

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 three months ended March 31, 2020. 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 three months ended March 31, 2020 should be read in conjunction with the consolidated financial statements for the year ended December 31, 2019 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 March 31, 2020 – 77.7325 (as of March 31, 2019 – 64.7347);
- as of December 31, 2019 – 61.9057 (as of December 31, 2018 – 69.4706).

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

- as of March 31, 2020 – 85.7389 (as of March 31, 2019 – 72.7230);
- as of December 31, 2019 – 69.3406 (as of December 31, 2018 – 79.4605).

The average exchange rates of RUB for the three months ended March 31, 2020 and for the three months ended March 31, 2019 were:

- to US Dollar – 66.3818 and 66.1271, respectively;
- to Euro – 73.2348 and 75.1715, respectively.

RESULTS OF OPERATION

(in RUB million)	Three months ended March 31,	
	2020	2019
Sales	1,739,832	2,291,821
Net gain (loss) from trading activity	10,395	(6,595)
Operating expenses	(1,439,701)	(1,782,216)
Impairment loss on financial assets	<u>(17,067)</u>	<u>(44,248)</u>
Operating profit	293,459	458,762
Finance income	134,966	258,223
Finance expense	(682,970)	(68,991)
Share of profit of associates and joint ventures	<u>45,825</u>	<u>63,932</u>
(Loss) profit before profit tax	(208,720)	711,926
Current profit tax expense	(27,904)	(120,264)
Deferred profit tax income (expense)	<u>128,542</u>	<u>(32,149)</u>
Profit tax	100,638	(152,413)
(Loss) profit for the period	(108,082)	559,513
Other comprehensive income (loss):		
Items that will not be reclassified to profit or loss:		
Loss arising from changes in fair value of financial assets measured at fair value through other comprehensive income, net of tax	(106,093)	(23,167)
Remeasurement of provision for post-employment benefits	<u>5,199</u>	<u>(24,113)</u>
Total other comprehensive loss that will not be reclassified to profit or loss	(100,894)	(47,280)
Items that may be reclassified subsequently to profit or loss:		
Share of other comprehensive loss of associates and joint ventures	(33,085)	(1,896)
Translation differences	326,119	(115,965)
(Loss) gain from hedging operations, net of tax	<u>(11,945)</u>	<u>5,356</u>
Total other comprehensive income (loss) that may be reclassified subsequently to profit or loss	281,089	(112,505)
Total other comprehensive income (loss) for the period, net of tax	180,195	(159,785)
Comprehensive income for the period	72,113	399,728
(Loss) profit for the period attributable to:		
Owners of PJSC Gazprom	(116,249)	535,908
Non-controlling interest	<u>8,167</u>	<u>23,605</u>
	(108,082)	559,513
Comprehensive income for the period attributable to:		
Owners of PJSC Gazprom	42,037	383,210
Non-controlling interest	<u>30,076</u>	<u>16,518</u>
	72,113	399,728

Sales

The following table sets out volumes and sales prices:

(in RUB million unless indicated otherwise)	Three months ended March 31,	
	2020	2019
Sales of gas		
<i>Europe and other countries</i>		
Gross sales ⁽¹⁾	558,452	1,064,207
Customs duties	(88,409)	(207,796)
Excise tax	(10,559)	(19,015)
Net sales	459,484	837,396
Volumes in bcm	51.6	62.4
Average price, US Dollar per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	162.1	259.1
Average price, RUB per mcm ⁽²⁾ (including excise tax and customs duties)	10,832.8	17,053.8
<i>Former Soviet Union countries</i>		
Gross sales ⁽¹⁾	90,886	133,950
Customs duties	(3,767)	(16,453)
Net sales	87,119	117,497
Volumes in bcm	9.3	12.2
Average price, US Dollar per mcm ⁽²⁾ (including customs duties) ⁽³⁾	145.7	167.4
Average price, RUB per mcm ⁽²⁾ (including customs duties)	9,739.0	11,015.7
<i>Russian Federation</i>		
Gross sales (net of VAT)	322,765	348,930
Net sales	322,765	348,930
Volumes in bcm	77.2	84.3
Average price, RUB per mcm ⁽²⁾ (net of VAT)	4,180.7	4,141.0
<i>Total gas sales</i>		
Gross sales (net of VAT)	972,103	1,547,087
Customs duties	(92,176)	(224,249)
Excise tax	(10,559)	(19,015)
Retroactive gas price adjustments	(3,762)	-
Net sales	865,606	1,303,823
Volumes in bcm	138.1	158.9
Net sales of refined products (net of excise tax, VAT and customs duties)	472,959	506,909
Net sales of crude oil and gas condensate (net of VAT and customs duties)	120,861	190,389
Electric and heat energy net sales (net of VAT)	158,083	173,413
Gas transportation net sales (net of VAT)	56,087	55,501
Other sales (net of VAT)	66,236	61,786
Total sales (net of excise tax, VAT and customs duties)	1,739,832	2,291,821

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 exchange rate between the RUB and US Dollar.

Total sales (net of excise tax, VAT and customs duties) decreased by RUB 551,989 million, or 24 %, to RUB 1,739,832 million for the three months ended March 31, 2020 compared to the same period of the prior year. The decrease in sales was mainly due to a decrease in sales of gas to Europe and other countries.

Net sales of gas accounted for 50 % of total net sales for the three months ended March 31, 2020 (57 % for the same period of the prior year).

Net sales of gas decreased by RUB 438,217 million, or 34 %, from RUB 1,303,823 million for the three months ended March 31, 2019 to RUB 865,606 million for the three months ended March 31, 2020.

Net sales of gas to Europe and other countries decreased by RUB 377,912 million, or 45 %, to RUB 459,484 million for the three months ended March 31, 2020 compared to the same period of the prior year. The change was due to the decrease in average prices (including excise tax and customs duties) denominated in the Russian Ruble by 36 % and the decrease in volumes of gas sold by 17 % for the three months ended March 31, 2020 compared to the same period of the prior year. At the same time average prices denominated in US Dollar decreased by 37 % compared to the same period of the prior year.

Net sales of gas to Former Soviet Union countries decreased by RUB 30,378 million, or 26 %, to RUB 87,119 million for the three months ended March 31, 2020 compared to the same period of the prior year. The change was due to the decrease in volumes of gas sold by 24 % and the decrease in average prices (including customs duties) denominated in the Russian Ruble by 12 % for the three months ended March 31, 2020 compared to the same period of the prior year. At the same time average prices denominated in US Dollar decreased by 13 % compared to the same period of the prior year.

Net sales of gas in the Russian Federation decreased by RUB 26,165 million, or 7 %, to RUB 322,765 million for the three months ended March 31, 2020 compared to the same period of the prior year. This change was explained by the decrease in volumes of gas sold by 8 %, which was partially compensated by the increase in average prices in the Russian Ruble (net of VAT) by 1 %.

Net sales of crude oil and gas condensate (net of VAT and customs duties) decreased by RUB 69,528 million, or 37 %, to RUB 120,861 million for the three months ended March 31, 2020 compared to the same period of the prior year. The change was mainly due to a decrease in net sales of crude oil primarily caused by a decrease in average prices of crude oil.

Operating expenses

Operating expenses decreased by RUB 342,515 million, or 19 %, to RUB 1,439,701 million for the three months ended March 31, 2020 compared to RUB 1,782,216 million for the same period of the prior year. Operating expenses as a percentage of sales increased from 78 % for the three months ended March 31, 2019 to 83 % for the three months ended March 31, 2020. The table below presents a breakdown of operating expenses in each period.

(in RUB million)	Three months ended March 31,	
	2020	2019
Taxes other than on profit	346,036	376,305
Purchased gas and oil	279,116	403,862
Staff costs	207,057	186,819
Depreciation	199,564	172,652
Transit of gas, oil and refined products	153,904	168,702
Materials	56,926	63,843
Cost of goods for resale, including refined products	51,106	56,066
Electricity and heating	31,495	33,196
Repairs and maintenance	18,383	18,067
Impairment loss on non-financial assets	14,051	2,153
Insurance	8,686	7,522
Transportation expenses	7,477	6,268
Social expenses	7,266	6,793
Processing services	5,730	5,367
Research and development	4,941	5,215
Lease	3,974	7,303
Derivatives (gain) loss	(454)	7,064
Foreign exchange differences on operating items	(115,584)	47,251
Other	91,173	138,612
	1,370,847	1,713,060
Change in balances of finished goods, work in progress and other effects	68,854	69,156
Total operating expenses	1,439,701	1,782,216

Taxes other than on profit

Taxes other than on profit consist of:

(in RUB million)	Three months ended March 31,	
	2020	2019
Mineral extraction tax	236,640	299,672
Excise tax	56,288	34,407
Property tax	39,575	37,068
Other taxes	<u>13,533</u>	<u>5,158</u>
Total taxes other than on profit	346,036	376,305

Expenses for taxes other than on profit decreased by RUB 30,269 million, or 8 %, to RUB 346,036 million for the three months ended March 31, 2020 compared to RUB 376,305 million for the same period of the prior year. The change was mainly due to a decrease in the mineral extraction tax expenses that was partially compensated by an increase in the excise tax expenses.

Mineral extraction tax (MET) expenses decreased by RUB 63,032 million, or 21 %, to RUB 236,640 million for the three months ended March 31, 2020 compared to RUB 299,672 million for the same period of the prior year. MET expenses decreased mainly due to a decrease in crude oil prices for the three months ended March 31, 2020 compared to the same period of the prior year.

Excise tax expenses increased by RUB 21,881 million, or 64 %, to RUB 56,288 million for the three months ended March 31, 2020 compared to RUB 34,407 million for the same period of the prior year. Excise taxes expenses increased mainly due to the impact of the dampfer component, resulting from the reduction in export-parity prices for automobile gasoline and diesel fuel on the external market, arising from the lower oil price and the worsening epidemiological situation.

Purchased gas and oil

Cost of purchased gas and oil decreased by RUB 124,746 million, or 31 %, to RUB 279,116 million for the three months ended March 31, 2020 compared to RUB 403,862 million for the same period of the prior year.

Cost of purchased gas included in the purchased gas and oil decreased by RUB 82,369 million, or 29 %, to RUB 205,349 million for the three months ended March 31, 2020 compared to RUB 287,718 million for the same period of the prior year. The change was mainly due to a decrease in average prices and a decrease in volumes of purchased gas.

Cost of purchased oil included in the purchased gas and oil decreased by RUB 42,377 million, or 36 %, to RUB 73,767 million for the three months ended March 31, 2020 compared to RUB 116,144 million for the same period of the prior year. The change was mainly due to a decrease in prices of oil and volumes of purchased oil.

Staff costs

Staff costs increased by RUB 20,238 million, or 11 %, to RUB 207,057 million for the three months ended March 31, 2020 compared to RUB 186,819 million for the same period of the prior year.

Depreciation

Depreciation increased by RUB 26,912 million, or 16 %, to RUB 199,564 million for the three months ended March 31, 2020 compared to RUB 172,652 million for the same period of the prior year. The increase was mainly due to an increase in the fixed asset base.

Foreign exchange differences on operating items

The foreign exchange gain on operating items amounted to RUB 115,584 million for the three months ended March 31, 2020 compared to the foreign exchange loss in the amount of RUB 47,251 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 appreciation of the US Dollar and the Euro against the Russian Ruble by 26 % and 24 %, respectively, for the three months ended March 31, 2020 compared to the depreciation of the US Dollar and the Euro against the Russian Ruble by 7 % and 8 %, respectively, for the same period of the prior year.

Other operating expenses

Other operating expenses decreased by RUB 47,439 million, or 34 %, to RUB 91,173 million for the three months ended March 31, 2020 compared to RUB 138,612 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.

Impairment loss on financial assets

Impairment loss on financial assets decreased by RUB 27,181 million, or 61 %, to RUB 17,067 million for the three months ended March 31, 2020 compared to RUB 44,248 million for the same period of the prior year. The decrease was mainly due to the termination of the accrual of the allowance for expected credit losses on accounts receivable due from NJSC Naftogaz of Ukraine as a result of the settlement of mutual debts in accordance with the agreement between NJSC Naftogaz of Ukraine and PJSC Gazprom.

Operating profit

As a result of the factors discussed above, operating profit decreased by RUB 165,303 million, or 36 %, to RUB 293,459 million for the three months ended March 31, 2020 compared to RUB 458,762 million for the same period of the prior year. The operating profit margin decreased from 20 % for the three months ended March 31, 2019 to 17 % for the three months ended March 31, 2020.

Net finance (expense) income

(in RUB million)	Three months ended March 31,	
	2020	2019
Foreign exchange gain	114,624	234,603
Foreign exchange loss	<u>(666,020)</u>	<u>(50,618)</u>
Net foreign exchange (loss) gain	(551,396)	183,985
Interest income	20,342	23,620
Interest expense	<u>(16,950)</u>	<u>(18,373)</u>
Net finance (expense) income	<u>(548,004)</u>	<u>189,232</u>

The net foreign exchange loss amounted to RUB 551,396 million for the three months ended March 31, 2020 compared to the net foreign exchange gain of RUB 183,985 million for the same period of the prior year. The change was explained by the appreciation of US Dollar and Euro against the Russian Ruble by 26 % and 24 %, respectively for the three months ended March 31, 2020 and the depreciation of US Dollar and Euro against the Russian Ruble by 7 % and 8 % respectively for the same period of the prior year. The loss and the gain were mainly related to the revaluation of loans and borrowings denominated in foreign currencies.

Interest income decreased by RUB 3,278 million, or 14 %, to RUB 20,342 million for the three months ended March 31, 2020 compared to RUB 23,620 million for the same period of the prior year.

Interest expense decreased by RUB 1,423 million, or 8 %, to RUB 16,950 million for the three months ended March 31, 2020 compared to RUB 18,373 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 decreased by RUB 18,107 million, or 28 %, to RUB 45,825 million for the three months ended March 31, 2020 compared to RUB 63,932 million for the same period of the prior year. This change was mainly caused by a decrease in the share of profit PJSC NGK Slavneft and its subsidiaries and JSC Messoyakhaneftegaz.

Profit tax

Income on profit tax amounted to RUB 100,638 million for the three months ended March 31, 2020 compared to expense on profit tax in the amount of RUB 152,413 million for the same period of the prior year.

(Loss) profit for the period attributable to the owners of PJSC Gazprom

As a result of the factors discussed above, loss attributable to the owners of PJSC Gazprom amounted to RUB 116,249 million for the three months ended March 31, 2020 compared to profit in the amount of RUB 535,908 million for the same period of the prior year.

Profit for the period attributable to non-controlling interest

Profit attributable to non-controlling interest decreased by RUB 15,438 million, or 65 %, to RUB 8,167 million for the three months ended March 31, 2020 compared to RUB 23,605 million for the same period of the prior year.

Liquidity and capital resources

The following table summarises the cash flows for the three months ended March 31, 2020 and March 31, 2019:

(in RUB million)	Three months ended March 31,	
	2020	2019
Net cash from operating activities	590,101	684,920
Net cash used in investing activities	(493,007)	(667,573)
Net cash (used in) from financing activities	(113,117)	236,525

Net cash from operating activities

Net cash from operating activities decreased by RUB 94,819 million, or 14 %, to RUB 590,101 million for the three months ended March 31, 2020 compared to RUB 684,920 million for the same period of the prior year. This change was mainly driven by a decrease in cash flow from operating activities before working capital changes for the three months ended March 31, 2020 compared to the same period of the prior year.

Net cash used in investing activities

Net cash used in investing activities decreased by RUB 174,566 million, or 26 %, to RUB 493,007 million for the three months ended March 31, 2020 compared to RUB 667,573 million for the same period of the prior year. The change was mainly due to a decrease in loans issued for the three months ended March 31, 2020 compared to the same period of the prior year.

Net cash (used in) from financing activities

Net cash used in financing activities amounted to RUB 113,117 million for the three months ended March 31, 2020 compared to net cash from financing activities in the amount to RUB 236,525 million for the same period of the prior year. This change was mainly due to an increase in repayments of long-term borrowings compared to the same period of the prior year.

Capital expenditures

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) by segments for the three months ended March 31, 2020 and for the three months ended March 31, 2019 denominated in the Russian Ruble are presented in the following table:

(in RUB million)	Three months ended March 31,	
	2020	2019
Production of crude oil and gas condensate	87,027	56,254
Refining	65,707	50,878
Production of gas	48,783	41,515
Transportation	32,644	82,456
Electric and heat energy generation and sales	24,947	9,663
Distribution of gas	2,420	1,109
Gas storage	1,215	2,626
All other segments	<u>19,587</u>	<u>51,949</u>
Total	282,330	296,450

Total capital expenditures decreased by RUB 14,120 million, or 5 %, to RUB 282,330 million for the three months ended March 31, 2020 compared to RUB 296,450 million for the same period of the prior year.

Debts obligation

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, net of cash and cash equivalents) increased by RUB 571,766 million, or 18 %, from RUB 3,167,847 million as of December 31, 2019 to RUB 3,739,613 million as of March 31, 2020. This change was mainly due to an increase in the amount of long-term borrowings denominated in the Russian Ruble caused by the appreciation of US Dollar and Euro against the Russian Ruble.