

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 six months ended June 30, 2011. 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, 2010, 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.

RESULTS OF OPERATIONS

(RR million)

	Six months periods ended	
	June 30,	
	2011	2010
Sales	2,347,071	1,716,279
Net (loss) gain from trading activity	(236)	2,437
Operating expenses	<u>(1,498,340)</u>	<u>(1,140,996)</u>
Operating profit	848,495	577,720
Finance income	106,765	91,588
Finance expense	(44,675)	(83,444)
Share of net income of associated undertakings and jointly controlled entities	62,566	52,945
Gains on disposal of available-for-sale financial assets	<u>831</u>	<u>1,389</u>
Profit before profit tax	973,982	640,198
Current profit tax expense	(170,346)	(99,390)
Deferred profit tax expense	<u>(18,434)</u>	<u>(32,574)</u>
Profit tax expense	(188,780)	(131,964)
Profit for the period	785,202	508,234
Other comprehensive income		
(Losses) gains arising from change in fair value of available-for-sale financial assets, net of tax	(2,389)	174
Share of other comprehensive (loss) income of associated undertakings and jointly controlled entities	(6,352)	726
Translation differences	<u>(25,034)</u>	<u>(13,315)</u>
Other comprehensive loss for the period, net of tax	(33,775)	(12,415)
Total comprehensive income for the period	751,427	495,819
Profit attributable to:		
owners of OAO Gazprom	771,669	494,684
non-controlling interest	<u>13,533</u>	<u>13,550</u>
	785,202	508,234
Total comprehensive income attributable to:		
owners of OAO Gazprom	739,777	480,079
non-controlling interest	<u>11,650</u>	<u>15,740</u>
	751,427	495,819

Sales

The following table sets out our volumes and realized prices for the six months periods ended June 30, 2011 and 2010.

(RR million unless indicated otherwise)	Six months periods ended June 30,	
	2011	2010
Sales of gas		
<i>Europe and other countries</i>		
Gross sales ⁽¹⁾	896,354	659,315
Customs duties	(154,142)	(134,954)
Net sales	742,212	524,361
Volumes in billion cubic meters (bcm)	86.6	76.3
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	361.8	287.6
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties)	10,356.0	8,646.0
<i>FSU (Former Soviet Union)</i>		
Gross sales (net of value added tax (VAT))	357,470	216,658
Customs duties	(26,036)	(28,506)
Net sales	331,434	188,152
Volumes in bcm	46.8	31.6
Gross average price, U.S.\$ per mcm ⁽²⁾ (including customs duties, net of VAT) ⁽³⁾	266.6	227.8
Gross average price, RR per mcm ⁽²⁾ (including customs duties, net of VAT)	7,630.5	6,848.2
<i>Russian Federation</i>		
Gross sales (net of VAT)	398,630	343,587
Net sales	398,630	343,587
Volumes in bcm	154.2	150.7
Gross average price, RR per mcm ⁽²⁾ (net of VAT)	2,585.6	2,279.5
<i>Total sales of gas</i>		
Gross sales (net of VAT)	1,652,454	1,219,560
Customs duties	(180,178)	(163,460)
Net sales	1,472,276	1,056,100
Volumes in bcm	287.6	258.6
Net sales of refined products (net of excise tax, VAT and customs duties)	451,938	319,125
Net sales of electric and heat energy (net of VAT)	180,215	145,733
Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties)	117,293	93,520
Gas transportation net sales (net of VAT)	55,500	45,576
Other revenues (net of VAT)	69,849	56,225
Total sales (net of excise tax, VAT and customs duties)	2,347,071	1,716,279

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 rate.

Total sales (net of excise tax, VAT and customs duties) increased by RR 630,792 million, or 37%, to RR 2,347,071 million in the six months period ended June 30, 2011 compared to the same period of the prior year.

Net sales of gas accounted for 63% and 62% of total net sales in the six months periods ended June 30, 2011 and 2010, respectively.

Net sales of gas increased from RR 1,056,100 million in the six months period ended June 30, 2010 to RR 1,472,276 million in the six months period ended June 30, 2011, or by 39%.

Net sales of gas to Europe and other countries increased in the six months period ended June 30, 2011 compared to the six months period ended June 30, 2010, by RR 217,851 million, or 42%, to RR 742,212 million. The overall increase in net sales of gas to Europe and other countries was primarily driven by the increase in average prices. The

gross average RR price (including excise tax and customs duties) increased by 20% in the six months period ended June 30, 2011, compared to the six months period ended June 30, 2010. In addition, volume of gas sold in the six months period ended June 30, 2011 increased by 13% compared to the same period of the prior year.

Net sales of gas to FSU countries increased in the six months period ended June 30, 2011 compared to the six months period ended June 30, 2010, by RR 143,282 million, or 76%, to RR 331,434 million. This increase was mainly due to the increase in volumes of gas sold to FSU countries by 48% in the six months period ended June 30, 2011 compared to the six months period ended June 30, 2010. In addition, the gross average RR price (including customs duties, net of VAT) increased by 11% in the six months period ended June 30, 2011 compared to the same period of the prior year.

Net sales of gas in the Russian Federation increased in the six months period ended June 30, 2011 compared to the same period of the prior year, by RR 55,043 million, or 16%, to RR 398,630 million. This increase was due to the increase in the gross average price for domestic gas sales by 13% in the six months period ended June 30, 2011 compared to the same period of the prior year due to the increase in tariffs which are set by the Federal Tariffs Service (FTS).

Net sales of refined products (net of excise tax, VAT and customs duties) increased by RR 132,813 million, or 42%, to RR 451,938 million in the six months period ended June 30, 2011 in comparison with the same period of the prior year. The increase mainly resulted from the increase of world prices for refined products and increase in volumes sold in the six months period ended June 30, 2011 compared to the same period of the prior year. In the six months periods ended June 30, 2011 and 2010 Gazprom neft Group's sales comprised 84% and 83% of the total amount of our net sales of refined products, respectively.

Net sales of electric and heat energy (net of VAT) increased by RR 34,482 million, or 24%, to RR 180,215 million in the six months period ended June 30, 2011 compared to the same period of the prior year. Increase of electric and heat energy sales was mainly due to the increase in tariffs and in volumes sold.

Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties) increased by RR 23,773 million, or 25%, to RR 117,293 million in the six months period ended June 30, 2011 compared to RR 93,520 million in the six months period ended June 30, 2010. The increase was mainly caused by the increase in oil and gas condensate prices in the six months period ended June 30, 2011 compared to the same period of the prior year. Also the increase was supported by the increase of the volume of gas condensate sold in the six months period ended June 30, 2011 compared to the same period of the prior year. Sales of crude oil included in net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties), amounted to RR 96,232 million and RR 80,835 million in the six months periods ended June 30, 2011 and 2010, respectively.

Gas transportation net sales (net of VAT) increased by RR 9,924 million, or 22%, to RR 55,500 million in the six months period ended June 30, 2011 from RR 45,576 million in the six months period ended June 30, 2010. The increase was mainly caused by the increase in gas transportation tariffs for independent gas suppliers and by the increase of gas volumes transported for independent gas suppliers in the six months period ended June 30, 2011 compared to the same period of the prior year.

Other revenues increased by RR 13,624 million, or 24%, to RR 69,849 million in the six months period ended June 30, 2011 compared to RR 56,225 million in the six months period ended June 30, 2010.

Net loss from trading activity is RR 236 million in six months period ended June 30, 2011 compared with gain of RR 2,437 million in six months period ended June 30, 2010.

Operating expenses

Operating expenses increased by 31% in the six months period ended June 30, 2011 to RR 1,498,340 million from RR 1,140,996 million in the six months period ended June 30, 2010. Operating expenses as a percentage of sales decreased from 66% in the six months period ended June 30, 2010 to 64% in the six months period ended June 30, 2011. The table below presents a breakdown of operating expenses in each period:

(RR million)	Six months periods ended June 30,	
	2011	2010
Purchased gas and oil	452,311	273,908
Taxes other than on income	206,542	144,866
Staff costs	178,058	150,537
Depreciation	133,920	120,619
Transit of gas, oil and refined products	133,414	145,805
Repairs and maintenance	70,940	69,556
Cost of goods for resale, including refined products	50,867	22,300
Materials	49,636	46,447
Electricity and heating expenses	39,081	29,863
Exchange rate differences on operating items	29,442	6,975
Transportation services	16,810	10,924
Heat transmission	16,014	14,191
Social expenses	13,742	10,975
Rental expenses	11,878	10,087
Research and development expenses	10,193	10,437
Insurance expenses	8,339	7,588
Processing services	4,114	4,240
Charge for impairment provisions	1,350	8,968
Other	<u>68,851</u>	<u>67,347</u>
	<u>1,495,502</u>	<u>1,155,633</u>
Changes in inventories of finished goods, work in progress and other effects	<u>2,838</u>	<u>(14,637)</u>
Total operating expenses	<u>1,498,340</u>	<u>1,140,996</u>

Purchased gas and oil

Cost of purchased gas and oil increased by 65% to RR 452,311 million in the six months period ended June 30, 2011 from RR 273,908 million in the six months period ended June 30, 2010. Cost of purchased gas increased by RR 140,914 million, or 76%. This increase relates to the increase in volumes and increase in prices of gas purchased from third parties within Russian Federation and abroad. The cost of purchased oil included in the cost of purchased gas and oil increased by RR 37,489 million, or 43%, and amounted to RR 125,476 million in the six months period ended June 30, 2011 in comparison with RR 87,987 million in the six months period ended June 30, 2010 due to the increase in oil prices.

Taxes other than on income

Taxes other than on income consist of:

(RR million)	Six months periods ended June 30,	
	2011	2010
Natural resources production tax	132,067	86,404
Excise tax	46,004	31,700
Property tax	23,264	21,433
Other taxes	<u>5,207</u>	<u>5,329</u>
Taxes other than on income	<u>206,542</u>	<u>144,866</u>

The natural resources production tax increased by 53% to RR 132,067 million in the six months period ended June 30, 2011 from RR 86,404 million in the six months period ended June 30, 2010. The increase mainly resulted from the general increase of natural resources production tax rate for gas from RR 147 to RR 237 per thousand cubic meters from January 1, 2011 as well as from the increase of natural resources production tax rate for oil due to the increase in average world oil prices.

Staff costs

Staff costs increased by 18% to RR 178,058 million in the six months period ended June 30, 2011 from RR 150,537 million in the six months period ended June 30, 2010. The increase mainly resulted from the salary indexation.

Depreciation

Depreciation increased by 11%, or RR 13,301 million, to RR 133,920 million in the six months period ended June 30, 2011 from RR 120,619 million in the six months period ended June 30, 2010. The increase primarily relates to the growth in fixed asset base.

Transit of gas, oil and refined products

Transit of gas, oil and refined products decreased by 8% to RR 133,414 million in the six months period ended June 30, 2011 from RR 145,805 million in the six months period ended June 30, 2010. This decrease mainly relates to the decrease in costs of transportation through Ukraine.

Repairs and maintenance

Cost of repairs and maintenance increased by 2% to RR 70,940 million in six months period ended June 30, 2011 from RR 69,556 million in the six months period ended June 30, 2010. This increase was caused by the increase of volume of repair services rendered by third parties to the Group in the six months period ended June 30, 2011.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products increased by 128% to RR 50,867 million in the six months period ended June 30, 2011 from RR 22,300 million in the six months period ended June 30, 2010. The increase in cost of goods for resale, including refined products, mainly results from the increase in volumes of refined products purchased by the Gazprom neft Group and the increase in prices for refined products.

Materials

Cost of materials increased by 7% to RR 49,636 million in the six months period ended June 30, 2011 from RR 46,447 million in the six months period ended June 30, 2010. The increase mainly resulted from the increase in prices for purchased materials.

Electricity and heating expenses

Electricity and heating expenses increased by 31% to RR 39,081 million in the six months period ended June 30, 2011 from RR 29,863 million in the six months period ended June 30, 2010. The increase mainly resulted from the increase of electricity tariffs.

Exchange rate differences on operating items

Exchange rate differences on operating items in the six months periods ended June 30, 2011 and 2010 amounted to a net loss of RR 29,442 million and RR 6,975 million, respectively. The change was primarily driven by appreciation of RUR against USD by 8%, in the six months ended June 30, 2011, compared to depreciation of RUR against USD by 3% and appreciation of RUR against EURO by 12%, in the same period of the prior year.

Other operating expenses

Other operating expenses increased by 2% to RR 68,851 million in the six months period ended June 30, 2011 from RR 67,347 million in the six months period ended June 30, 2010. 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

Changes in inventories of finished goods, work in progress and other effects changed from gain of RR 14,637 million in the six months period ended June 30, 2010 to loss of RR 2,838 million in the six months period ended June 30, 2011. These changes in inventories of finished goods, work in progress and other effects in the six months period ended June 30, 2011 relate mainly to the decrease in the balances of finished goods as of June 30, 2011 in comparison with those as of December 31, 2010.

Operating profit

As a result of the factors discussed above, our operating profit increased by RR 270,775 million, or 47%, to RR 848,495 million in the six months period ended June 30, 2011 from RR 577,720 million in the same period of the prior year. Our operating profit margin increased from 34% in the six months period ended June 30, 2010 to 36% in the six months period ended June 30, 2011.

Net finance income

(RR million)	Six months periods ended June 30,	
	2011	2010
Exchange gains	99,110	80,242
Exchange losses	<u>(25,307)</u>	<u>(59,290)</u>
Net exchange gain	73,803	20,952
Interest income	7,557	11,342
Interest expense	(19,368)	(24,154)
Gains on extinguishment of restructured liabilities	<u>98</u>	<u>4</u>
Net finance income	62,090	8,144

Exchange gains increased by RR 18,868 million to RR 99,110 million in the six months period ended June 30, 2011, compared to RR 80,242 million in the six months period ended June 30, 2010. Exchange losses decreased by RR 33,983 million to RR 25,307 million in the six months period ended June 30, 2011 from RR 59,290 million in the six months period ended June 30, 2010. The increase in net exchange gains resulted from higher fluctuation of USD exchange rate against RUR in the six months ended June 30, 2011 in comparison with the same period of the prior year.

Interest income decreased by 33% to RR 7,557 million in the six months period ended June 30, 2011 from RR 11,342 million in the six months period ended June 30, 2010, mainly due to deconsolidation of ZAO Gazenergoprombank in the second quarter 2010.

Interest expense decreased by 20% to RR 19,368 million in the six months period ended June 30, 2011 from RR 24,154 million in the six months period ended June 30, 2010, mainly due to decrease in average borrowings balance during the six months period ended June 30, 2011 in comparison with the same period of the prior year.

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 9,621 million, or 18%, to RR 62,566 million in the six months period ended June 30, 2011 compared to RR 52,945 million in the same period of the prior year. The increase of the Group's share of net income of associated undertakings and jointly controlled entities in the six months period ended June 30, 2011 relates mainly to the increase of net income of Sakhalin Energy Investment Company Ltd. due to the increase of liquefied natural gas sales and crude oil sales and the increase of net income of Gazprombank Group in the six months period ended June 30, 2011 compared to the same period of the prior year.

Profit tax

Total profit tax expense increased by RR 56,816 million, or 43%, to RR 188,780 million in the six months period ended June 30, 2011 compared to RR 131,964 million in the six months period ended June 30, 2010. The effective profit tax rate was 19.4% and 20.6% in the six months periods ended June 30, 2011 and 2010, respectively. Change of the effective profit tax rate mainly resulted from a relative decrease of non-deductable expenses and increase of non-taxable share of net income of associated undertakings and jointly controlled entities in the six months period ended June 30, 2011 compared to the 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 RR 276,985 million, or 56%, from RR 494,684 million in the six months period ended June 30, 2010 to RR 771,669 million in the six months period ended June 30, 2011.

Profit for the period attributable to non-controlling interest

Profit for the period attributable to non-controlling interest decreased by RR 17 million, or 0.1%, to RR 13,533 million in the six months period ended June 30, 2011 compared to RR 13,550 million in the six months period ended June 30, 2010.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our statements of cash flows for the six months ended June 30, 2011 and 2010:

(RR million)	Six months periods ended June 30,	
	2011	2010
Net cash provided by operating activities	689,448	747,782
Net cash used for investing activities	(666,947)	(493,954)
Net cash provided by (used for) financing activities	1,776	(126,509)

Net cash provided by operating activities

Net cash provided by operating activities amounted to RR 689,448 million in the six months period ended June 30, 2011 compared to RR 747,782 million in the six months period ended June 30, 2010. The decrease was primarily due to the negative dynamics of changes in working capital. This effect was partly offset by the growth of our operating profit in the six months period ended June 30, 2011 in comparison with the same period of the prior year.

Net cash used for investing activities

Net cash used for investing activities increased by RR 172,993 million, or 35%, to RR 666,947 million in the six months period ended June 30, 2011 compared to RR 493,954 million in the six months period ended June 30, 2010. The increase was primarily due to the increase in total capital expenditures in the six months period ended June 30, 2011 in comparison with the same period of the prior year. This effect was partly offset by the decrease in cash used for acquisition of subsidiaries and investment in associated undertakings and jointly controlled entities in the six months period ended June 30, 2011 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 RR 1,776 million in the six months period ended June 30, 2011 compared to net cash used for financing activities in amount RR 126,509 million in the six months period ended June 30, 2010. This change was mainly due to the increase in proceeds from long-term borrowings in the six months period ended June 30, 2011 compared to the same period of the prior year.

CAPITAL EXPENDITURES

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) by segment for the six months periods ended June 30, 2011 and 2010 in nominal RR terms, amounted to the following:

(RR million)	Six months periods ended June 30,	
	2011	2010
Transport	234,016	143,884
Production of gas	102,251	112,076
Production of crude oil and gas condensate	39,883	41,795
Refining	35,080	26,869
Electric and heat energy generation and sales	23,365	19,056
Distribution	13,904	15,000
Gas storage	4,833	4,281
All other segments	15,606	11,005
Total	468,938	373,966

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) increased by RR 94,972 million, or 25%, from RR 373,966 million in the six months period ended June 30, 2010 to RR 468,938 million in the six months period ended June 30, 2011. The increase of our capital expenditures in the Transport segment was primarily

due to increased capital expenditure on the construction of major transportation projects, including Pipeline Bovanenkovo-Uhta and Pipeline Sakhalin-Khabarovsk-Vladivostok. The increase of our capital expenditures in the Refining segment was primarily due to increased capital expenditures Of Gazprom нефт Group and OOO Novourengoysky GCC. The decrease of our capital expenditures in the Production of gas segment was primarily due to decreased capital expenditures on the construction of Obskaya-Bovanenkovo railway, which was partly compensated by acquisition of property of OAO RUSIA Petroleum.

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 59,384 million, or 7%, from RR 870,993 million as of December 31, 2010 to RR 811,609 million as of June 30, 2011. This decrease resulted mainly from the decrease in long-term borrowings caused by appreciation of RUR against USD.