

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, 2013. 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, 2012, prepared in accordance with International Financial Reporting Standards ("IFRS").

OVERVIEW

We are one of the world's largest gas and oil 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 principal businesses:

- Production of gas – exploration and production of gas;
- Transport – transportation of gas;
- Distribution – sales of gas within Russian Federation and abroad;
- Gas storage – storage of extracted and purchased gas in underground gas storages;
- Production of crude oil and gas condensate – exploration and production 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; and
- Electric and heat energy generation and sales.

Other businesses primarily comprise production of other products and sales of several goods, works, services.

Our 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 gas from our Production of gas segment and 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.

Application of new IFRS

Starting from January 1, 2013 the Group adopted a set of standards on consolidation: IFRS 10 "Consolidated Financial Statements" ("IFRS 10"), IFRS 11 "Joint Arrangements" ("IFRS 11"), IFRS 12 "Disclosure of Interests in Other Entities" ("IFRS 12"). As a result of the application of new standards, IFRS 11 "Joint Arrangements" in particular, The Group derecognised the investments in OAO Tomksneft VNK, Salym Petroleum Development N.V. and Blue Stream Pipeline company B.V. that were previously accounted for using the equity method and recognised its share of each of the assets and the liabilities in respect of the interest in those companies.

IAS 19 "Employee Benefits" (IAS 19) (revised) makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits.

The operational information below is restated (including prior period) to offer a clear comparison with these new accounting methods.

For more information on adoption of new standards, refer to the Note 4 of the IFRS Consolidated Interim Condensed Financial Information for the three months ended March 31, 2013.

RESULTS OF OPERATIONS

(RUB million)

	Three months periods ended March 31,	
	2013	2012 (restated)
Sales	1,461,441	1,225,278
Net gain from trading activity	4,592	1,490
Operating expenses	<u>(950,052)</u>	<u>(917,575)</u>
Operating profit	515,981	309,193
Finance income	27,366	139,474
Finance expense	(51,292)	(30,079)
Share of net income of associated undertakings and joint ventures	(2,158)	42,983
Gains (losses) on disposal of available-for-sale financial assets	<u>22</u>	<u>(200)</u>
Profit before profit tax	489,919	461,371
Current profit tax expense	(6,705)	(102,682)
Deferred profit tax (expense) benefit	<u>(95,062)</u>	<u>12,488</u>
Profit tax expense	(101,767)	(90,194)
Profit for the period	388,152	371,177
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Other comprehensive income/ (loss)		
Items that will not be reclassified to profit or loss:		
Remeasurements of post-employment benefit obligations	<u>753</u>	<u>(1,081)</u>
Total items that will not be reclassified to profit or loss	753	(1,081)
Items that will be reclassified to profit or loss:		
(Losses) gains arising from change in fair value of available-for-sale financial assets, net of tax	(12,174)	3,551
Share of other comprehensive gain (loss) of associated undertakings and joint ventures	1,178	(2,758)
Translation differences	7,439	(51,238)
Gains from cash flow hedges, net of tax	<u>1,037</u>	<u>6,218</u>
Total items that will be reclassified to profit or loss	(2,520)	(44,227)
Other comprehensive loss for the period, net of tax	(1,767)	(45,308)
Total comprehensive income for the period	386,385	325,869
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Profit attributable to:		
owners of OAO Gazprom	380,665	361,403
non-controlling interest	<u>7,487</u>	<u>9,774</u>
	388,152	371,177
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Total comprehensive income attributable to:		
owners of OAO Gazprom	378,647	318,894
non-controlling interest	<u>7,738</u>	<u>6,975</u>
	386,385	325,869

Sales

The following table sets out our volumes and realized prices for year ended March 31, 2013 and 2012.

(RUB million unless indicated otherwise)	Three months periods ended March 31,	
	2013	2012 (restated)
Sales of gas		
<i>Europe and Other Countries</i>		
Gross sales ⁽¹⁾	538,132	492,302
Customs duties	(109,818)	(105,702)
Net sales	428,314	386,600
Volumes in billion cubic meters (bcm)	45.4	42.7
Gross average price, U.S.\$ per mcm ⁽²⁾ (including customs duties) ⁽³⁾	390.0	383.8
Gross average price, RUB per mcm ⁽²⁾ (including customs duties)	11,862.8	11,525.7
<i>FSU (Former Soviet Union)</i>		
Gross sales ⁽¹⁾	146,605	172,365
Customs duties	(24,828)	(28,040)
Net sales	121,777	144,325
Volumes in bcm	18.2	20.0
Gross average price, U.S.\$ per mcm ⁽²⁾ (including customs duties, net of VAT) ⁽³⁾	265.2	287.5
Gross average price, RUB per mcm ⁽²⁾ (including customs duties, net of VAT)	8,066.0	8,633.4
<i>Russian Federation</i>		
Gross sales (net of VAT)	280,298	269,070
Net sales	280,298	269,070
Volumes in bcm	90.3	99.6
Gross average price, RUB per mcm ⁽²⁾ (net of VAT)	3,104.5	2,701.3
<i>Total sales of gas</i>		
Gross sales (net of VAT)	965,035	933,737
Customs duties	(134,646)	(133,742)
Retroactive gas price adjustments	73,430	(78,505)
Net sales	903,819	721,490
Volumes in bcm	153.9	162.3
Net sales of refined products (net of excise tax, VAT and customs duties)	319,178	255,971
Net sales of electric and heat energy (net of VAT)	106,851	111,601
Net sales of crude oil and gas condensate (net of VAT and customs duties)	52,280	65,651
Gas transportation net sales (net of VAT)	41,232	32,059
Other revenues (net of VAT)	38,081	38,506
Total sales (net of excise tax, VAT and customs duties)	1,461,441	1,225,278

Notes:

⁽¹⁾ VAT is not charged on sales to Europe and Other Countries.

⁽²⁾ One mcm is equivalent to 35,316 cubic feet.

⁽³⁾ Calculated on the basis of average exchange rate between RUB and U.S.\$.

Total sales (net of VAT, excise tax and customs duties) increased by RUB 236,163 million, or 19%, to RUB 1,461,441 million in the three months period ended March 31, 2013 compared to the same period of the prior year.

Net sales of gas accounted for 62% and 59% of total net sales in the three months periods ended March 31, 2013 and 2012, respectively.

Net sales of gas increased by RUB 182,329 million from RUB 721,490 million in the three months period ended March 31, 2012 to RUB 903,819 million in the three months period ended March 31, 2013, or by 25%.

Net sales of gas to Europe and Other Countries increased by RUB 41,714 million, or 11%, to RUB 428,314 million in the three months period ended March 31, 2013 as compared to the three months period ended March 31, 2012 primarily due to increases in volumes of gas sold and average prices. The volume of gas sold in the three months period ended March 31, 2013 increased by 6% as compared to the same period of the prior year. The gross average RUB price (including customs duties) increased by 3%.

Retroactive gas price adjustments were recognized in the financial statements for the three months period ended March 31, 2013 as an increase of sales in amount RUB 73,430 million reflecting a decrease in a related accrual following estimates made and agreements reached prior to the issuance of the first quarter 2013 financial informations.

Net sales of gas to FSU countries decreased by RUB 22,548 million, or 16% to RUB 121,777 million in the three months period ended March 31, 2013 compared to the three months period ended March 31, 2012 primarily due to a 9% decrease in volumes of gas sold to FSU countries. The gross average RUB price (including customs duties, net of VAT) decreased by 7% in the three months period ended March 31, 2013, compared to the same period of the prior year.

Net sales of gas in the Russian Federation increased by RUB 11,228 million, or 4%, to RUB 280,298 million in three months period ended March 31, 2013 compared to the same period of the prior year due to a 15% increase in the gross average domestic gas prices partly offset by a 9% decrease in volume of gas sold in the three months period ended March 31, 2013 compared to the three months period ended March 31, 2012.

Net sales of refined products (net of excise tax, VAT and customs duties) increased by RUB 63,207 million, or 25%, to RUB 319,178 million in the three months period ended March 31, 2013 in comparison with the same period of the prior year primarily due to consolidation of OAO Gazprom neftekhim Salavat's sales, due to the fact that in 2012 the Group obtained control over the operating and financial activities of the company and an increase in volumes sold by Gazprom нефт Group to customers in Europe and Other Countries. In the three months periods ended December 31, 2013 and 2012 Gazprom нефт Group's sales comprised 73% and 83% of the total amount of net sales of refined products, respectively.

Net sales of electric and heat energy (net of VAT) decreased by RUB 4,750 million, or 4%, to 106,851 in the three months period ended March 31, 2013 compared to the same period of the prior year. The decrease is mainly caused by the decrease of OAO Mosenergo's sales as well as the changes in the scheme of payments since October 1, 2012 after consolidation of OAO "MOEK" and OAO "MTK".

Net sales of crude oil and gas condensate (net of VAT and customs duties) decreased by RUB 13,371 million, or 20%, to RUB 52,280 million in the three months period ended March 31, 2013 compared to RUB 65,651 million in the three months period ended March 31, 2012 due to a decrease in crude oil volumes and average price to customers in Europe and Other Countries. Sales of gas condensate decreased due to inclusion of OAO Gazprom neftekhim Salavat in the consolidated financial statements from June 2012. Sales of crude oil included in net sales of crude oil and gas condensate (net of VAT and customs duties), amounted to RUB 42,815 million and RUB 51,645 million in the three months periods ended March 31, 2013 and 2012, respectively.

Gas transportation net sales (net of VAT) increased by RUB 9,173 million, or 29%, to RUB 41,232 million in the three months period ended March 31, 2013 from RUB 32,059 million in the three months period ended March 31, 2012 primarily due to an increase in volume of gas transportation services rendered to independent gas suppliers.

Other revenues decreased by RUB 425 million, or 1%, to RUB 38,081 million in the three months period ended March 31, 2013 compared to RUB 38,506 million in the three months period ended March 31, 2012.

Operating expenses

Operating expenses increased by 4% in the three months period ended March 31, 2013 to RUB 950,052 million from RUB 917,575 million in the three months period ended March 31, 2012. Operating expenses as a percentage of sales decreased from 75% in the three months period ended March 31, 2012 to 65% in the three months period ended March 31, 2013. The table below presents a breakdown of operating expenses in each period:

	Three months periods ended March 31,	
	2013	2012 (restated)
Purchased gas and oil	187,280	177,233
Taxes other than on income	182,816	169,976
Staff costs	119,854	93,710
Depreciation	109,873	82,607
Transit of gas, oil and refined products	86,453	82,108
Materials	52,084	23,907
Repairs and maintenance	31,445	28,135
Cost of goods for resale, including refined products	30,750	34,652
Electricity and heating expenses	23,729	19,104
Charge for impairment provisions	13,314	9,123
Social expenses	8,890	4,067
Transportation services	7,459	5,451
Losses from derivatives financial instruments in the operating activities	6,444	20,209
Rental expenses	5,874	5,562
Insurance expenses	5,385	4,811
Research and development expenses	4,714	5,250
Heat transmission	3,835	11,809
Processing services	3,507	3,491
Exchange rate differences on operating items	(5,318)	33,707
Other	<u>43,695</u>	<u>47,316</u>
	<u>922,083</u>	<u>862,228</u>
Changes in inventories of finished goods, work in progress and other effects	<u>27,969</u>	<u>55,347</u>
Total operating expenses	<u>950,052</u>	<u>917,575</u>

Purchased gas and oil

Cost of purchased gas and oil increased by 6% to RUB 187,280 million in the three months period ended March 31, 2013 from RUB 177,233 million in the three months period ended March 31, 2012. Cost of purchased gas increased by RUB 9,593 million, or 8%. This increase mainly relates to the growth in prices of gas purchased from third parties outside of the Russian Federation. The cost of purchased oil included in the cost of purchased gas and oil increased by RUB 454 million, or 1%, and amounted to RUB 50,107 million in the three months period ended March 31, 2013 in comparison with RUB 49,653 million in the three months period ended March 31, 2012.

Taxes other than on income

Taxes other than on income consist of:

(RUB million)	Three months periods ended March 31,	
	2013	2012
Natural resources production tax	131,701	126,619
Property tax	19,392	13,941
Other taxes	<u>31,723</u>	<u>29,416</u>
Taxes other than on income	<u>182,816</u>	<u>169,976</u>

The natural resources production tax increased by 4% to RUB 131,701 million in the three months period ended March 31, 2013 from RUB 126,619 million in the three months period ended March 31, 2012. The increase of natural resources production tax on gas extraction results from growth of tax rate for gas from RUB 509 to RUB 582 per thousand cubic meters since 1 January 2013.

Staff costs

Staff costs increased by 28% to RUB 119,854 million in the three months period ended March 31, 2013 from RUB 93,710 million in the three months period ended March 31, 2012. The increase in staff costs mainly resulted from the average salary indexation.

Depreciation

Depreciation increased by 33%, or RUB 27,266 million, to RUB 109,873 million in the three months period ended March 31, 2013 from RUB 82,607 million in the three months period ended March 31, 2012. The increase primarily relates to the growth in the fixed asset base.

Transit of gas, oil and refined products

Transit of gas, oil and refined products increased by 5% to RUB 86,453 million in the three months period ended March 31, 2013 from RUB 82,108 million in the three months period ended March 31, 2012. This increase is mainly driven by increase of transit costs of oil and refined products.

Materials

Cost of materials increased by 118% to RUB 52,084 million in the three months period ended March 31, 2013 from RUB 23,907 million in the three months period ended March 31, 2012. The change mainly relates to inclusion of OAO Gazprom neftekhim Salavat in the consolidated financial statements from June 2012, as well as to increase of materials purchase prices.

Repairs and maintenance

Cost of repairs and maintenance increased by 12% to RUB 31,445 million in three months period ended March 31, 2013 from RUB 28,135 million in the three months period ended March 31, 2012. This increase was caused by the increase of volume of repair services rendered by third parties to the Group during three months ended March 31, 2013.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products decreased by 11% to RUB 30,750 million in the three months period ended March 31, 2013 from RUB 34,652 million in the three months period ended March 31, 2012. The decrease in cost of goods for resale, including refined products, mainly results from the decline in the Group's trading activity.

Electricity and heating expenses

Electricity and heating expenses increased by 24% to RUB 23,729 million in the three months period ended March 31, 2013 from RUB 19,104 million in the three months period ended March 31, 2012. The increase mainly resulted from the increase in consumption of electricity and increase in electricity tariffs.

Exchange rate differences on operating items

Exchange rate differences on operating items for three months ended March 31, 2013 amounted to a net gain of RUB 5,318 million and net loss of RUB 33,707 million during three months ended March 31, 2012. The change was primarily driven by depreciation of EURO by 1% and appreciation of USD by 2% against RUB during three months ended March 31, 2013, compared to depreciation of EURO and USD against RUB by 6% and 9% during three months ended March 31, 2012, respectively.

Other operating expenses

Other operating expenses decreased by 8% to RUB 43,695 million in the three months period ended March 31, 2013 from RUB 47,316 million in the three months period ended March 31, 2012. Other expenses include bank charges, security services, legal and consulting services, charity and finance aid, advertising and software services.

Changes in inventories of finished goods, work in progress and other effects

Change in inventories of finished goods, work in progress and other effects decreased by 49% from RUB 55,347 million in the three months period ended March 31, 2012 to RUB 27,969 million in the three months

period ended March 31, 2013. The decrease relates mainly to the decrease in the balances of finished goods as of March 31, 2013 compared to the balance as of December 31, 2012.

Operating profit

As a result of the factors discussed above, our operating profit increased by RUB 206,788 million, or 67%, to RUB 515,981 million in the three months period ended 31 March 2013 from RUB 309,193 million in the three months period ended 31 March 2012. Operating profit margin increases from 25% in the three months period ended 31 March 2012 to 35% in the three months period ended 31 March 2013.

Net finance (loss) income

(RUB million)	Three months periods ended March 31, 2012	
	2013	(restated)
Exchange gains	21,641	133,926
Exchange losses	(44,281)	(14,547)
Net exchange (loss) gain	(22,640)	119,379
Interest income	5,725	5,548
Interest expense	(7,011)	(15,532)
Net finance (loss) income	(23,926)	109,395

The net exchange loss of RUB 22,640 million in the three months period ended March 31, 2013 in comparison with net exchange gain of RUB 119,379 million in the same period of the prior year is explained by appreciation of USD against RUB by 2% and depreciation of euro against RUB by 1% in the three months period ended March 31, 2013, respectively, compared to depreciation of USD and euro against RUB by 9% and 6% in the same period of the prior year, respectively.

Interest income increased by 3% to RUB 5,725 million in the three months period ended March 31, 2013 from RUB 5,548 million in the same period of the prior year.

Interest expense decreased by 55% to RUB 7,011 million in the three months period ended March 31, 2013 from RUB 15,532 million in the same period of the prior year, mainly due to decrease in loans and borrowings, interest expense from which relates to finance expense.

Share of net (loss) income of associated undertakings and joint ventures

Share of net loss of associated undertakings and joint ventures in the three months ended March 31, 2013, amounted to RUB 2,158 million compared to the share of net income in the same period of the prior year in the amount of RUB 42,983 million. The decrease of the Group's share of net (loss) income of associated undertakings and joint ventures in the three months ended March 31, 2013 relates mainly to the decline in net income of Sakhalin Energy Investment Company Ltd. by RUB 8,250 million due to the increase of royalty obligations (a fee for subsoil use) as a share of Russian Federation's profit in production; Gazprombank Group's profits decreased by RUB 3,983 million mainly due to decrease of profit from the banking activity; decrease in net income of OAO NGK Slavneft and its subsidiaries - by RUB 4,050 million caused by the decrease of crude oil extraction volume for the three months period ended March 31, 2013 compared to the same period of the prior year. The Group's share of net loss of associated undertakings and joint ventures for the three months ended 31 March 2013 includes additional expense of RUB 25,961 million recognized for OAO NGK Slavneft and its subsidiaries as a result of a one-time adjustment to correct the prior understatement of depreciation on the basis difference for property, plant and equipment since the Group's acquisition of interests in OAO NGK Slavneft.

Profit tax

Total profit tax expense increased by RUB 11,573 million, or 13%, to RUB 101,767 million in the three months period ended March 31, 2013 compared to RUB 90,194 million in the three months period ended March 31, 2012. The effective profit tax rate was 20.8% and 19.5% in the three months periods ended March 31, 2013 and 2012, respectively. Increase of the effective profit tax rate mainly resulted from a recognition of non-taxable share of net loss of associated undertakings and joint ventures in the three months period ended March 31, 2013 compared to the income recognized in same period of the prior year.

Profit for the period attributable to owners of OAO Gazprom

As a result of the factors discussed above, our profit for the period attributable to owners of OAO Gazprom increased by RUB 19,262 million, or 5%, from RUB 361,403 million in the three months period ended March 31, 2012 to RUB 380,665 million in the three months period ended March 31, 2013.

Profit for the period attributable to non-controlling interest

Profit for the period attributable to non-controlling interest decreased by RUB 2,287 million, or 23%, to RUB 7,487 million in the three months period ended March 31, 2013 compared to RUB 9,774 million in the three months period ended March 31, 2012.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our statements of cash flows for the three months ended March 31, 2013 and 2012:

(RUB million)	Three months periods ended March 31,	
	2013	2012 (restated)
Net cash provided by operating activities	517,873	606,343
Net cash used for investing activities	(398,770)	(358,220)
Net cash provided (used for)by financing activities	26,108	(45,054)

Net cash provided by operating activities

Net cash provided by operating activities amounted to RUB 517,873 million in the three months period ended March 31, 2013 compared to RUB 606,343 million in the three months period ended March 31, 2012. The decrease was primarily due to the negative dynamics of changes in working capital in the three months period ended March 31, 2013 in comparison with the same period of the prior year.

Net cash used for investing activities

Net cash used for investing activities increased by RUB 40,550 million, or 11%, to RUB 398,770 million in the three months period ended March 31, 2013 compared to RUB 358,220 million in the three months period ended March 31, 2012. The increase was primarily due to the decrease in proceeds from associated undertakings and joint ventures in the three months period ended March 31, 2013 in comparison with the same period of the prior year.

Net cash provided by (used for) financing activities

Net cash provided by financing activities amounted to RUB 26,108 million in the three months period ended March 31, 2013 compared to net cash used for financing activities in the amount of RUB 45,054 million in the three months period ended March 31, 2012. This change was mainly due to the fact that cash provided by proceeds from long-term borrowings exceeded the repayment of long-term borrowings in the three months period ended March 31, 2013, while compared to the same period of the prior year cash used for repayment of long-term borrowings exceeded cash provided by proceeds from long-term borrowings.

Capital expenditures

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) by segment for the three months periods ended March 31, 2013 and 2012 in nominal RR terms, amounted to the following:

(RR million)	Three months periods ended	
	2013 ⁽¹⁾	2012 ⁽¹⁾
Production of gas	49,018	49,233
Transport	48,611	104,159
Production of crude oil and gas condensate	37,403	27,522
Refining	24,755	24,070
Electric and heat energy generation and sales	16,699	6,813
Distribution	4,281	6,710
Gas storage	4,001	1,765
All other segments	<u>14,369</u>	<u>3,638</u>
Total	199,137	223,910

Note:

(1) The capital expenditures in the present analysis differs from the capital additions disclosed within the Group's business segments in IFRS consolidated interim condensed financial statements of OAO Gazprom primarily due to VAT.

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) decreased by RR 24,773 million, or 11%, from RR 223,910 million in the three months period ended March 31, 2012 to RR 199,137 million in the three months period ended March 31, 2013.

The decrease of our capital expenditures in the Transport segment was primarily due to put into operation of Pipeline Bovanenkovo-Ukhta, Pipeline Ukhta-Torzhok in connection with launching of Bovanenkovo field. The increase of our capital expenditures in the segment of Production of crude oil and gas condensate was due to capital expenditures of Gazprom Neft Group. The increase of our capital expenditures in the Electric and heat energy generation and sales segment was primarily due to increase of capital expenditures of Mosenergo in construction of modern steamgas power-generating units at TPP-12, TPP-16 and TPP-20. The increase of capital investment in other segments was mainly due to construction in the scope of the Program of Construction of Olympic Venues and the Development of Sochi as a Mountain Climate Resort.

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 and long-term promissory notes payable, 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 RUB 98,784 million, or 9%, from RUB 1,071,214 million as of December 31, 2012 to RUB 972,430 million as of March 31, 2013. This decrease resulted mainly from the increase in cash and cash equivalents.