

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the unaudited consolidated interim condensed financial information for the six months ended June 30, 2021. This consolidated interim condensed financial information is prepared in accordance with International Accounting Standard 34 Interim Financial Reporting. The consolidated interim condensed financial information for the six months ended June 30, 2021 should be read in conjunction with the consolidated financial statements for the year ended December 31, 2020 prepared in accordance with International Financial Reporting Standards.

OVERVIEW

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

We are involved in the following activities:

- exploration and production of gas;
- transportation of gas;
- sales of gas within the Russian Federation and abroad;
- gas storage;
- production of crude oil and gas condensate;
- processing of oil, gas condensate and other hydrocarbons and sales of refined products;
- electric and heat energy generation and sales.

Other activities include production of other goods, other works and rendering of other services.

The official Russian Ruble ("RUB") to US Dollar foreign exchange rate as determined by the Central Bank of the Russian Federation was as follows:

- as of June 30, 2021 – 72.3723 (as of June 30, 2020 – 69.9513);
- as of December 31, 2020 – 73.8757 (as of December 31, 2019 – 61.9057).

The official RUB to Euro foreign exchange rate as determined by the Central Bank of the Russian Federation was as follows:

- as of June 30, 2021 – 86.2026 (as of June 30, 2020 – 78.6812);
- as of December 31, 2020 – 90.6824 (as of December 31, 2019 – 69.3406).

The average foreign exchange rates of RUB for the six months ended June 30, 2021 and for the six months ended June 30, 2020 were:

- to US Dollar – 74.2781 and 69.3714, respectively;
- to Euro – 89.5471 and 76.4417, respectively.

RESULTS OF OPERATION

(in RUB million)

	Three months ended June 30,		Six months ended June 30,	
	2021	2020	2021	2020
Sales	2,066,807	1,163,316	4,351,968	2,903,148
Net gain from trading activity	9,233	4,043	4,336	14,438
Operating expenses	(1,561,314)	(1,253,556)	(3,328,167)	(2,693,257)
Impairment loss on financial assets	<u>(18,321)</u>	<u>(17,277)</u>	<u>(41,539)</u>	<u>(34,344)</u>
Operating profit (loss)	496,405	(103,474)	986,598	189,985
Finance income	178,255	324,386	327,978	459,352
Finance expenses	(79,856)	(58,014)	(217,715)	(740,984)
Share of profit of associates and joint ventures	<u>72,936</u>	<u>29,016</u>	<u>144,365</u>	<u>74,841</u>
Profit (loss) before profit tax	667,740	191,914	1,241,226	(16,806)
Current profit tax expenses	(73,571)	(9,884)	(130,091)	(37,788)
Deferred profit tax (expenses) income	<u>(64,262)</u>	<u>(28,488)</u>	<u>(115,614)</u>	<u>100,054</u>
Profit tax	(137,833)	(38,372)	(245,705)	62,266
Profit for the period	529,907	153,542	995,521	45,460
Other comprehensive income (loss):				
Items that will not be reclassified subsequently to profit or loss:				
Gain (loss) arising from changes in fair value of financial assets measured at fair value through other comprehensive income, net of tax				
	21,659	34,820	93,593	(71,273)
Remeasurement of provision for post-employment benefits	<u>(7,548)</u>	<u>(40,290)</u>	<u>47,480</u>	<u>(35,091)</u>
Total other comprehensive income (loss) that will not be reclassified subsequently to profit or loss	14,111	(5,470)	141,073	(106,364)
Items that may be reclassified subsequently to profit or loss:				
Share of other comprehensive (loss) income of associates and joint ventures				
	49	(1,450)	(22)	(34,535)
Translation differences	(60,334)	(154,043)	(61,325)	172,076
Gain (loss) from hedging operations, net of tax	<u>(9,082)</u>	<u>(54)</u>	<u>4,316</u>	<u>(11,999)</u>
Total other comprehensive (loss) income that may be reclassified subsequently to profit or loss	(69,367)	(155,547)	(57,031)	125,542
Total other comprehensive income (loss) for the period, net of tax	<u>(55,256)</u>	<u>(161,017)</u>	<u>84,042</u>	<u>19,178</u>
Comprehensive income (loss) for the period	474,651	(7,475)	1,079,563	64,638
Profit for the period attributable to:				
Owners of PJSC Gazprom	521,235	149,168	968,498	32,919
Non-controlling interest	<u>8,672</u>	<u>4,374</u>	<u>27,023</u>	<u>12,541</u>
	529,907	153,542	995,521	45,460
Comprehensive income (loss) for the period attributable to:				
Owners of PJSC Gazprom	468,790	(1,371)	1,058,135	40,666
Non-controlling interest	<u>5,861</u>	<u>(6,104)</u>	<u>21,428</u>	<u>23,972</u>
	474,651	(7,475)	1,079,563	64,638

Sales

The following table sets out volumes and sales prices:

(in RUB million unless indicated otherwise)

	Three months ended June 30,		Six months ended June 30,	
	2021	2020	2021	2020
Sales of gas				
<i>Europe and other countries</i>				
Gross sales ⁽¹⁾	935,542	372,028	1,865,619	930,480
Customs duties	(190,420)	(73,239)	(375,739)	(161,648)
Excise tax	(16,058)	(1,994)	(31,187)	(12,553)
Net sales	729,064	296,795	1,458,693	756,279
Volumes in bcm	56.1	46.6	120.6	98.2
Average price, US Dollar per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	224.4	110.1	208.1	136.0
Average price, RUB per mcm ⁽²⁾ (including excise tax and customs duties)	16,670.4	7,975.2	15,469.1	9,475.4
<i>Former Soviet Union countries</i>				
Gross sales ⁽¹⁾	84,447	55,300	202,349	146,186
Customs duties	(10,015)	(3,136)	(14,648)	(6,903)
Net sales	74,432	52,164	187,701	139,283
Volumes in bcm	6.4	5.6	18.3	14.9
Average price, US Dollar per mcm ⁽²⁾ (including customs duties) ⁽³⁾	178.0	136.8	148.7	140.7
Average price, RUB per mcm ⁽²⁾ (including customs duties)	13,220.9	9,911.3	11,051.9	9,803.5
<i>The Russian Federation</i>				
Gross sales (net of VAT)	176,475	165,938	574,158	488,703
Net sales	176,475	165,938	574,158	488,703
Volumes in bcm	41.7	40.4	133.4	117.6
Average price, RUB per mcm ⁽²⁾ (net of VAT)	4,238.2	4,111.1	4,304.9	4 156.8
<i>Total gas sales</i>				
Gross sales (net of VAT)	1,196,464	593,266	2,642,126	1,565,369
Customs duties	(200,435)	(76,375)	(390,387)	(168,551)
Excise tax	(16,058)	(1,994)	(31,187)	(12,553)
Retroactive gas price adjustments	-	6,086	5	2,324
Net sales	979,971	520,983	2,220,557	1,386,589
Volumes in bcm	104.2	92.6	272.3	230.7
Net sales of refined products (net of excise tax, VAT and customs duties)	643,086	347,894	1,192,765	820,853
Net sales of crude oil and gas condensate (net of VAT and customs duties)	211,054	91,189	393,058	212,050
Electric and heat energy net sales (net of VAT)	111,680	94,157	299,185	252,240
Gas transportation net sales (net of VAT)	54,999	53,203	112,173	109,290
Other sales (net of VAT)	<u>66,017</u>	<u>55,890</u>	<u>134,230</u>	<u>122,126</u>
Total sales (net of excise tax, VAT and customs duties)	2,066,807	1,163,316	4,351,968	2,903,148

Notes:

⁽¹⁾ VAT is not charged on sales to Europe and other countries as well as Former Soviet Union countries.

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

⁽³⁾ Calculated on the basis of average foreign exchange rate of the RUB to the US Dollar.

Total sales (net of excise tax, VAT and customs duties) increased by RUB 1,448,820 million, or 50 %, to RUB 4,351,968 million for the six months ended June 30, 2021 compared to the same period of the prior year. The increase in sales was mainly due to an increase in sales of gas, refined products, crude oil and gas condensate.

Net sales of gas accounted for 51 % of total net sales for the six months ended June 30, 2021 (48 % for the same period of the prior year).

Net sales of gas increased by RUB 833,968 million, or 60 %, from RUB 1,386,589 million for the six months ended June 30, 2020 to RUB 2,220,557 million for the six months ended June 30, 2021.

Net sales of gas to Europe and other countries increased by RUB 702,414 million, or 93 %, to RUB 1,458,693 million for the six months ended June 30, 2021 compared to the same period of the prior year. The change was due to an increase in average prices (including excise tax and customs duties) denominated in the Russian Ruble by 63 % and an increase in volumes of gas sold by 23 % for the six months ended June 30, 2021 compared to the same period of the prior year. At the same time average prices denominated in the US Dollar increased by 53 % compared to the same period of the prior year.

Net sales of gas to Former Soviet Union countries increased by RUB 48,418 million or 35 %, to RUB 187,701 million for the six months ended June 30, 2021 compared to the same period of the prior year. The change was due to an increase in volumes of gas sold by 23 % and an increase in average prices (including customs duties) denominated in the Russian Ruble by 13 % for the six months ended June 30, 2021 compared to the same period of the prior year. At the same time average prices denominated in the US Dollar increased by 6 % compared to the same period of the prior year.

Net sales of gas in the Russian Federation increased by RUB 85,455 million, or 17 %, to RUB 574,158 million for the six months ended June 30, 2021 compared to the same period of the prior year. This change was explained by an increase in volumes of gas sold by 13 %, and an increase in average prices in the Russian Ruble (net of VAT) by 4 %.

Net sales of refined products (net of excise tax, VAT and customs duties) increased by RUB 371,912 million, or 45 %, to RUB 1,192,765 million for the six months ended June 30, 2021 compared to the same period of the prior year. The change was mainly due to an increase in average prices in all geographic segments.

Net sales of crude oil and gas condensate (net of VAT and customs duties) increased by RUB 181,008 million, or 85 %, to RUB 393,058 million for the six months ended June 30, 2021 compared to the same period of the prior year. The change was mainly due to an increase in net sales of crude oil primarily caused by an increase in average prices of crude oil.

Operating expenses

Operating expenses increased by RUB 634,910 million, or 24 %, to RUB 3,328,167 million for the six months ended June 30, 2021 compared to RUB 2,693,257 million for the same period of the prior year. Operating expenses as a percentage of sales decreased from 93 % for the six months ended June 30, 2020 to 76 % for the six months ended June 30, 2021. The table below presents a breakdown of operating expenses in each period:

(in RUB million)	Three months ended June 30,		Six months ended June 30,	
	2021	2020	2021	2020
Taxes other than on profit	372,809	271,643	758,940	617,679
Purchased gas and oil	349,466	162,406	682,138	441,522
Staff costs	222,851	207,530	439,797	414,587
Depreciation	206,173	197,327	413,843	396,891
Transit of gas, oil and refined products	170,039	158,519	332,413	312,423
Materials	66,043	53,424	120,439	110,350
Goods for resale, including refined products	65,978	33,940	114,566	85,046
Electricity and heating	30,197	24,788	66,236	56,283
Repairs and maintenance	34,853	30,633	54,299	49,016
Foreign exchange differences on operating items	17,889	52,125	44,413	(63,459)
Loss (gain) on derivative financial instruments	23,444	(1,344)	22,733	(1,798)
Insurance	8,658	8,514	16,758	17,200
Social expenses	8,401	8,840	16,098	16,106
Transportation expenses	8,264	6,547	15,664	14,024
Processing services	6,003	4,611	11,867	10,341
Research and development	5,848	4,360	11,684	9,301
Lease	4,366	4,574	8,831	8,548
Impairment loss on non-financial assets	786	149	3,696	14,200
Other	67,886	79,290	163,016	170,463
	1,669,954	1,307,876	3,297,431	2,678,723
Change in balances of finished goods, work in progress and other effects	(108,640)	(54,320)	30,736	14,534
Total operating expenses	1,561,314	1,253,556	3,328,167	2,693,257

Taxes other than on profit

Taxes other than on profit consist of:

(in RUB million)	Three months ended June 30,		Six months ended June 30,	
	2021	2020	2021	2020
Mineral extraction tax	319,991	152,804	621,870	389,444
Excise tax	(4,973)	74,388	20,728	130,676
Property tax	38,910	39,235	78,254	78,810
Other taxes	18,881	5,216	38,088	18,749
Total taxes other than on profit	372,809	271,643	758,940	617,679

Taxes other than on profit increased by RUB 141,261 million, or 23 %, to RUB 758,940 million for the six months ended June 30, 2021 compared to RUB 617,679 million for the same period of the prior year. The change was mainly due to an increase in the mineral extraction tax expenses that was partially compensated by a decrease in the excise tax expenses.

Mineral extraction tax (MET) expenses increased by RUB 232,426 million or 60 % to RUB 621,870 million for the six months ended June 30, 2021 compared to RUB 389,444 million for the same period of the prior year. MET expenses increased mainly due to an increase in crude oil prices, tax rate as a result of a tax maneuver and an increase in volumes of gas production for the six months ended June 30, 2021 compared to the same period of the prior year.

Excise tax expenses decreased by RUB 109,948 million, or 84 %, to RUB 20,728 million for the six months ended June 30, 2021 compared to RUB 130,676 million for the same period of the prior year. Excise tax expenses decreased mainly due to the impact of crude oil and petroleum products prices growth on damper component and excise deduction rates level.

Purchased gas and oil

The cost of purchased gas and oil increased by RUB 240,616 million, or 54 %, to RUB 682,138 million for the six months ended June 30, 2021 compared to RUB 441,522 million for the same period of the prior year.

The cost of purchased gas included in the cost of purchased gas and oil increased by RUB 106,055 million, or 33 %, to RUB 429,894 million for the six months ended June 30, 2021 compared to RUB 323,839 million for the same period of the prior year. The change was mainly due to an increase in average prices of gas purchase.

The cost of purchased oil included in the cost of purchased gas and oil increased by RUB 134,561 million, or 114 %, to RUB 252,244 million for the six months ended June 30, 2021 compared to RUB 117,683 million for the same period of the prior year. The change was mainly due to an increase in the oil prices.

Goods for resale, including refined products

Cost of goods for resale, including refined products increased by RUB 29,520 million, or 35 %, to RUB 114,566 million for the six months ended June 30, 2021 compared to RUB 85,046 million for the same period of the prior year. The increase in cost was mainly due to an increase in volumes of refined products purchases.

Foreign exchange differences on operating items

The foreign exchange loss on operating items amounted to RUB 44,413 million for the six months ended June 30, 2021 compared to the gain in the amount of RUB 63,459 million for the same period of the prior year. This change was mainly due to the revaluation of accounts receivable from foreign customers and loans issued, which was caused by the depreciation of the US Dollar and the Euro against the Russian Ruble by 2 % and 5 %, respectively, for the six months ended June 30, 2021 compared to the appreciation of the US Dollar and the Euro against the Russian Ruble by 13 % for the same period of the prior year.

Other operating expenses

Other operating expenses decreased by RUB 7,447 million, or 4 %, to RUB 163,016 million for the six months ended June 30, 2021 compared to RUB 170,463 million for the same period of the prior year. Other expenses include gas and gas condensate production expenses, services from gas distribution companies, bank charges, security services, legal and consulting services, charity and financial aid and advertising.

Change in balances of finished goods, work in progress and other effects

The expense in the line item “Change in balances of finished goods, work in progress and other effects” changed by RUB 16,202 million, or 111 %, to RUB 30,736 million for the six months ended June 30, 2021 compared to the expense in the amount of RUB 14,534 million for the same period of the prior year. The change in this line item was due to a larger decrease in the balances of finished goods for the six months ended June 30, 2021 compared to a decrease in the balances of finished goods for the same period of the prior year.

Operating profit

As a result of the factors discussed above, operating profit increased by RUB 796,613 million, or 419 %, to RUB 986,598 million for the six months ended June 30, 2021 compared to RUB 189,985 million for the same period of the prior year. The operating profit margin increased from 7 % for the six months ended June 30, 2020 to 23 % for the six months ended June 30, 2021.

Net finance income (expense)

(in RUB million)	Three months ended June 30,		Six months ended June 30,	
	2021	2020	2021	2020
Foreign exchange gain	161,018	307,175	298,435	421,799
Foreign exchange loss	<u>(61,988)</u>	<u>(40,887)</u>	<u>(183,105)</u>	<u>(706,907)</u>
Net foreign exchange gain (loss)	99,030	266,288	115,330	(285,108)
Interest income	17,237	17,211	29,543	37,553
Interest expense	<u>(17,868)</u>	<u>(17,127)</u>	<u>(34,610)</u>	<u>(34,077)</u>
Net finance income (expense)	98,399	266,372	110,263	(281,632)

The net foreign exchange gain amounted to RUB 115,330 million for the six months ended June 30, 2021 compared to the net foreign exchange loss of RUB 285,108 million for the same period of the prior year. The change was explained by the depreciation of the US Dollar and the Euro against the Russian Ruble by 2 % and 5 %, respectively, for the six months ended June 30, 2021 compared to the appreciation of the US Dollar and the Euro against the Russian Ruble by 13 % for the same period of the prior year. The gain and the loss were mainly related to the revaluation of borrowings denominated in foreign currencies.

Interest income decreased by RUB 8,010 million, or 21 %, to RUB 29,543 million for the six months ended June 30, 2021 compared to RUB 37,553 million for the same period of the prior year.

Interest expense increased by RUB 533 million, or 2 %, to RUB 34,610 million for the six months ended June 30, 2021 compared to RUB 34,077 million for the same period of the prior year.

Share of profit of associates and joint ventures

Share of profit of associates and joint ventures increased by RUB 69,524 million, or 93 %, to RUB 144,365 million for the six months ended June 30, 2021 compared to RUB 74,841 million for the same period of the prior year. This change was mainly caused by an increase in the share of profit of JSC Arcticgas, Gazprombank (Joint Stock Company) and its subsidiaries and PJSC NGK Slavneft and its subsidiaries.

Profit for the period attributable to the owners of PJSC Gazprom

As a result of the factors discussed above, profit attributable to the owners of PJSC Gazprom amounted to RUB 968,498 million for the six months ended June 30, 2021.

Liquidity and capital resources

The following table summarises cash flows for the six months ended June 30, 2021 and for the six months ended June 30, 2020:

(in RUB million)	Six months ended	
	June 30,	
	2021	2020
Net cash from operating activities	1,211,986	759,651
Net cash used in investing activities	(855,060)	(858,971)
Net cash from financing activities	44,495	86,404

Net cash from operating activities

Net cash from operating activities increased by RUB 452,335 million, or 60 %, to RUB 1,211,986 million for the six months ended June 30, 2021 compared to RUB 759,651 million for the same period of the prior year. This change was mainly driven by an increase in cash flow from operating activities before working capital changes for the six months ended June 30, 2021 compared to the same period of the prior year.

Net cash used in investing activities

Net cash used in investing activities decreased by RUB 3,911 million to RUB 855,060 million for the six months ended June 30, 2021 compared to RUB 858,971 million for the same period of the prior year. The change was mainly due to an increase in proceeds from associates and joint ventures partly compensated by an increase in cash flow directed to capital expenditures for the six months ended June 30, 2021 compared to the same period of the prior year.

Net cash from financing activities

Net cash from financing activities decreased by RUB 41,909 million, or 49 %, to RUB 44,495 million for the six months ended June 30, 2021 compared to RUB 86,404 million for the same period of the prior year. This change was mainly due to a decrease in proceeds from long-term borrowings compared to the same period of the prior year, that was partly compensated by issue of perpetual bonds in the reporting period.

Capital expenditures

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) by segments for the six months ended June 30, 2021 and for the six months ended June 30, 2020 denominated in the Russian Ruble are presented in the following table:

(in RUB million)	Six months ended	
	June 30,	
	2021	2020
Transportation of gas	167,166	81,927
Refining	141,915	147,517
Production of crude oil and gas condensate	140,813	176,482
Production of gas	114,217	89,293
Electric and heat energy generation and sales	38,182	40,201
Distribution of gas	13,446	5,313
Gas storage	4,274	3,072
All other segments	<u>39,592</u>	<u>32,085</u>
Total	659,605	575,890

Total capital expenditures increased by RUB 83,715 million, or 15 %, from RUB 575,890 million for the six months ended June 30, 2020 to RUB 659,605 million for the six months ended June 30, 2021.

The amount of capital expenditures of the Transportation of gas segment increased by RUB 85,239 million, or 104 %, to RUB 167,166 million for the six months ended June 30, 2021, mainly due to the construction of the Kovykta - Chayanda section of the Power of Siberia gas pipeline, as well as ongoing work on the construction of the Sakhalin - Khabarovsk - Vladivostok gas pipeline within the framework of the project to withdraw gas from the shelf of Sakhalin Island.

The amount of capital expenditures of the Production of crude oil and gas condensate segment decreased by RUB 35,669 million, or 20 %, to RUB 140,813 million for the six months ended June 30, 2021, mainly due to optimization activities within limitations under the OPEC+ agreement.

The amount of capital expenditures of the Production of gas segment increased by RUB 24,924 million, or 28 %, to RUB 114,217 million for the six months ended June 30, 2021, which is mainly caused by the ongoing development of the Kharasaveyskoye and Kovyktinskoye gas condensate fields.

Debts obligation

Net debt balance (defined as the sum of short-term borrowings and the current portion of long-term borrowings, short-term promissory notes payable, long-term borrowings, long-term promissory notes payable, less cash and cash equivalents) decreased by RUB 476,982 million, or 12 %, from RUB 3,872,695 million as of December 31, 2020 to RUB 3,395,713 million as of June 30, 2021. This change was mainly due to an increase in cash and cash equivalents.