

## **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 30 June, 2009. The consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard 34 "Interim financial reporting" ("IAS 34"). This unaudited consolidated interim condensed financial information should be read together with the consolidated financial statements for the year ended December 31, 2008, 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 principal businesses:

- Production of gas – exploration and production of gas;
- Transport – transportation of gas;
- Distribution – domestic and export sales of gas;
- Gas storage – storage of gas in underground gas storages;
- 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; and
- Electric and heat energy generation and sales.

Other businesses primarily comprise banking.

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.

### **RECENT VOLATILITY IN GLOBAL AND RUSSIAN FINANCIAL MARKETS**

The change in market conditions caused by the global financial crisis have resulted in significant uncertainties in the banking sector and wider economy. The global financial crisis has led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the terms of new borrowings and our ability to re-finance our existing borrowings at terms and conditions similar to those applied to earlier transactions. Our debtors and borrowers may also be affected by the recent market volatility which could in turn impact their ability to repay their outstanding debts to us.

These market conditions have an impact on medium term cash flow forecast and assessment of potential impairment of financial and non-financial assets. We believe that as of June 30, 2009 market conditions did not result in significant change from December 31, 2008 in medium term cash flow forecasts and impairment assessment.

We are unable to estimate reliably the effects on our financial position of any further volatility in financial markets. We believe we are taking all the necessary measures to support the sustainability and growth of our business in the current circumstances.

## RESULTS OF OPERATIONS

(RR million)

	Six months periods ended June 30,	
	2009	2008
Sales (net of excise tax, VAT and customs duties)	1,639,698	1,755,113
Operating expenses	<u>(1,207,761)</u>	<u>(1,038,493)</u>
<b>Operating profit</b>	<b>431,937</b>	<b>716,620</b>
Purchase of non-controlling interest in OAO Gazprom neft	13,865	-
Gain from change in fair value of call option	-	28,375
Finance income	240,415	85,605
Finance expenses	(317,073)	(71,925)
Share of net income of associated undertakings and jointly controlled entities	15,790	25,392
Gains on disposal of available-for-sale financial assets	<u>2,839</u>	<u>11,476</u>
<b>Profit before profit tax</b>	<b>387,773</b>	<b>795,543</b>
Current profit tax expense	(88,393)	(180,530)
Deferred profit tax	<u>6,380</u>	<u>(5,660)</u>
Profit tax expense	<u>(82,013)</u>	<u>(186,190)</u>
<b>Profit for the period</b>	<b>305,760</b>	<b>609,353</b>
<b>Other comprehensive income</b>		
Gains (losses) arising from change in fair value of available-for-sale financial assets, net of tax	12,468	(68,372)
Share of other comprehensive income of associated undertakings and jointly controlled entities	3,960	-
Translation differences	5,926	3,320
Revaluation of equity interest	<u>9,911</u>	<u>-</u>
<b>Other comprehensive income (loss) for the period, net of tax</b>	<b>32,265</b>	<b>(65,052)</b>
<b>Total comprehensive income for the period</b>	<b>338,025</b>	<b>544,301</b>
<b>Profit attributable to:</b>		
owners of OAO Gazprom	296,243	573,757
non-controlling interest	<u>9,517</u>	<u>35,596</u>
	<b>305,760</b>	<b>609,353</b>
<b>Total comprehensive income attributable to:</b>		
owners of OAO Gazprom	330,396	509,619
non-controlling interest	<u>7,629</u>	<u>34,682</u>
	<b>338,025</b>	<b>544,301</b>

## Sales

The following table sets out our volumes and realized prices for the six months periods ended June 30, 2009 and 2008.

(RR million unless indicated otherwise)

	<b>Six months periods ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Sales of gas</b>		
<i>Europe and other countries</i>		
Gross sales <sup>(1)</sup>	833,594	873,585
Excise tax	(290)	-
Customs duties <sup>(2)</sup>	(135,098)	(212,031)
Net sales	698,206	661,554
Volumes in billion cubic meters (bcm)	76.2	99.7
Gross average price, U.S.\$ per mcm <sup>(3)</sup> (including excise tax and customs duties) <sup>(4)</sup>	331.0	366.0
Gross average price, RR per mcm <sup>(3)</sup> (including excise tax and customs duties)	10,946.7	8,762.4
<i>FSU (Former Soviet Union)</i>		
Gross sales (net of value added tax (VAT))	170,803	177,231
Customs duties	(9,519)	(13,594)
Net sales	161,284	163,637
Volumes in bcm	21.1	49.5
Gross average price, U.S.\$ per mcm <sup>(3)</sup> (including excise tax and customs duties, net of VAT) <sup>(4)</sup>	245.1	149.4
Gross average price, RR per mcm <sup>(3)</sup> (including excise tax and customs duties, net of VAT)	8,103.6	3,578.2
<i>Russia</i>		
Gross sales (net of VAT)	248,215	264,273
Net sales	248,215	264,273
Volumes in bcm	142.8	159.9
Gross average price, RR per mcm <sup>(3)</sup> (including excise tax, net of VAT)	1,737.8	1,652.7
<i>Total sales of gas</i>		
Gross sales (net of VAT)	1,252,612	1,315,089
Excise tax	(290)	-
Customs duties	(144,617)	(225,625)
Net sales	1,107,705	1,089,464
Volumes in bcm	240.1	309.1
Net sales of refined products (net of excise tax, VAT and customs duties)	222,631	365,241
Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties)	79,285	134,616
Net sales of electric and heat energy (net of VAT)	145,589	70,906
Gas transportation sales (net of VAT)	26,797	31,048
Other revenues (net of VAT)	<u>57,691</u>	<u>63,838</u>
<b>Total sales (net of excise tax, VAT and customs duties)</b>	<b><u>1,639,698</u></b>	<b><u>1,755,113</u></b>

Notes:

<sup>(1)</sup> VAT is not charged on sales to Europe and other countries.

<sup>(2)</sup> Custom duties in the amount of RR 56,993 million were accrued based on our estimates pending resolution of certain matters with the Federal Customs Service.

<sup>(3)</sup> One mcm is equivalent to 35,316 cubic feet.

<sup>(4)</sup> Calculated on the basis of average rate.

Total sales (net of excise tax, VAT and customs duties) decreased by RR 115,415 million, or 7%, to RR 1,639,698 million in the six months period ended June 30, 2009 compared to the same period of the prior year.

Net sales of gas accounted for 68% and 62% of total net sales in the six months period ended June 30, 2009 and 2008, respectively.

Net sales of gas increased from RR 1,089,464 million in the six months period ended June 30, 2008 to RR 1,107,705 million in the six months period ended June 30, 2009 or by 2%.

Net sales of gas to Europe and other countries increased in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008, by RR 36,652 million, or 6%, to RR 698,206 million. The overall increase in net sales of gas to Europe and other countries was primarily driven by price, denominated in Russian roubles. The gross average RR price (including excise and customs duties) increased by 25% for the six months period ended June 30, 2009, compared to the six months period ended June 30, 2008. At the same time volume of gas sold for the six months period ended June 30, 2009 decreased by 24% compared to the six months period ended June 30, 2008. In addition the increase in net sales of gas to this geographical segment is achieved mainly by the increase in prices during the first quarter of 2009.

Net sales of gas to FSU countries decreased in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008, by RR 2,353 million, or 1%, to RR 161,284 million. This decrease was mainly due to decrease in volumes of gas sold to FSU countries in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008. This decrease was partly offset by the price increase in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008.

Net sales of gas in the domestic market decreased by RR 16,058 million, or 6%, in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008. This decrease was mainly due to the decrease in the volume of gas sold by 11% in the six months period ended June 30, 2009 compared to six months period ended June 30, 2008. At the same time the gross average price for domestic gas sales increased by 5% in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008 due to 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) decreased by RR 142,610 million, or 39%, to RR 222,631 million in the six months period ended June 30, 2009 compared to RR 365,241 million in the six months period ended June 30, 2008. The decrease mainly resulted from the deconsolidation of Sibur Group as of June 30, 2008 and the decrease in world prices for refined products in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008. In the six months period ended June 30, 2009 and 2008 Gazprom Neft Group's sales comprised 85% and 60% of the total amount of our net sales of refined products, respectively.

Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties) decreased by RR 55,331 million, or 41%, to RR 79,285 million in the six months period ended June 30, 2009 compared to RR 134,616 million in the six months period ended June 30, 2008. The decrease was mainly caused by the decrease of oil price in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008. Sales of crude oil included in net sales of crude oil and gas condensate (net of excise tax, customs duties and VAT), amounted to RR 72,495 million and RR 120,129 million in the six months period ended June 30, 2009 and 2008, respectively.

Net sales of electric and heat energy (net of VAT) increased by RR 74,683 million, or 105% in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008. This increase was mainly due to sales by WGC-2 and WGC-6, which were consolidated in the second half of 2008, and also due to the sales of the Gazprom Germania Group.

Gas transportation sales decreased by RR 4,251 million, or 14%, to RR 26,797 million in the six months period ended June 30, 2009 from RR 31,048 million in the six months period ended June 30, 2008. The decrease was mainly due to the fact that transportation of Turkmen and Russian gas through RosUkrEnergO AG to the Ukraine was discontinued after 2008. During 2008 these services were rendered to RosUkrEnergO AG acting as the operator in supplies of central Asian and Russian gas to Ukraine.

### Operating expenses

Operating expenses increased by 16% in the six months period ended June 30, 2009 to RR 1,207,761 million from RR 1,038,493 million in the six months period ended June 30, 2008. Operating expenses as a percentage of sales increased from 59% in the six months period ended June 30, 2008 to 74% in the six months period ended June 30, 2009. The table below presents a breakdown of operating expenses in each period:

(RR million)	Six months periods ended June 30,	
	2009	2008
Purchased oil and gas	474,141	284,048
Staff costs	122,170	130,125
Transit of gas, oil and refined products	111,265	93,157
Taxes other than on income	107,666	136,306

	<b>Six months periods ended</b>	
	<b>June 30,</b>	
	<b>2009</b>	<b>2008</b>
Depreciation	106,342	99,747
Cost of goods for resale, including refined products	93,208	59,072
Repairs and maintenance	56,062	56,801
Materials	31,813	44,890
Electricity and heating expenses	20,014	29,285
Rental expenses	8,868	6,305
Social expenses	8,430	8,317
Charge for impairment provisions	7,589	8,506
Insurance expenses	7,349	7,257
Other	<u>52,844</u>	<u>74,677</u>
<b>Total operating expenses</b>	<b><u>1,207,761</u></b>	<b><u>1,038,493</u></b>

#### *Purchased oil and gas*

Cost of purchased oil and gas increased by 67% to RR 474,141 million in the six months period ended June 30, 2009 from RR 284,048 million in the six months period ended June 30, 2008. The increase primarily relates to the increase in the gas purchase price from Central Asian suppliers. During the first quarter of 2009 the cost of purchased gas amounted to RR 281,103 million, during the second quarter of 2009 the cost of purchased gas amounted to RR 135,287 million. The cost of purchased oil included in the cost of purchased oil and gas decreased by RR 22,995 million, or 28%, and amounted to RR 57,751 million in the six months period ended June 30, 2009 in comparison with RR 80,746 million in the six months period ended June 30, 2008 due to decrease in oil price.

#### *Staff costs*

Staff costs decreased by 6% to RR 122,170 million in the six months period ended June 30, 2009 from RR 130,125 million in the six months period ended June 30, 2008. The decrease resulted from the deconsolidation of the Gazprombank Group (including Sibur Group and Gazprom Media Group).

#### *Transit of gas, oil and refined products*

Transit of gas, oil and refined products increased by 19% to RR 111,265 million in the six months period ended June 30, 2009 from RR 93,157 million in the six months period ended June 30, 2008. This increase mainly relates to increased costs of transportation through Kazakhstan and Uzbekistan in the six months period ended June 30, 2009 in comparison with the six months period ended June 30, 2008.

#### *Taxes other than on income*

Taxes other than on income consist of:

(RR million)	<b>Six months periods ended</b>	
	<b>June 30,</b>	
	<b>2009</b>	<b>2008</b>
Natural resources production tax	62,689	102,740
Property tax	17,421	12,622
Other taxes	<u>27,556</u>	<u>20,944</u>
<b>Taxes other than on income</b>	<b><u>107,666</u></b>	<b><u>136,306</u></b>

The natural resources production tax decreased by 39% to RR 62,689 million in the six months period ended June 30, 2009 from RR 102,740 million in the six months period ended June 30, 2008. The decrease mainly related to our crude oil production activity and was caused by a decrease in average world oil prices, which resulted in a lower effective tax rate.

#### *Depreciation*

Depreciation increased by 7% or RR 6,595 million to RR 106,342 million in the six months period ended June 30, 2009 from RR 99,747 million in the six months period ended June 30, 2008.

#### *Cost of goods for resale, including refined products*

Cost of goods for resale, including refined products increased by 58% to RR 93,208 million in the six months period ended June 30, 2009 from RR 59,072 million in the six months period ended June 30, 2008. The increase in cost of goods for resale, including refined products, mainly results from operations of the Gazprom Germania Group (purchase and sale of electricity).

#### *Repairs and maintenance*

Cost of repairs and maintenance decreased by 1% to RR 56,062 million in six months period ended June 30, 2009 from RR 56,801 million in the six months period ended June 30, 2008.

#### *Materials*

Cost of materials decreased by 29% to RR 31,813 million in the six months period ended June 30, 2009 from RR 44,890 million in the six months period ended June 30, 2008. The decrease mainly resulted from the deconsolidation of the Sibur Group.

#### *Electricity and heating expenses*

Electricity and heating expenses decreased by 32% to RR 20,014 million in the six months period ended June 30, 2009 from RR 29,285 million in the six months period ended June 30, 2008. The decrease mainly resulted from the deconsolidation of the Sibur Group.

#### *Other operating expenses*

Other operating expenses decreased by 29% to RR 52,844 million in the six months period ended June 30, 2009 from RR 74,677 million in the six months period ended June 30, 2008. Other operating expenses mainly decreased due to gain from revaluation of assets and liabilities (excluding loans and borrowings) denominated in foreign currency in the amount of RR 36,046 million in six months period ended June 30, 2009, compared to loss in the amount of RR 4,931 million in six months period ended June 30, 2008. Other operating expenses include heating transfer services purchased by OAO Mosenergo, research and development expenses, refining services, transportation expenses, bank charges, security services, legal and consulting services, and advertising.

### **Operating profit**

As a result of the factors discussed above, our operating profit decreased by RR 284,683 million, or 40%, to RR 431,937 million in the six months period ended June 30, 2009 from RR 716,620 million in the six months period ended June 30, 2008. Our operating profit margin decreased from 41% in the six months period ended June 30, 2008 to 26% in the six months period ended June 30, 2009.

### **Finance income and expenses**

(RR million)	Six months periods ended	
	June 30,	
	2009	2008
Exchange gains	224,545	48,699
Exchange losses	<u>(280,968)</u>	<u>(32,424)</u>
Net exchange (loss) gain	(56,423)	16,275
Interest income	15,798	36,890
Interest expense	(36,105)	(39,501)
Gains on extinguishment of restructured liabilities	<u>72</u>	<u>16</u>
<b>Net finance (expense) income</b>	<b>(76,658)</b>	<b>13,680</b>

Exchange gains increased by RR 175,846 million to RR 224,545 million in the six months period ended June 30, 2009, compared to RR 48,699 million in the six months period ended June 30, 2008. Exchange losses increased by RR 248,544 million to RR 280,968 million in the six months period ended June 30, 2009 from RR 32,424 million in the six months period ended June 30, 2008. The net exchange loss of RR 56,423 million in the six months period ended June 30, 2009 compared to net exchange gain of RR 16,275 million in the six months period ended June 30, 2008, is explained mainly by a significant appreciation of USD against RUR in the six months period ended June 30, 2009, respectively, compared to depreciation of USD against RUR in the six months period ended June 30, 2008.

Interest income decreased by 57% to RR 15,798 million in the six months period ended June 30, 2009 from RR 36,890 million in the six months period ended June 30, 2008, mainly due to deconsolidation of Gazprombank Group.

Interest expense decreased by 9% from RR 39,501 million in the six months period ended June 30, 2008 to RR 36,105 million in the six months period ended June 30, 2009 mainly due to Gazprombank Group deconsolidation.

#### **Profit tax**

Total profit tax expense decreased by RR 104,177 million, or 56%, to RR 82,013 million in the six months period ended June 30, 2009 compared to RR 186,190 million in the six months period ended June 30, 2008. The effective income tax rate was 21.1% in the six months period ended June 30, 2009, compared to 23.4% in the same period of the prior year. The decrease is mainly effected by change of the tax rate from 24% to 20% starting from January 1, 2009, and the fact that in the six months period ended June 30, 2009 financial results went down and profit before profit tax decreased significantly.

#### **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 decreased by RR 277,514 million or 48%, from RR 573,757 million in the six months period ended June 30, 2008 to RR 296,243 million in the six months period ended June 30, 2009.

#### **Profit for the period attributable to non-controlling interest**

Profit for the period attributable to non-controlling interest decreased by RR 26,079 million or 73% to RR 9,517 million in the six months period ended June 30, 2009 compared to RR 35,596 million in the six months period ended June 30, 2008 mainly due to the deconsolidation of Gazprombank Group and purchase of non-controlling interest in OAO Gazprom Neft in April 2009.

### **LIQUIDITY AND CAPITAL RESOURCES**

The following table summarizes our statements of cash flows for the six months ended June 30, 2009 and 2008:

(RR million)	<b>Six months periods ended June 30,</b>	
	<b>2009</b>	<b>2008</b>
Net cash provided by operating activities	524,187	498,161
Net cash used for investing activities	(617,817)	(473,093)
Net cash provided by (used for) financing activities	116,988	(22,916)

#### *Net cash provided by operating activities*

Net cash provided by operating activities amounted to RR 524,187 million in the six months period ended June 30, 2009 compared to RR 498,161 million in the six months period ended June 30, 2008. The increase was primarily due to positive changes of working capital what was partly offset by the reduction of our operating profit in the six months period ended June 30, 2009 in comparison with the six months period ended June 30, 2008.

#### *Net cash used for investing activities*

Net cash used for investing activities increased by RR 144,724 million or 31% to RR 617,817 million in the six months period ended June 30, 2009 compared to RR 473,093 million in the six months period ended June 30, 2008. The increase was primarily due to acquisition of non-controlling interest in OAO Gazprom Neft in the amount of RR 138,527 million.

#### *Net cash provided by (used for) financing activities*

Net cash provided by financing activities amounted to RR 116,988 million in the six months period ended June 30, 2009 compared to net cash used for financing activities in the amount of RR 22,916 million in the six months period ended June 30, 2008. This change was primarily due to increase in proceeds from long-term borrowings in the six months period ended June 30, 2009 compared to the six months period ended June 30, 2008.

## CAPITAL EXPENDITURES

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) by segment for the six months periods ended June 30, 2009 and 2008 in nominal RR terms, amounted to the following:

	Six months periods ended June 30,	
	2009	2008
(RR million)		
Transport	119,784	84,389
Production of gas	114,167	99,334
Production of crude oil and gas condensate	38,529	44,833
Refining	28,636	22,233
Distribution	21,443	17,307
Electric and heat energy generation and sales	6,792	13,616
Gas storage	3,318	2,902
All other segments	<u>7,356</u>	<u>10,754</u>
<b>Total</b>	<b>340,025</b>	<b>295,368</b>

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) increased by RR 44,657 million, or 15%, from RR 295,368 million in the six months period ended June 30, 2008 to RR 340,025 million in the six months period ended June 30, 2009. The increase of our capital expenditures in the Transportation segment was primarily due to increased capital expenditure on the construction of major transportation projects, including Bovanenkovo-Uhta and Pochinki-Gryazovets. The increase of our capital expenditures in the Production of gas segment was primarily due to increased capital expenditure on the construction of new wells and associated gas preparation units at Bovanenkovskoye and Kharasaveyskoye fields.

## 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) increased by RR 316,446 million, or 31%, from RR 1,018,346 million as of December 31, 2008 to RR 1,334,792 million as of June 30, 2009. This growth resulted mainly from procurement of new long-term borrowings and an increase of borrowings due to appreciation of USD and EUR against RUR.