

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following management's discussion in conjunction with our unaudited consolidated interim condensed financial information as of and for the three months ended March 31, 2008. The consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard 34 "Interim financial reporting" ("IAS 34"). This financial information should be read together with the consolidated financial statements for the year ended December 31, 2007 prepared in accordance with International Financial Reporting Standards ("IFRS").

OVERVIEW

We are one of the world's largest oil and gas companies in terms of reserves, production and market capitalization. Our revenues are primarily derived from sales of natural gas, crude oil and other hydrocarbon products to Western and Central Europe, Russia and other former Soviet Union countries.

We divide our operations into the following five main business segments:

- Production of gas – exploration and production of gas;
- Transport – transportation of gas;
- Distribution – domestic and export sale of gas;
- Production of crude oil and gas condensate – exploration of oil and gas condensate, sales of crude oil and gas condensate;
- Refining – processing of oil, gas condensate and other hydrocarbons, and sales of refined products;

Other businesses primarily comprise banking, electricity and media.

Our five main business segments are mutually dependent, with a significant portion of the revenues of one segment comprising a part of the costs of another segment. In particular, our Distribution segment purchases natural gas from our Production of gas segment and transportation services from our Transport segment. Our Refining segment purchases crude oil and gas condensate from the Production of crude oil and gas condensate segment. We establish internal transfer prices with reference to the specific funding requirements of the individual subsidiaries within each segment. Accordingly, the results of operations of these segments on a stand-alone basis do not necessarily represent each segment's underlying financial position and results of operations as if it was a stand-alone business. For this reason, we do not analyze any of our main segments separately in the discussion that follows.

RECENT VOLATILITY IN GLOBAL AND RUSSIAN FINANCIAL MARKETS

While the Group does not have any exposure to the US sub-prime market, the ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the Russian banking sector, and higher interbank lending rates. The uncertainties in the global financial markets, have also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. The borrowers of the Group may also be affected by the lower liquidity situation which could in turn impact their ability to repay their outstanding loans. Deteriorating operating conditions for borrowers may also have an impact on Management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Group's business in the current circumstances.

RESULTS OF OPERATIONS

(RR million)	Three months ended March 31	
	2008	2007
Sales (net of excise tax, VAT and customs duties)	902,944	611,528
Operating expenses	(537,317)	(401,733)
Operating profit	365,627	209,795
Loss from change in fair value of call option	(17,423)	-
Deconsolidation of NPF Gazfund	-	44,692
Finance income	56,644	25,415
Finance expenses	(40,590)	(20,036)
Share of net income of associated undertakings and jointly controlled entities	12,454	11,046
Gains on disposal of available-for-sale financial assets	3,616	8,593
Profit before profit tax	380,328	279,505
Current profit tax expense	(92,196)	(56,334)
Deferred profit tax expense	(2,082)	(6,034)
Total profit tax expense	(94,278)	(62,368)
Profit for the period	286,050	217,137
Attributable to:		
Equity holders of OAO Gazprom	273,439	210,312
Minority interest	12,611	6,825
	286,050	217,137

Sales

The following table sets out our volumes and realized prices for the three months ended March 31, 2008 and 2007.

(RR million unless indicated otherwise)	Three months ended March 31	
	2008	2007
Sales of gas		
<i>Far Abroad</i>		
Gross sales ⁽¹⁾	448,617	282,661
Customs duties	(109,580)	(64,221)
Net sales	339,037	218,440
Volumes in billion cubic meters (bcm)	53.5	39.9
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	345.5	269.6
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties)	8,381.7	7,091.4
<i>FSU (Former Soviet Union)</i>		
Gross sales (net of value added tax (VAT))	91,213	82,714
Customs duties	(7,834)	(8,636)
Net sales	83,379	74,078
Volumes in bcm	25.0	28.1
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties, net of VAT) ⁽³⁾	150.6	111.8
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties, net of VAT)	3,654.1	2,942.1
<i>Russia</i>		
Gross sales (net of VAT)	173,376	135,915
Net sales	173,376	135,915
Volumes in bcm	105.0	105.6
Gross average price, RR per mcm ⁽²⁾ (including excise tax, net of VAT)	1,651.5	1,286.9
<i>Total sales of gas</i>		
Gross sales (net of VAT)	713,206	501,290
Customs duties	(117,414)	(72,857)
Net sales	595,792	428,433
Volumes in bcm	183.5	173.6

(RR million unless indicated otherwise)	Three months ended	
	March 31	
	2008	2007
Net sales of refined products (net of excise tax, VAT and customs duties)	162,357	105,767
Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties)	57,950	32,348
Gas transportation sales (net of VAT)	15,905	10,799
Other revenues (net of VAT)	<u>70,940</u>	<u>34,181</u>
Total sales (net of excise tax, VAT and customs duties)	902,944	611,528

Notes:

- (1) VAT is not charged on sales to Far Abroad countries.
- (2) One mcm is equivalent to 35,316 cubic feet.
- (3) Calculated on the basis of average rate.

Total sales (net of excise tax, VAT and customs duties) increased by RR 291,416 million, or 48%, to RR 902,944 million in the three months ended March 31, 2008 compared to the same period of the prior year.

Net sales of gas accounted for 66% of total net sales in the three months ended March 31, 2008 (70% in the same period of the prior year).

Net sales of gas increased from RR 428,433 million in the three months ended March 31, 2007 to RR 595,792 million in the three months ended March 31, 2008, or by 39%.

Net sales of natural gas to Far Abroad countries increased in the three months, ended March 31, 2008 compared to the same period of the prior year by RR 120,597 million, or 55%, to RR 339,037 million. The overall increase in Far Abroad sales was driven both by volume and price. Average RR price grew by 18% for the three months, ended 31 March 2008, compared to the same period of the prior year, at the same time volumes for the three months ended March 31, 2008 increased by 34% compared to the same period of the prior year. The increase in export gas prices reflects the increase in world prices for hydrocarbons that are used as price-determinants in most gas supply contracts. In the majority of contracts hydrocarbons prices of prior periods are used as price determinants.

Net sales of natural gas to FSU countries increased in the three months ended March 31, 2008 compared to the same period of the prior year by RR 9,301 million, or 13%, to RR 83,379 million. This increase was mainly due to a 27% increase in prices in RR terms (net of excise tax, customs duties and VAT), which was partly offset by 11% decrease in sales volumes.

Net sales of natural gas in the domestic market increased by RR 37,461 million, or 28%, in the three months ended March 31, 2008 compared to the same period of the prior year. This increase was mainly due to the increase in domestic gas tariffs set by the Federal Tariffs Service (FTS).

Sales of refined products (net of excise tax, VAT and customs duties) increased by RR 56,590 million, or 54%, to RR 162,357 million in the three months ended March 31, 2008 compared to RR 105,767 million in the same period of the prior year. The increase mainly related to increase in world prices for refined products in the three months, ended March 31, 2008 compared to the same period of the prior year. Gazprom Neft's sales comprise 59% of the total amount of refined products sales of Gazprom Group.

Sales of crude oil and gas condensate (net of excise tax, customs duties and VAT) increased by RR 25,602 million, or 79%, to RR 57,950 million in the three months ended March 31, 2008 compared to RR 32,348 million in the same period of the prior year. Sales of crude oil included in net sales of crude oil and gas condensate (net of customs duties and VAT), amounted to RR 51,842 million and RR 28,558 million in the three months ended March 31, 2008 and 2007, respectively.

Gas transportation sales increased by RR 5,106 million, or 47%, to RR 15,905 million in the three months ended March 31, 2008 from RR 10,799 million in the same period of the prior year. This increase was due to an increase in both transportation tariffs (set by FTS) and volumes of gas transported.

Other revenues increased by RR 36,759 million, or 108%, to RR 70,940 million in the three months ended March 31, 2008 compared to RR 34,181 million in the same period of the prior year. Increase in other revenues was mainly due to sales of Mosenergo, consolidated since June 2007. Other sales represent activities including electricity sales, media, construction works, and sales of other services and goods.

Operating expenses

Operating expenses increased by 34% in the three months ended March 31, 2008 to RR 537,317 million from RR 401,733 million in the same period of the prior year. Operating expenses as a percentage of sales decreased from 66% in the three months ended March 31, 2007 to 60% in the three months ended March 31, 2008. The table below presents a breakdown of operating expenses in each period:

(RR million)	Three months ended March 31	
	2008	2007
Purchased oil and gas	137,348	104,272
Staff costs	72,133	55,311
Taxes other than on income	63,842	50,509
Depreciation	56,409	50,090
Transit of gas, oil and refined products	48,278	37,747
Cost of goods for resale, including refined products	32,327	13,734
Repairs and maintenance	28,546	18,131
Materials	19,910	22,592
Electricity and heating expenses	16,854	12,322
Social expenses	4,099	3,384
Insurance expenses	4,097	3,204
Charge for impairment provisions	3,732	996
Rental expenses	3,597	4,229
Other operating expenses	<u>46,145</u>	<u>25,212</u>
Total operating expenses	537,317	401,733

Purchased oil and gas

Cost of purchased oil and gas increased by 32% to RR 137,348 million in the three months ended March 31, 2008 from RR 104,272 million in the same period of the prior year. The increase primarily relates to the increase in the amount of gas sales and purchase transaction in the European market and, therefore, the volume of purchased gas. These transactions are executed at market prices and are related mainly to Gazprom Germania Group. The cost of purchased oil included in the cost of purchased oil and gas increased by RR 18,339 or 112% and amounted to RR 34,775 million in the three months ended March 31, 2008 from RR 16,436 in the same period of the prior year.

Staff costs

Staff costs increased by 30% to RR 72,133 million in the three months ended March 31, 2008 from RR 55,311 million in the same period of the prior year. The increase mainly resulted from the growth of average base salaries and salaries of OAO Mosenergo, which is consolidated as a subsidiary from June, 2007. The increase in staff costs is also partially attributable to the increase in pumping out of gas from Underground Gas Storages (UGS) and respective expensing of staff costs, capitalized earlier in cost of gas.

Taxes other than on income

Taxes other than on income consist of:

(RR million)	Three months ended March 31	
	2008	2007
Natural resources production tax	53,179	40,324
Property tax	7,151	5,758
Other taxes	<u>3,512</u>	<u>4,427</u>
Taxes other than on income	63,842	50,509

Natural resources production tax increased by 32% to RR 53,179 million in the three months ended March 31, 2008 from RR 40,324 million in the same period of the prior year. The increase mainly relates to the increase in Natural resource production tax for oil due to increase in oil price ratio, used for calculation of the tax for oil. The ratio increased following the increase in oil prices.

Depreciation

Depreciation increased by 13% to RR 56,409 million in the three months ended March 31, 2008 from RR 50,090 million in the same period of the prior year. The increase primarily relates to the growth in our fixed asset base. The increase in depreciation is also partially attributable to the increase in pumping out of gas from UGSs and respective expensing of depreciation, capitalized earlier in cost of gas.

Transit of gas, oil and refined products

Transit of gas, oil and refined products increased by 28% to RR 48,278 million in the three months ended March 31, 2008 from RR 37,747 million in the three same period of the prior year. This increase mainly relates to the increase in cost of transportation through Ukrainian and Belorussian territory due to increased tariffs.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products increased by 135% to RR 32,327 million in the three months ended March 31, 2008 from RR 13,734 million in the same period of the prior year. The increase is mainly caused by the increase in prices for refined products and increase in volumes of refined products purchased.

Repairs and maintenance

Cost of repairs and maintenance increased by 57% to RR 28,546 million in the three months ended March 31, 2008 from RR 18,131 million in the same period of the prior year. This growth resulted from the increase in volumes of repair services rendered by third parties. The increase in Repairs and maintenance was also contributed by is also partially attributable to the increase in pumping out of gas from UGSs and respective expensing of Repairs and maintenance, which was earlier capitalized in cost of gas.

Materials

Cost of materials decreased by 12% to RR 19,910 million in the three months ended March 31, 2008 from RR 22,592 million in the same period of the prior year. The decrease was primarily caused by less materials, used for repair purposes. In the three months, ended March 31, 2008 more repairs were performed by third parties.

Electricity and heating expenses

Electricity and heating expenses increased by 37% to RR 16,854 million in the three months ended March 31, 2008 from RR 12,322 million in the same period of the prior year. The increase was mainly caused by the increase in electricity consumption and increase in share of electricity, purchased at market (not regulated) prices.

Other operating expenses

Other operating expenses increased by 83% to RR 46,145 million in the three months ended March 31, 2008 from RR 25,212 million in the same period of the prior year. Other operating expenses include research and development expenses, processing services, transportation services, bank charges, security services, legal and consulting services, and advertising. Included in other operating expenses for the three months, ended March 31, 2007 income from investment activities of NPF "Gazfund". NPF "Gazfund" is not consolidated since March 2007. OAO "Mosenergo", which is consolidated as a subsidiary from June 2007, also contributed to the increase. Other expenses of OAO "Mosenergo" for the three months ended 31 March 2008, including heating transportation expenses, are equal to RR 7,675 million.

Operating profit

As a result of the factors discussed above, our operating profit increased by RR 155,832 million, or 74% to RR 365,627 million in the three months ended March 31, 2008 from RR 209,795 million in the same period of the prior year. Our operating profit margin increased from 34% in the three months ended March 31, 2007 to 40% in the three months ended March 31, 2008.

Loss from change in fair value of call option with ENI.

In April 2007, ENI S.p.A. (Eni) offered the Group an option to acquire its 20% interest in OAO Gazprom Neft by April 2009, at a price of USD 3.7 billion plus certain financial expenses. For the three months, ended March 31, 2008 the fair value of the option decreased from RR 50,738 million as 31 December 2007 to RR 33,315 million as of 31 March 2008. The change in fair value in the amount of RR 17,423 million was recognized in the income statement for the three months, ended March 31, 2008.

Finance income and expenses

(RR million)	Three months ended March 31	
	2008	2007
Exchange gain	38,140	10,374
Exchange loss	(21,587)	(4,988)
Interest income	18,499	14,166
Interest expense	(19,003)	(15,048)
Gain on and extinguishment of restructured liabilities	<u>5</u>	<u>875</u>
Net finance income/(expense)	16,054	5,379

Exchange gain increased by 268% to RR 38,140 million in the three months ended March 31, 2008, compared to RR 10,374 million in same period of the prior year. Exchange loss increased by 333% to RR 21,587 million in the three months ended March 31, 2008 from RR 4,988 million in the same period of the prior year. The increase in exchange gain was caused by the increase in borrowings and loans denominated in USD in three months, ended March 31, 2008 in comparison with the same period of the prior year and higher depreciation rate of USD against RR in the three months ended March 31, 2008. The increase in exchange loss resulted from higher appreciation rate of EURO against RR in the three months ended March 31, 2008 in comparison with the same period of the prior year.

Interest income increased by 31% to RR 18,499 million in the three months ended March 31, 2008 from RR 14,166 million in the same period of the prior year mainly due to increase in interest income of OAO Gazprombank by 3,606 million in three months ended March 31, 2008, in comparison with the same period of the prior year. This was due to the increase in the amounts of loans issued in the year 2007. Interest expense increased by 26% from RR 15,048 million in the three months ended March 31, 2007 to RR 19,003 million in the same period of the current year mainly due to increased loans and borrowings.

Share of net income of associated undertakings and jointly controlled entities

Share of net income of associated undertakings and jointly controlled entities increased by RR 1,408 million or 13%, to RR 12,454 million in the three months ended March 31, 2008 compared to RR 11,046 million in the same period of the prior year. The increase was caused by the increase in share of net income of RosUkrEnergo AG from RR 48 million to RR 4,719 million. The increase was partly offset by our loss from Sakhalin Energy Investment Company Ltd in the amount of RR 1,619 million. The group acquired 50% plus one share in Sakhalin Energy Investment Company Ltd in April 2007. Losses of Sakhalin Energy Investment Company Ltd are due to the fact that the company did not start production of hydrocarbons.

Profit tax

Total profit tax expense increased by RR 31,910 million, or 51%, to RR 94,278 million in the three months ended March 31, 2008 compared to RR 62,368 million in the same period of the prior year. Our effective profit tax rate in the three months ended March 31, 2008 compared to the same period of the prior year increased from 22% to 25% mainly due to two factors: recognition of non-deductible loss from the reduction in the fair value of option with ENI during three months ended March 31, 2008 and one-time recognition of non-taxable income related to the NPF Gazfund deconsolidation during the same period of the prior year.

Profit for the period attributable to equity holders of OAO Gazprom

As a result of the factors discussed above, our profit for the period attributable to equity holders of OAO Gazprom increased by RR 63,127 million or 30%, from RR 210,312 million in the three months ended March 31, 2007 to RR 273,439 million in the three months ended March 31, 2008.

Profit for the period attributable to minority interest

Minority interest increased by 85% to RR 12,611 million in the three months ended March 31, 2008 compared to RR 6,825 million in the same period of the prior year.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our statements of cash flows for the three months ended March 31, 2008 and 2007:

(RR million)	Three months ended March 31	
	2008	2007
Net cash provided by operating activities	375,935	461,468
Net cash used for investing activities	(232,832)	(116,386)
Net cash (used for) provided by financing activities	(47,888)	53,121

Net cash provided by operating activities

Net cash provided by operating activities amounted to RR 375,935 million in the three months ended March 31, 2008 compared to RR 461,468 million in the same period of the prior year. This decrease was primarily due to cash inflow in OAO Gazprombank from temporary cash deposits from participants of the auctions in the amount of RR 157,166 in the three months ended 31 December 2007.

Net cash used for investing activities

Net cash used for investing activities amounted to RR 232,832 million in the three months ended March 31, 2008 compared to RR 116,386 million in the same period of the prior year. The increase was primarily due to higher capital expenditures on field development and gas transportation infrastructure (see Capital Expenditures), as well as additional investments in Sakhalin Energy Investment Company Ltd, OAO TGK-1, and OAO Beltransgaz.

Net cash (used for) provided by financing activities

Net cash used for financing activities amounted to RR 47,888 million in three months ended March 31, 2008 compared to net cash provided by financing activities in the amount of RR 53,121 million in the same period of the prior year. This change was primarily due to early repayment of a portion of long-term borrowings.

CAPITAL EXPENDITURES

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) by segment for the three months ended March 31, 2008 and 2007 in nominal RR terms, amounted to the following:

(RR million)	Three months ended March 31	
	2008	2007
Production of gas	36,300	29,215
Transport	34,454	36,018
Production of crude oil and gas condensate	19,203	9,905
Refining	9,252	6,011
Distribution	8,318	4,541
Other	<u>11,058</u>	<u>1,557</u>
Total	118,585	87,247

The increase of our capital expenditures in the Production of crude oil and gas condensate segment was primarily due to increased capital expenditures in Gazprom нефт. The increase of capital expenditures in the Other segment was mainly caused by capital expenditures of Mosenergo.

DEBT OBLIGATIONS

Net debt balance (defined as the sum of short-term borrowings, current portion of long-term borrowings, short-term promissory notes payable, long-term borrowings, long-term promissory notes payable and restructured tax liabilities, net of cash and cash equivalents and balances of cash and cash equivalents restricted as to withdrawal under the terms of certain borrowings and other contractual obligations) decreased by RR 125,287 million, or 10%, from RR 1,228,583 million as of 31 December 2007 to RR 1,103,296 million as of 31 March 2008. This decline can be explained by a significant increase of cash and cash equivalent balances on bank accounts of the Group.