, an agreement between the

federal authorities and Tatarstan on the division of competencies and mutual delegation of authority was signed in February 1994, giving Tatarstan greater privileges than most parts of the Russian Federation. The petroleum sector was regulated by special agreements. Therefore, Tatarstan was able to pursue a relatively independent energy policy and ensure significant fiscal benefits for Tatneft to encourage the company to continue production from wells with low daily output and/or a high water-cut, commissioning of new fields and introduction of new methods of enhanced oil recovery.

In 1994, Tatneft was privatized. Its authorized capital was split into ordinary shares (93.66%) and preference shares (6.34%). In October 1994, 2.3% of the authorized capital was sold at auctions. In accordance with the privatization plan, 30% of the authorized capital was sold at a discount or transferred free of charge to employees. Preference shares were also given to personnel, including 5.16% sold for privatization vouchers. Another large shareholder was the State Property Committee of Tatarstan, which held 40% plus the 'golden share'. Ten per cent of shares were given to investment funds. Other smaller stakes were sold to top managers, suppliers and residents of the oil-producing regions of Tatarstan (Khisamov 2007).

Owing to the favourable tax regime, Tatneft managed to stabilize crude production at 24 million tonnes per annum beginning in 1995. A decree signed by Tatarstan's then President Mintimer Shaimiev in 1997 created some 30 small oil companies operating in Tatarstan in addition to Tatneft, which provided diversification and competition for the larger company (Khisamov 2007).

During the 1990s, Tatneft was a Russian pioneer in the stock markets. Its shares were first traded over the counter in April 1995, and in September 1995 they were listed on the Russian Trading System (RTS). In June 1996, about 0.1% of its shares were traded in American depository receipt (ADR) form on NASDAQ's bulletin board, with the Bank of New York acting as depository.

By 1996, Tatneft had provided two years of US GAAP accounts, and Miller and Lents undertook an independent reserve audit. In light of this, investment analysts noted that no other Russian oil company had issued similar quality information (Lazard Capital Markets 1996, p. 4). In December 1996, Tatneft's ADRs were listed on the London Stock Exchange (LSE) and two years later on the New York Stock Exchange (NYSE), where 11.5 % of its shares were traded in the form of ADRs. At that point, Tatneft was the only oil company in Russia that had listings on two major international exchanges.

In December 1996, Tatarstan offered part of its stake in Tatneft for sale to global investors. After that, the government's share shrank to some 30%, but it was to retain the 'golden share' until 1999 (Lazard Capital Markets 1996, p. 1). Russian experts regarded the December 1996 sale of Tatneft's shares as the most significant stock market event related to Russian oil companies that year. Even a statement by the Federal Agency on Insolvency about the alleged

imminent bankruptcy of Tatneft made on the eve of the private presentation that the company gave to Western investors did not mar the event (Savushkin 1997). It subsequently turned out that Tatneft did not go bankrupt: it reached an agreement with the federal authorities, probably with the help of Tatarstan's political leaders, who did their best to protect the republic's enterprises (Melnikov 1996).

Tatneft entered the debt market in 1997 when it issued Eurobonds worth USD 300 million (Mazneva 2010). In 1998, Tatneft became the first Russian company to undergo the procedure of official listing of common and preferred stocks in the RTS. In 1999, it received listing for ordinary and preference shares at the Moscow Interbank Currency Exchange.

During the 1990s, Tatneft actively searched for international partners to help it overcome the inevitable problems associated with its declining reserve base, although its in-house engineers were quite advanced and technologically sophisticated and TatNIPIneft delivered high-class research results and registered valuable innovations. By the mid-1990s, Tatneft had established three joint ventures with foreigners. The most important of them was Tatalpetro with Total (Tatneft owned 50%). Its objective was to increase oil production in the Romashkinskoye field through the use of modern enhanced oil recovery (EOR) techniques, including chemical injection. Tatex, a joint venture with the American company Global Natural Resources (Tatneft had 50%), installed Western equipment to increase the recovery of liquids from associated petroleum gas (APG) streams. Tatoilgaz was Tatneft's first production-oriented joint venture, with the German company Mineralol Rohstoff Handel (MRH). This joint venture was engaged primarily in reviving old fields with a combination of horizontal drilling, hydrofracking and secondary recovery. An associate of MRH also cooperated with Tatneft in setting up fuel stations in Tatarstan (Lazard Capital Markets 1996, p. 15).

Initially, Tatneft was exclusively established as an exploration and production (E&P) company with insignificant refining capabilities equivalent to less than 2% of its oil output. However, by the late 1990s, Tatneft had acquired major stakes in petrochemical enterprises in Tatarstan and had actively started building its network of fuel stations, thus gradually transforming itself into a vertically integrated company.

During the mid-1990s, Tatneft tried to secure stable markets for its heavy and sour crude by attempting to establish three financial-industrial groups: Mostatnafta (based on a refinery in Moscow), Volga-Oil (based on a refinery in Nizhniy Novgorod) and Ukratnafta (based on a refinery in Kremenchug). However, all three attempts failed for various reasons, and in the following decade, Tatneft was forced to build its own refinery for processing its oil.

## The 2000s

Changes in President Vladimir Putin's Russia affected Tatneft, particularly in the fiscal sphere. From the beginning of 2002, the profit tax rate was reduced in Russia and a flat mineral production tax was introduced in place of several previous charges for the use of subsurface resources. YUKOS and Sibneft, with their high-quality reserves and thus low lifting costs, were the main beneficiaries of this initiative (which they had strongly lobbied), while Tatneft (and its neighbour Bashneft), with their inferior reserves and mature fields depleted by some 80% resulting in high lifting costs, suffered from this change. Also, Moscow began to feel uncomfortable about the independence of the regions and started to suppress them and especially Tatarstan, which was perceived to be the most independent of all. For example, in 2001, Tatarstan lost the privileges granted to it in 1994, and Tatneft was deprived of the fiscal benefits that it had enjoyed (Poussenkova 2010).

In the new millennium, Tatneft continued to be plagued by its declining reserve base, and in 2006, it became the first oil company in Russia to announce the downgrading of its proved reserves. A repeat audit conducted by Miller and Lents revealed that Tatneft's proved reserves of oil as of 1 January 2005 amounted to 5801 billion barrels, whereas it had earlier reported 5965 billion barrels. Following this announcement, Tatneft's market capitalization fell by USD 350 million to USD 12 billion (Tutushkin and Borisov 2006). Tatneft sought to combat the combined challenges of the declining reserve base and the new fiscal rules through an adaptive management and production strategy, including the expansion of its refining capabilities with the construction of its TANECO refinery (see the section on production strategy below).

Although Tatneft mainly focused on production issues and never played high-profile power games (in contrast to many other Russian oil companies), during the 2000s, as a minority shareholder, it became indirectly involved in one of the most notorious corporate conflicts of the decade around the refinery that was located in Moscow. In 1997, President Boris Yeltsin had issued a decree whereby Moscow was to receive 51% of voting shares in the Moscow refinery. In 1999, the Moscow city authorities united the refinery with Sibir Energy to form a fully vertically integrated company – the Moscow Oil and Gas Company, 69% of which was owned by Moscow and 31% by Sibir Energy (Khrennikov and Shevelkova 2007). The struggle for the control of the Moscow refinery between its main shareholders – Sibneft and Tatneft – and Moscow Oil and Gas Company lasted six years (see the chapter on Gazprom Neft in this book). However, when Gazprom bought 72% of Sibneft, it sought to resolve the issue. In 2007, peaceful negotiations began, and in early 2008, the shareholders agreed to manage the enterprise jointly, and a memorandum

was signed between Yuri Luzhkov, the then Mayor of Moscow, and Alexei Miller, the CEO of Gazprom (Tutushkin 2008).

In the first two decades of the twenty-first century, Tatneft's stock market performance was somewhat patchy in contrast to the previous decade when it was described as a trailblazer in terms of information disclosure and corporate governance. This was reflected in the increasingly divergent perception of its performance by the key international rating agencies, which had been fairly unanimous in their positive assessments of Tatneft during the previous decade. Thus, in 2003, Fitch upgraded its rating of Tatneft's obligations from B- to B. Yet Tatneft was consistently late in providing its financial statements in the mid-2000s. In late 2004, 'due to limited transparency and disclosure as well as aggressive acquisition plans', S&P downgraded its rating from B to B- and, in August 2006, even revoked the B- rating following delayed financial statements. By contrast, in the same year, Fitch upgraded Tatneft's forecast rating to 'positive' because it expected that Tatneft could significantly improve its business structure following the launch of its new refinery (Mazneva and Malkova 2006). Moreover, in June 2006, Tatneft announced that it intended to delist its ADRs from the NYSE, and the exchange stopped trading Tatneft's securities in September 2006 (Panov and Gubeydullina 2006).

In the mid- to late 2000s, Tatneft explored opportunities to expand its upstream and downstream operations overseas with limited success (see the section on internationalization below). On the other hand, Tatneft benefited from some domestic policy developments. In July 2006, a federal law was adopted on the differentiation of mineral production tax for fields depleted by more than 80%, and a zero mineral production tax for super-viscous oil was introduced. These benefits were applicable to the Romashkinskoye field that had been depleted by 84% by that time, as well as four other Tatneft fields (Takhautdinov 2007).

Thus, despite a few setbacks, Tatneft remained among the best performing Russian stocks between 2005 and 2012 since its share price rose five-fold over the period, as observed by Sberbank analysts. The analysts attributed this performance to the company's fundamental changes. First, it allayed concerns that its production was facing an imminent decline. Second, it managed to de-leverage while maintaining a net cash surplus for three years running before the construction of the TANECO refinery began. Tatneft was not involved in any major mergers and acquisitions (M&A) or other projects. In addition, Tatneft improved disclosure: it began publishing Management Discussion and Analysis (MD&A) in 2006 and moved to quarterly reporting and regular calls with investors in 2008. It also increased dividends to 30% in 2006 and, in 2007, secured mineral production tax benefits on its depleted fields (Sberbank CIB 2014).

## Post-2010

In recent years, Tatneft's position in global credit ratings has significantly improved. In November 2017, Fitch confirmed Tatneft's credit rating at BBB- with a 'stable' forecast. This reflected Tatneft's strong financial position following the commissioning and further development of TANECO. Compared to its Russian peers, the company also had a meagre ratio of debt to cash flow from operations (Tatneft Press-Tsentr 2017a). In January 2018, Moody's upgraded Tatneft's credit rating to Baa3 with a 'positive' forecast (Tatneft Press-Tsentr 2017b).

In 2016, together with LUKOIL and Novatek, Tatneft was included (as number five) in the top ten companies of the global petroleum sector by the Boston Consulting Group (BCG) (Tatneft Press-Tsentr 2017c). During that period, Russian experts also agreed that Tatneft, LUKOIL and Novatek were among the most profitable companies in Russia in terms of shareholder returns (Makhnyeva 2016). According to these experts, Tatneft was well known for its efficient management of existing projects, good communication with investors and low debt burden compared to its peers (Makhnyeva 2016). In 2017, Tatneft retained its top ten position in the BCG rating with a slight drop to number eight. As BCG noted, Tatneft kept a strong position in the rating due to higher operating efficiency, a low level of debt and a balanced dividend policy (Tatneft Press-Tsentr 2017c).

In 2016, Tatneft also became number one on the list of the most innovative European oil and gas exploration companies, according to the Thomson Reuters report *The Future is Open: 2016 State of Innovation* (cited in Tatneft Press-Tsentr 2016a). Tatneft may deserve this accolade, as it registered its five-thousandth patent for inventions in 2012 (Tatneft 2018d).

## COMPANY PROFILE

### Production Strategy

Tatneft currently produces the lion's share of its oil from six major fields (Romashkinskoye, Bavlinskoye, Sabanchinskoye, Novo-Elkhovskoye, Pervomaiskoye and Bondyuzhskoye), with Romashkinskoye accounting for the bulk of crude output: 15.8 million tonnes in 2016 (out of 28.3 million tonnes produced in total by Tatneft) (Tatneft 2018e). Tatneft delivers oil to the domestic market (15 million tonnes per annum), the former Soviet Union (1.3 million tonnes per annum) and other overseas destinations (10.4 million tonnes per annum). Domestic deliveries are mainly made to the TANECO refinery (8.6 million tonnes) and TAIF-NK (6.2 million tonnes) (Tatneft 2018f).

TAIF-NK is a major refining complex located in Nizhnekamsk, Tatarstan. It includes a refinery, gasoline plant and a facility for processing gas condensate.

Tatneft's production strategy is determined by the fundamental problems and weaknesses of its reserve base in Tatarstan, an ageing petroleum province. Tatneft faces a serious challenge from depleting fields and a low average daily output of operating wells – 3.9 tonnes per day with an average output of new wells of only 10 tonnes per day (Tatneft 2017). Having to cope with the problems presented by the continuously ageing reserve base as well as the tougher fiscal conditions imposed on its operations, Tatneft has been forced to adapt to these changes and adjust its strategies accordingly.

First, Tatneft sought to optimize its management structure and expand its activities beyond E&P. In 2002, it added gas and petrochemical branches to the business (Tatneftegazpererabotka and Tatneft-Neftekhim, respectively). In 2008, the company undertook large-scale restructuring and divested itself of some non-core assets, reorganized its system of managing the oil services sector and formed managing companies for different activities. In 2008, probably as a result of this streamlining, Tatneft was included for the first time in the Platts global rating of the most efficient energy companies (Top250). In 2010, Tatneft launched another new line of business, heat and power generation.

Second, Tatneft searched for innovative ways to increase its resources and maintain oil production levels. It began to develop Tatarstan's significant resources of super-viscous (or bituminous) oil, which requires heating to be extracted. In 2003, Tatneft started exploration and test production in the Ashalchinsk field of super-viscous oil. In 2006, Tatneft drilled a unique horizontal well there and produced its first 100 tonnes of bituminous crude (Tatneft 2018d). It also started expanding into new regions. It entered the Timan-Pechora province in the mid-2000s through two companies, Severgazneftprom and Severgeologiya, which owned prospecting and E&P licences for four blocks in Nenets Autonomous District (Tatneft had a 50% stake in both companies) (Tatneft 2018d).

Third, Tatneft continued its transformation into a fully vertically integrated oil company by establishing its own refining facilities. In fact, it became the only Russian vertically integrated oil company that built a major refinery from scratch after the collapse of the USSR. Before that, it had only minor refining facilities at NGDU Elhovneft, part of the old Tatneft Production Association. In summer 2005, the leadership of Tatarstan decided to build an oil-refining complex in the republic. The project operator was to be an especially established closed JSC Nizhnekamsk refinery founded by Tatneft (40%), the state holding Svyazinvestneftekhim (9%) and two offshore companies that held a blocking stake. The plan was to build a 7-million-tonne-per-annum refinery (to be expanded later to 14 million tonnes per annum) – to be named TANECO – and a petrochemical facility in Nizhnekamsk.

Tatneft was to take care of financing, and it found an unusual way to raise funds. Its subsidiary Tatneft Oil AG became the co-founder of an investment fund, the International Petro-Chemical Growth Fund (registered on the island of Jersey). Tatneft contributed 5% of its ordinary shares to the authorized capital of the fund, the value of which was estimated at that time to be USD 485 million (Tatneft 2018d). In early 2006, Tatneft decided not to wait for external investors to finance the construction of the new TANECO refinery and, instead, allocated over USD 200 million of its own funds to the project. Experts noted that since the company was not actively buying new assets at the time, it had enough cash to fund the project (Borisov 2006). In 2006, TANECO also received federal support: The Russian Federation Investment Fund financed the design and construction of the external transportation infrastructure, including an oil pipeline, petroleum product pipeline and railroad facilities. In 2011, the first phase of the TANECO complex was commissioned – a facility for primary oil refining with a capacity for 7 million tonnes per annum. Tatneft and Chevron Lummus Global have been cooperating on projects related to the refinery since 2006 when they signed a licensing agreement and an agreement to design hydrocracking installations for TANECO (see below).

In 2016, Tatneft formulated its Strategy 2025, which envisaged the transition from stabilization to sustainable organic growth in the E&P segment with crude output to surpass 30 million tonnes by 2025. The company also aimed at reducing operating costs by 10% (Tatneft Strategy 2016). According to Strategy 2025, Tatneft's exploration division aimed for 100% replacement of its economically recoverable resource base through the following measures:

1. Increased efficiency in conventional oil exploration within mature fields.
2. Study and follow-up exploration of missed plays.
3. Exploration of new super-viscous oilfields.
4. Exploration of new fields in Nenets Autonomous District, Samara, Orenburg, Ulyanovsk regions and Kalmykia.
5. Exploration of oil in the Domanic formation in Tatarstan (Tatneft 2016).

Besides traditional seismic exploration, Tatneft is using several new technologies, such as artificial intelligence, geochemical exploration for oil and gas layers with the use of passive adsorption of hydrocarbons, low-frequency seismic sondage and electromagnetic sondage (Tatneft 2018g).

In the production sphere, the company continues to be strongly focused on super-viscous oil. Between 2017 and 2018, Tatneft planned to invest around RUB 20 billion into developing its super-viscous fields (20% of the overall investment programme of RUB 100 billion for this period). High-viscosity oil resources in Tatarstan are estimated to exceed 1.4 billion tonnes, and Tatneft

hopes that it will be able to substitute the ageing fields with this type of crude in the future (Astakhova 2017; Tatneft Press-Tsentr 2016b).

Tatneft produced 1.9 million tonnes of super-viscous oil in 2018 (Finam 2019). The company considers bituminous crude to be a priority for growing its resource base. It is currently developing seven layers of super-viscous oil: four layers in Ashalchinsk field and one each in Languevsk, Karmalinsk and Nizhne-Karmalsk.

Nayl Maganov, Tatneft's General Director, admits that super-viscous oil is a complicated, knowledge-intensive and costly business, but still sees it as promising (Zavalishina 2015). It requires major investments that it is hoped will bring results in the form of produced oil in the future. Bituminous oil might become a crucial reserve for Russia's petroleum industry in years to come because resources of conventional crude in Russia are being depleted. According to Maganov, the mining and geological conditions of bitumen fields in Tatarstan are much more challenging than in Canada: bitumen is produced in the Canadian tundra while Tatneft's fields are located in populated areas of Tatarstan. Therefore, Tatneft must channel considerable funds into putting the territories in order, recultivating land and imposing strict environmental monitoring (Zavalishina 2015).

Unlike many of its Russian peers, Tatneft continues to focus much of its long-term production strategy on its refining capacities, and it is constantly developing its TANECO refinery. In December 2014, using a Chevron licence, TANECO commissioned a combined installation for hydrocracking vacuum gasoil. This permitted TANECO to launch the production of Euro-5 diesel, aviation kerosene and basic oils. The Euro-5 diesel fuel produced by TANECO is relatively clean with a sulphur content of less than 3 parts per million (ppm), while the threshold indicator for Euro-5 is 10 ppm.

In early 2016, Tatneft bought an additional 9% of TANECO and obtained full control over the enterprise. According to Tatneft's Strategy 2025, by that year the refinery's installed capacity should reach 14 million tonnes per annum; the conversion ratio will be 97% (compared to 74% in 2014) and the yield of light products 90% (compared to 69% in 2014). These would be high levels by current Russian standards (Neft i kapital 2014a; Tatneft Strategy 2016). In October 2017, TANECO and Chevron Lummus Global signed a MoU to enhance the efficiency of TANECO (Tatneft Press-Tsentr 2017d). Tatneft consistently supports domestic producers by placing orders for equipment in Russian enterprises; for instance, the Izhora Machine-Building plant has manufactured hydrocracking reactors, a product that was unique for Russia (Tatneft Press-Tsentr 2018).

Unlike many of its Russian peers, Tatneft has a well-developed petrochemical arm, comprising three tyre-manufacturing plants and several support

enterprises, including hi-tech services for the petrochemical and tyre industries and Russia's largest producer of technical carbon (a key component of rubber).

Prompted by the complexity of its reserve base, Tatneft consistently pursues a policy of innovation, applying the most advanced technologies throughout the company. Its research institute TatNIPIneft has always been one of the most respected R&D establishments in the former Soviet Union and is responsible for several regionally significant advances in production technology and reservoir engineering. In 2014, Tatneft began the digital transformation of its whole production system, and by 2016, practically all branches of the company had been transferred to new information platforms. Currently, Tatneft is working on artificial intelligence and creating digital 'twins' of real objects. IT is not only used to revitalize Tatneft's own operations, but also developed and marketed for other companies.

### **Internationalization**

Tatneft has a minimal presence abroad. Upstream, it now mainly operates in Turkmenistan. In 2008, Tatneft and Turkmenneft signed a protocol on the development of oil and gas cooperation in Turkmenistan, and in 2010, the two companies entered into a production contract. Tatneft subsequently opened a subsidiary in Turkmenistan to provide enhanced oil recovery services and maximize the potential of the Goturdepe field. In 2012, Tatneft began well operations under a service contract between Tatneft and Turkmennebit (Tatneft 2018h).

In the early 2000s, Tatneft signed a service contract with the Iraqi government; however, it had to leave urgently following the US invasion of 2003. In 2009, Tatneft qualified to participate in the second Iraqi licensing round but failed to win (Mazneva and Tutushkin 2009). In 2005, Tatneft was the first Russian company to enter Libya, winning the largest share of a 2006 licensing round and securing a PSA to work on four blocks with the National Oil Corporation of Libya. In 2009, Tatneft achieved its first commercial oil when testing an exploration well. However, the political unrest in Libya forced Tatneft to evacuate hundreds of workers and suspend its businesses in the country (Soldatkin 2011). In 2010, Tatneft began operating in Syria; however, it had to halt its operations because of escalating violence. In October 2016, Tatneft signed a MoU with the NIOC. Tatneft planned to study opportunities to develop Iran's Dehloran field (Tatneft Press-Tsentr 2016b). In early January 2018, Nayl Maganov announced that Tatneft had presented to NIOC its proposals for the development of Dehloran and Shadegan fields (Finance-Rambler 2018); however, no real progress has been reported since then.

Tatneft has been even less successful in developing its downstream activities overseas. For instance, in early 2004, a consortium of the Turkish Zorlu

Holding and Tatneft won 65.7% of the Turkish oil-refining holding TUPRAS (total capacity 26.6 million tonnes per annum). However, the deal was halted by the local trade unions and minority shareholders of TUPRAS, who initiated numerous lawsuits (Neft i kapital 2004).

Tatneft's experience in Ukraine has been particularly unsettling. In autumn 2006, Tatarstan transferred to Tatneft its stake in Ukrtatnafta that controlled the Kremenchug refinery in Ukraine (Tutushkin 2006). However, a corporate raid in October 2007 by the Ukrainian special forces caused the leadership of Ukrtatnafta to be replaced by the former chairman of its managing board, Pavel Ovcharenko. This followed a protracted conflict between the Ukrainian authorities and Naftogaz Ukraine, on the one hand, and the refinery management, controlled by Tatarstan, on the other. Prior to the raid, the Supreme Court of Ukraine had made a decision to transfer a controlling interest in the joint venture to Naftogaz. Tatneft disputed this in court and, following the raid, halted deliveries of its crude to Kremenchug (Tutushkin et al. 2007). It also bought two shareholders of Ukrtatnafta to strengthen its position in court (Mazneva 2008).

In 2008, Tatneft filed a lawsuit in Zurich against Ukraine, demanding the reimbursement of USD 1.1 billion for damages (Malkova and Kazmin 2008). Since 2008, the claim has risen to USD 2.4 billion. In 2014, the International Arbitration Court in The Hague reached a verdict in favour of Tatneft, but only for USD 112 million, and Ukraine filed a counter-suit in the Court of Appeal in Paris (Kozlov 2016). In early 2016, Tatneft filed a lawsuit in the British courts to recover USD 334 million of debt with interest from Ukrtatnafta for deliveries of oil to Kremenchug. In March 2016, Tatneft began court proceedings in the UK against Pavel Ovcharenko and three Ukrainian oligarchs concerning non-payment for oil delivered to the refinery in 2007. In November 2016, the Supreme Court of London declined the lawsuit on the grounds that it had no prospects of success. However, on 18 October 2017, the Court of Appeal of England and Wales revoked this decision (Tatneft Press-Tsentr 2017e). The legal war between Tatneft and Ukraine continues, having been described by *Kommersant* as one of the most important corporate conflicts of 2017 (Zanina and Rayskiy 2017). Also, in 2017, Tatneft filed a lawsuit against Ukraine in the Arbitration Court of Moscow, and this litigation continued in 2018 (Interfax 2018).

## Shale Oil

Like its Russian peers, Tatneft was late to take an interest in shale oil due to its failure to foresee its importance. This is particularly interesting in the case of Tatneft as it specializes in extracting other difficult oil, notably extra-viscous oil.

Still, in response to the question of whether Russia and the rest of the oil-producing countries slept through the shale revolution, General Director Nayl Maganov made the following observation in an interview with *Kommersant-FM*:

The question is, what do we mean by 'slept through'? Oil in shale rocks was known for a long time; since the 1960s–70s, people were quietly dealing with it; quietly trying to produce this oil. These technologies have continuously been developing since the 1960s, and at some point, they reached a level at which production became profitable. I do not exactly understand what revolution and who slept through it. (Kuzichev and Bogdanov 2016)

Tatneft began studying shale oil prospects more intensively in 2013 by drilling a pilot well to a depth of some 1700 metres. Tatneft's top management fully recognized the implications of the shale revolution in its 2012 Annual Report: 'The recent changes in the global oil and gas sector in which shale hydrocarbons began to play an increasingly prominent role could not help but make an impact on the major trends and priorities for the development of the Russian oil industry' (Gariffulin et al. 2012).

A report on the exploration and implementation of pilot shale oil projects was presented at a regular meeting of Tatneft's board of directors chaired by the republic's President Minnikhanov in Kazan in 2014. It stated that hydrofracking had been carried out in the Dankov-Lebedyanskiy reservoirs of the Bavlinskoye oilfield. The board of directors approved the shale programme for 2014–15; it also approved the establishment of testing grounds for the Domanic shale oil in Tatarstan (Oil & Gas Eurasia 2014).

In 2015, Tatneft booked some 29 million tonnes of shale oil reserves. In total, it planned to invest about RUB 1.5 billion under its 2016–18 shale programme. Tatneft also considered opportunities to join shale projects in the West. As Nayl Maganov admitted in an interview with *Business Gazeta*, the company's experts were invited by their American colleagues to visit the United States and study the prospects for Tatneft (Zavalishina 2015). In its 2016 Annual Report, Tatneft reconfirmed that the 'implementation of the pilot programme for shale oil production was among the company's priorities' (Voskoboinikov et al. 2016).

## CSR

Since 2005, Tatneft has been publishing annual reports on sustainable development and social responsibility aimed at business partners, public authorities,

employees, communities and civil society. The introduction to the 2013 report was as follows:

In 2013, Tatneft company continued implementing principles of social responsibility in the company's business practices. During the reporting period, considerable attention was traditionally paid to the environment, the creation of safe working conditions, social protection and the professional development of employees. A significant contribution was made to support healthcare, education, culture, sports and development of social infrastructure in the regions of activity.

Tatneft mainly operates in the central part of European Russia, a region with a relatively mild climate and a well-developed infrastructure. In contrast to the oil companies working in Western Siberia, Tatneft has not had to build oil towns from the ground up nor does it come into close contact with any Arctic indigenous peoples. On the other hand, it has greater visibility because it operates in more densely populated areas, and any environmental accident is likely to draw immediate large-scale attention. Moreover, its strong connection to the Tatarstan government and association with the Tatars as an ethnic group ensure that it is still under pressure to provide social services like other Russian oil companies.

Tatneft's CSR policy has several components. Much of its effort is focused on social projects. It also has projects related to environmental protection and the promotion of climate-friendly technology (see below). This comes in addition to its efforts to increase efficiency and reduce GHG emissions in its core operations (see the section on climate change below).

In collaboration with the local municipalities, Tatneft implements projects to improve life in the towns and settlements in the regions where it works. As part of the programme aimed at supplying Tatarstan's population with clean drinking water, a water-pumping tower was built in Molodezhniy, Almetievsk region, and a water pipeline grid was installed in the village of Mencha (Ilmukova et al. 2013, p. 80). General Director Nayl Maganov considers support for medical services to be the most important type of social activity for the company (Zavalishina 2015). Projects have included re-equipping a new oncology centre, modernizing a children's polyclinic in Almetievsk as well as supporting the construction of an emergency ward, an obstetrics hospital, a regional medical diagnostic centre and inter-regional oncological polyclinics in various cities of Tatarstan (Ilmukova et al. 2013, p. 83; Tatar-*Inform* 2017).

Tatneft occasionally finances the construction and reconstruction of mosques, cathedrals and churches; it has built kindergartens and, in one case, an ice palace. In 2004, Tatneft established a 'talented children' fund to support scientific and creative projects and participation in conferences (Ilmukova et al. 2013, p. 82). It finances the Ruhiyat Fund of Spiritual Renaissance (founded in 1997), which supports children's creative development, festivals, publications

and art and literature contests; it also established a literary scholarship prize in the name of Sazhida Suleimanova, a poetess. The charitable fund Mercy was founded to provide targeted support for orphans, veterans, the disabled and low-income families (Tatneft 2018j). Much of this charitable activity is typical of Soviet and Russian companies. However, in a move *not* typical of a Russian oil company, in 2017, Tatneft launched a social project to lease bicycles to the residents of Almetievsk at a low cost (Krivopatre 2017).

Regarding its environmental commitments, Tatneft has demonstrated leadership in developing and installing environmentally friendly technology and has made efforts to reduce its climate impact and enhance the efficiency of its operations (see the section on climate change below). Some of the company's environmental programmes have been designed along traditional Soviet-era lines, such as its programmes to plant trees along highways and oilfield routes. However, other efforts have indicated a commitment to stimulating good environmental performance in the energy sector within the company and beyond through technology development and promotion of new technologies. For instance, in January 2018, TANECO became the first enterprise in Russia to introduce automatic monitoring of emissions into the atmosphere (Tatneft Press-Tsentr 2018). Tatneft also seeks ways to enhance the efficiency of its petrochemical arm. Thus, in November 2014, Tatneft and the Italian company Marangoni launched the joint venture KaMaRetrade in Nizhnekamsk to restore old truck tyres. Marangoni contributed the technology and equipment and organized the training of personnel, while Tatneft provided the production facilities (Neft i kapital 2014b).

Tatneft has received some public recognition for these activities. It was ranked highest among Russian oil companies in the rating of social and environmental responsibility published by the Independent Environmental Rating Agency (NERA): *Ratings of business and regions of Russia: Environmental responsibility and energy efficiency* (Tatneft Press-Tsentr 2010). In September 2017, Tatneft was included in FTSE4Good Emerging Index, which is used to evaluate the activities of companies that demonstrate a commitment to progressive practices in the sphere of environment protection, CSR and corporate governance (Tatneft Press-Tsentr 2017g).

## COPING WITH THE CHALLENGES OF CHANGE

### Climate Change

According to the *Carbon Disclosure Project Russia 50* report, Tatneft is one of the leading Russian companies concerning climate change issues (CDP 2009), as attested by the company's measures to limit its GHG emissions. For Tatneft, one efficient way of reducing GHG emissions has been the introduction of

a system for catching light fractions of hydrocarbons evaporating from storage tanks. Tatneft also seeks to enhance the efficiency of energy use within its Energy-Efficient Economy Programme and has sought to reduce APG flaring (Ilmukova et al. 2013). In fact, it is one of the leaders in the Russian oil sector in terms of APG utilization. In 2015, Tatneft's rate of APG utilization was 95.17% (Tatneft 2018i). In 2018, its level of APG utilization grew to 96.2% (Tatneft 2018i).

Tatneft's APG utilization programme for 2009–13 included the construction of gas power stations, the introduction of furnaces for heating oil that use APG and the construction of gas-gathering systems with the subsequent processing of the gas. In 2012, Tatneft launched a three-year programme to introduce Capstone micro-turbine energy installations that run on APG. In 2013, power stations based on Capstone micro-turbines were commissioned at four Tatneft facilities with a total installed capacity of 4.4 MW (Ilmukova et al. 2013, p. 41). In 2013, Tatneft also introduced APG Control, a system for accumulating and disseminating information on the production and gathering of APG.

Tatneft has also made efforts to promote the use of electric vehicles by commissioning the installation of charging points as part of two projects. In May 2016, Tatneft launched a new facility for charging electric vehicles in Khimgrad industrial park in Kazan. President Minnikhanov took part in the ceremony, studying the specifics of recharging and test driving a smart electric car and stating that electric vehicles were environmentally safe and reliable and that this direction should be developed further (Tatneft press-tsentr 2016d). In June 2017, a second charging facility was opened at Tatneft's fuel station 3 in Almetievsk (Tatneft press-tsentr 2017f).

### **Sanctions, Crises and Oil Prices**

Tatneft weathered the 2008 economic crisis in Russia reasonably well. This does not necessarily mean that the company is good at predicting market changes; nonetheless, it does mean that its strategy represents a robust approach over time. This could be interpreted as indicating that the company is good at handling such changes (Gariffulin et al. 2010).

In 2008, Tatneft successfully pursued a conservative strategy and showed that this could work particularly well for a company holding mostly depleted fields. It was one of the few Russian oil companies that demonstrated production growth during that period; its debt burden remained limited, and it continued generating significant profit. In November 2008, Shafagat Tahautdinov, the then General Director, said that the company intended to cut its investment programme outside of Tatarstan in Orenburg and Samara regions and Nenets Autonomous District while maintaining it at the previous level within Tatarstan (Neft i kapital 2008).

Following the 2014 drop in oil prices, Tatneft's 2015 Annual Report made the following statement:

Due to the negative macroeconomic factors and fall in oil prices, the company developed a programme of anti-crisis measures, including priority ranking of projects, with due account for the need to maintain full-scale production plans, measures to optimize general and administrative expenses, cut production costs, enhance labour productivity, strengthen control to prevent price hikes by suppliers and improve tender procedures. (Cited in Mukhamadeev et al. 2015)

The current General Director, Nayl Maganov, said in an interview a year after the 2014 oil price collapse that Tatneft's cost cuts did not affect its social programmes. Similar to its policy during the 2008–09 crisis, Tatneft curtailed its activities outside of Tatarstan, making additional investments only to complete commenced projects where it had already invested serious money. Salaries and social benefits were protected as much as possible. In 2015, it even created some 1000 new jobs in the development of extra-viscous oil, constructed new facilities at TANECO and expanded its tyre-manufacturing operations (Zavalishina 2015).

As a 2015 interview with Maganov indicates, he understands that oil prices depend on many factors, including reserves, consumption, geopolitics, demand, technology, innovation and the actions of exchange speculators (Maganov, cited in Zavalishina 2015). Maganov stated that 'one should be oriented towards the price that the market would propose ... Consensus opinion testifies to the growth of prices up to USD 70 by the end of the year. A lot will depend on the events in the Middle East.' The oil price of USD 55 at the time of the interview permitted the company to implement its programmes and to look forward to 15 years of profitable operations. He also reiterated that it would have been better if prices and the exchange rate had remained unchanged since the company had to halt some of its programmes and shelve its boldest ideas.

Maganov admitted in his 2015 interview that the rapid and drastic drop in oil prices affected Tatneft's earnings, and it had to cut costs in spheres that did not directly impact the development of the company (Maganov, cited in Zavalishina 2015). Cost reductions were not applied to investments in important strategic areas, such as oil production, enhanced oil recovery and refining and manufacturing of tyres. Spending was reduced on secondary projects that did not have a critical significance for key production processes:

Moreover, responding to the challenges of the global market, we developed a series of scenarios depending on the oil price, demand, dollar exchange rate and inflation forecasts. We constantly monitor the situation, and, depending on the current and

strategic analysis, the company uses instruments of the scenario that most fully corresponds to the current market realities. (Maganov, cited in Zavalishina 2015)

Also, in his interview with *Kommersant-FM*, Maganov said that ‘of course, we are not overjoyed that prices were dropping, but we do not see anything lethal for us or unexpected in this process’ (Kuzichev and Bogdanov 2016). Moreover, Tatneft’s Strategy 2025 contains macroeconomic forecasts of oil prices, the rouble exchange rate and inflation rates and presents three scenarios for the company’s market capitalization in 2025. The basic scenario envisages growth of Urals crude oil prices from USD 37 per barrel in 2016 to USD 40 in 2020 and USD 55 in 2025; it also envisages stable fiscal conditions. The negative scenario envisages low oil prices: Urals crude oil blend at USD 24 per barrel in 2016 and USD 45 by 2025. In this case, Tatneft’s capitalization would still grow to USD 16 billion. Under the optimistic scenario, the Urals price would be USD 70 per barrel by 2025 and Tatneft’s capitalization would increase to USD 28 billion (Tatneft 2016).

According to its 2016 Annual Report, Tatneft was affected by the agreement between Russia and OPEC:

The global demand for oil is projected to increase in 2017 in the context of the OPEC agreement to curtail oil production. Since January 2017, subject to the agreement between Russia and OPEC, the company committed itself to cut the current production level while preserving all economic and technological aspects to ensure stable operations of oilfields and maintain the production balance. (Voskoboinikov et al. 2016)

International sanctions against Russia in the aftermath of the conflict in Ukraine were not targeted at Tatneft. However, Tatneft was indirectly affected since some of its suppliers encountered serious problems because of the sanctions; for example, one of them delayed deliveries of foreign equipment to TANECO. There were also problems with supplies of pipes for super-viscous oil at high temperatures. However, a Russian company from Perm managed to arrange their manufacture in three months and began to deliver them to Tatneft at reasonable prices.

Maganov noted in 2015 that Tatneft was taking steps aimed at import substitution (Maganov, cited in Zavalishina 2015). Since 2014, it had not been using imported pumps and compressors for its projects; instead, it had been buying pumps and compressors from Russian companies. The company had been placing only domestic orders for reactor and column equipment since 2013. As noted above, the Izhora plant manufactured reactors for the hydrocracking facility that the company launched in 2014 at TANECO (Zavalishina 2015).

## CONCLUSION

Tatneft has faced the constant challenge of an ageing and depleting reserve base and has tried to behave proactively by anticipating and responding to changes. For instance, the company began the extraction and production of super-viscous oil to supplement its conventional petroleum reserves. It built a large modern refinery to process its heavy and sour crude; it developed a diverse petrochemical business and expanded into heat and power generation. Tatneft has demonstrated consistent support for domestic companies and capacities and has directed considerable investment to sponsor and maintain the TatNIPIneft research institute.

On climate and CSR, Tatneft does well by the standards of Russian oil companies. In particular, it has demonstrated leadership in the development and promotion of technology to increase energy efficiency and reduce GHG emissions. Tatneft also handled the oil price collapses of 2008 and 2014 well, thanks to its cautious policies. Tatneft has collaborated effectively with international partners and successfully taken home technological and technical expertise to enhance its production and processing operations. However, Tatneft's attempts to develop upstream and downstream activities overseas have been hampered by geopolitics in the Middle East and perhaps by the fact that, unlike its Russian peers, it does not have strong ties with leading politicians in Moscow.

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