

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 nine months ended September 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

(RUB million)

	Nine months periods ended September 30,	
	2011	2010
Sales	3,296,656	2,495,557
Net (loss) gain from trading activity	(837)	5,786
Operating expenses	<u>(2,119,289)</u>	<u>(1,726,604)</u>
Operating profit	1,176,530	774,739
Finance income	117,012	126,967
Finance expense	(192,323)	(128,402)
Share of net income of associated undertakings and jointly controlled entities	71,779	74,153
Gains on disposal of available-for-sale financial assets	<u>841</u>	<u>2,481</u>
Profit before profit tax	1,173,839	849,938
Current profit tax expense	(198,969)	(148,389)
Deferred profit tax expense	<u>(34,043)</u>	<u>(32,796)</u>
Profit tax expense	(233,012)	(181,185)
Profit for the period	940,827	668,753
Other comprehensive income		
(Losses) gains arising from change in fair value of available-for-sale financial assets, net of tax	(20,100)	13,426
Share of other comprehensive (loss) income of associated undertakings and jointly controlled entities	(6,854)	1,406
Translation differences	<u>23,373</u>	<u>(5,163)</u>
Other comprehensive (loss) gain for the period, net of tax	(3,581)	9,669
Total comprehensive income for the period	937,246	678,422
Profit attributable to:		
owners of OAO Gazprom	923,647	653,721
non-controlling interest	<u>17,180</u>	<u>15,032</u>
	940,827	668,753
Total comprehensive income attributable to:		
owners of OAO Gazprom	918,731	662,968
non-controlling interest	<u>18,515</u>	<u>15,454</u>
	937,246	678,422

Sales

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

(RUB million unless indicated otherwise)	Nine months periods ended September 30,	
	2011	2010
Sales of gas		
<i>Europe and other countries</i>		
Gross sales ⁽¹⁾	1,241,720	948,333
Customs duties	(215,269)	(180,478)
Net sales	1,026,451	767,855
Volumes in billion cubic meters (bcm)	114.8	106.5
Gross average price, U.S.\$ per mcm ⁽²⁾ (including customs duties) ⁽³⁾	376.0	294.5
Gross average price, RUB per mcm ⁽²⁾ (including customs duties)	10,815.6	8,908.0
<i>FSU (Former Soviet Union)</i>		
Gross sales (net of value added tax (VAT))	496,134	323,315
Customs duties	(37,526)	(33,245)
Net sales	458,608	290,070
Volumes in bcm	62.5	46.9
Gross average price, U.S.\$ per mcm ⁽²⁾ (including customs duties, net of VAT) ⁽³⁾	276.1	228.0
Gross average price, RUB per mcm ⁽²⁾ (including customs duties, net of VAT)	7,942.5	6,897.5
<i>Russian Federation</i>		
Gross sales (net of VAT)	502,271	437,410
Net sales	502,271	437,410
Volumes in bcm	194.5	191.4
Gross average price, RUB per mcm ⁽²⁾ (net of VAT)	2,583.0	2,284.7
<i>Total sales of gas</i>		
Gross sales (net of VAT)	2,240,125	1,709,058
Customs duties	(252,795)	(213,723)
Net sales	1,987,330	1,495,335
Volumes in bcm	371.8	344.8
Net sales of refined products (net of excise tax, VAT and customs duties)	717,723	504,711
Net sales of electric and heat energy (net of VAT)	237,545	199,448
Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties)	164,438	141,366
Gas transportation net sales (net of VAT)	82,501	67,195
Other revenues (net of VAT)	<u>107,119</u>	<u>87,502</u>
Total sales (net of excise tax, VAT and customs duties)	<u>3,296,656</u>	<u>2,495,557</u>

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 RUB 801,099 million, or 32%, to RUB 3,296,656 million in the nine months period ended September 30, 2011 compared to the same period of the prior year.

Net sales of gas accounted for 60% and 60% of total net sales in the nine months periods ended September 30, 2011 and 2010, respectively.

Net sales of gas increased from RUB 1,495,335 million in the nine months period ended September 30, 2010 to RUB 1,987,330 million in the nine months period ended September 30, 2011, or by 33%.

Net sales of gas to Europe and other countries increased in the nine months period ended September 30, 2011 compared to the nine months period ended September 30, 2010, by RUB 258,596 million, or 34%, to

RUB 1,026,451 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 RUB price (including customs duties) increased by 21% in the nine months period ended September 30, 2011, compared to the nine months period ended September 30, 2010. In addition, volume of gas sold in the nine months period ended September 30, 2011 increased by 8% compared to the same period of the prior year.

Net sales of gas to FSU countries increased in the nine months period ended September 30, 2011 compared to the nine months period ended September 30, 2010, by RUB 168,538 million, or 58%, to RUB 458,608 million. This increase was mainly due to the increase in volumes of gas sold to FSU countries by 33% in the nine months period ended September 30, 2011, compared to the nine months period ended September 30, 2010. In addition, the gross average RUB price (including customs duties, net of VAT) increased by 15% in the nine months period ended September 30, 2011 compared to the same period of the prior year.

Net sales of gas in the Russian Federation increased in the nine months period ended September 30, 2011 compared to the same period of the prior year, by RUB 64,861 million, or 15%, to RUB 502,271 million. This increase was mainly due to the increase in the gross average price for domestic gas sales by 13% in the nine months period ended September 30, 2011 compared to the same period of the prior year due to the increase in tariffs which are established by the Federal Tariffs Service (FTS).

Net sales of refined products (net of excise tax, VAT and customs duties) increased by RUB 213,012 million, or 42%, to RUB 717,723 million in the nine months period ended September 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 nine months period ended September 30, 2011 compared to the same period of the prior year. In the nine months periods ended September 30, 2011 and 2010 Gazprom Neft Group's sales comprised 85% and 84% of the total amount of our net sales of refined products, respectively.

Net sales of electric and heat energy (net of VAT) increased by RUB 38,097 million, or 19%, to RUB 237,545 million in the nine months period ended September 30, 2011 compared to the same period of the prior year. The 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 RUB 23,072 million, or 16%, to RUB 164,438 million in the nine months period ended September 30, 2011 compared to RUB 141,366 million in the nine months period ended September 30, 2010. The increase was mainly caused by the increase in oil and gas condensate prices in the nine months period ended September 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 nine months period ended September 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 RUB 133,368 million and RUB 121,675 million in the nine months periods ended September 30, 2011 and 2010, respectively.

Gas transportation net sales (net of VAT) increased by RUB 15,306 million, or 23%, to RUB 82,501 million in the nine months period ended September 30, 2011 from RUB 67,195 million in the nine months period ended September 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 nine months period ended September 30, 2011 compared to the same period of the prior year.

Other revenues increased by RUB 19,617 million, or 22%, to RUB 107,119 million in the nine months period ended September 30, 2011 compared to RUB 87,502 million in the nine months period ended September 30, 2010.

Net loss from trading activity is RUB 837 million in nine months period ended September 30, 2011 compared with gain of RUB 5,786 million in nine months period ended September 30, 2010.

Operating expenses

Operating expenses increased by 23% in the nine months period ended September 30, 2011 to RUB 2,119,289 million from RUB 1,726,604 million in the nine months period ended September 30, 2010. Operating expenses as a percentage of sales decreased from 69% in the nine months period ended September 30, 2010 to 64% in the nine months period ended September 30, 2011. The table below presents a breakdown of operating expenses in each period:

(RUB million)	Nine months periods ended	
	September 30,	
	2011	2010
Purchased gas and oil	628,590	428,209
Taxes other than on income	310,268	211,816
Staff costs	267,377	227,500
Depreciation	201,636	184,610
Transit of gas, oil and refined products	197,740	202,393
Repairs and maintenance	127,583	121,279
Cost of goods for resale, including refined products	77,676	36,006
Materials	76,595	69,737
Electricity and heating expenses	54,192	42,921
Transportation services	24,205	13,509
Social expenses	22,078	18,294
Rental expenses	20,339	15,775
Heat transmission	17,885	15,830
Research and development expenses	14,667	22,572
Insurance expenses	13,737	11,796
Charge for impairment provisions	11,527	10,249
Processing services	6,496	6,284
Exchange rate differences on operating items	(3,883)	6,961
Other	<u>123,964</u>	<u>138,024</u>
	<u>2,192,672</u>	<u>1,783,765</u>
Changes in inventories of finished goods, work in progress and other effects	<u>(73,383)</u>	<u>(57,161)</u>
Total operating expenses	2,119,289	1,726,604

Purchased gas and oil

Cost of purchased gas and oil increased by 47% to RUB 628,590 million in the nine months period ended September 30, 2011 from RUB 428,209 million in the nine months period ended September 30, 2010. Cost of purchased gas increased by RUB 159,843 million, or 57%. 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 RUB 40,538 million, or 28%, and amounted to RUB 186,509 million in the nine months period ended September 30, 2011 in comparison with RUB 145,971 million in the nine months period ended September 30, 2010 due to the increase in oil prices.

Taxes other than on income

Taxes other than on income consist of:

(RUB million)	Nine months periods ended	
	September 30,	
	2011	2010
Natural resources production tax	194,051	126,374
Excise tax	73,221	45,756
Property tax	34,954	32,296
Other taxes	<u>8,042</u>	<u>7,390</u>
Taxes other than on income	310,268	211,816

The natural resources production tax increased by 54% to RUB 194,051 million in the nine months period ended September 30, 2011 from RUB 126,374 million in the nine months period ended September 30, 2010. The increase mainly resulted from the general increase of natural resources production tax rate for gas from RUB 147 to RUB 237 per thousand cubic meters since 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 RUB 267,377 million in the nine months period ended September 30, 2011 from RUB 227,500 million in the nine months period ended September 30, 2010. The increase mainly resulted from the salary indexation.

Depreciation

Depreciation increased by 9%, or RUB 17,026 million, to RUB 201,636 million in the nine months period ended September 30, 2011 from RUB 184,610 million in the nine months period ended September 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 2% to RUB 197,740 million in the nine months period ended September 30, 2011 from RUB 202,393 million in the nine months period ended September 30, 2010. This decrease mainly relates to the decrease in costs of transportation through Ukraine and Kazakhstan.

Repairs and maintenance

Cost of repairs and maintenance increased by 5% to RUB 127,583 million in nine months period ended September 30, 2011 from RUB 121,279 million in the nine months period ended September 30, 2010. This increase was caused by the increase of volume of repair services rendered by third parties to the Group in the nine months period ended September 30, 2011.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products increased by 116% to RUB 77,676 million in the nine months period ended September 30, 2011 from RUB 36,006 million in the nine months period ended September 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 10% to RUB 76,595 million in the nine months period ended September 30, 2011 from RUB 69,737 million in the nine months period ended September 30, 2010. The increase mainly resulted from the increase in prices for purchased materials.

Electricity and heating expenses

Electricity and heating expenses increased by 26% to RUB 54,192 million in the nine months period ended September 30, 2011 from RUB 42,921 million in the nine months period ended September 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 nine months periods ended September 30, 2011 and 2010 amounted to a net gain of RUB 3,883 million and net loss of RUB 6,961 million, respectively. The change was primarily driven by depreciation of RUB against USD by 5% and EURO by 8% in the nine months ended September 30, 2011, compared to depreciation of RUB against USD by 1% and appreciation of RUB against EURO by 5%, in the same period of the prior year.

Other operating expenses

Other operating expenses decreased by 10% to RUB 123,964 million in the nine months period ended September 30, 2011 from RUB 138,024 million in the nine months period ended September 30, 2010. Other expenses include bank charges, security services, legal and consulting services, charity and finance aid, advertising 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 increased by 28% to RUB 73,383 million in the nine months period ended September 30, 2011. The negative amount of changes in inventory of

finished goods, work in progress and other effects in the nine months period, ended September 30, 2011 relates mainly to the increase in the balances of finished goods as of September 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 RUB 401,791 million, or 52%, to RUB 1,176,530 million in the nine months period ended September 30, 2011 from RUB 774,739 million in the same period of the prior year. Our operating profit margin increased from 31% in the nine months period ended September 30, 2010 to 36% in the nine months period ended September 30, 2011.

Net finance expense

(RUB million)	Nine months periods ended	
	September 30, 2011	September 30, 2010
Exchange gains	103,368	111,774
Exchange losses	(171,031)	(97,612)
Net exchange (loss) gain	(67,663)	14,162
Interest income	13,452	15,188
Interest expense	(21,292)	(30,790)
Gains on extinguishment of restructured liabilities	192	5
Net finance expense	(75,311)	(1,435)

Exchange gains decreased by RUB 8,406 million to RUB 103,368 million in the nine months period ended September 30, 2011, compared to RUB 111,774 million in the nine months period ended September 30, 2010. Exchange losses increased by RUB 73,419 million to RUB 171,031 million in the nine months period ended September 30, 2011 from RUB 97,612 million in the nine months period ended September 30, 2010. The net exchange loss of RUB 67,663 million in the nine months period ended September 30, 2011 in comparison with net exchange gain of RUB 14,162 million in the nine months period ended September 30, 2010, is explained by depreciation of RUB against USD and Euro in the nine months period ended September 30, 2011 in comparison with the same period of the prior year.

Interest income decreased by 11% to RUB 13,452 million in the nine months period ended September 30, 2011 from RUB 15,188 million in the nine months period ended September 30, 2010, mainly due to deconsolidation of ZAO Gazenergoprombank in the second quarter 2010.

Interest expense decreased by 31% to RUB 21,292 million in the nine months period ended September 30, 2011 from RUB 30,790 million in the nine months period ended September 30, 2010, mainly due to decrease in average borrowings balance during the nine months period ended September 30, 2011 in comparison with the same period of prior year.

Share of net income of associated undertakings and jointly controlled entities

Share of net income of associated undertakings and jointly controlled entities decreased by RUB 2,374 million, or 3%, to RUB 71,779 million in the nine months ended September 30, 2011 compared to RUB 74,153 million in the same period of the prior year. The decrease of the Group's share of net income of associated undertakings and jointly controlled entities in the nine months period ended September 30, 2011 relates mainly to the increase of losses of Nord Stream AG due to negative changes of variable rate for borrowings, that were obtained for construction of the Nord Stream pipeline; deconsolidation of OAO NOVATEK and losses incurred by OAO Beltransgaz due to negative influence of revaluation of assets accounted in foreign currency, partly offset by the increase of net income of Sakhalin Energy Investment Company Ltd. due to the increase of liquefied natural gas sales and crude oil sales in the nine months period ended September 30, 2011 compared to the same period of the prior year.

Profit tax

Total profit tax expense increased by RUB 51,827 million, or 29%, to RUB 233,012 million in the nine months period ended September 30, 2011 compared to RUB 181,185 million in the nine months period ended September 30, 2010. The effective profit tax rate was 19.9% and 21.3% in the nine months periods ended September 30, 2011 and

2010, respectively. Change of the effective profit tax rate mainly resulted from a relative decrease of non-deductable expenses in the nine months period ended September 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 RUB 269,926 million, or 41%, from RUB 653,721 million in the nine months period ended September 30, 2010 to RUB 923,647 million in the nine months period ended September 30, 2011.

Profit for the period attributable to non-controlling interest

Profit for the period attributable to non-controlling interest increased by RUB 2,148 million, or 14%, to RUB 17,180 million in the nine months period ended September 30, 2011 compared to RUB 15,032 million in the nine months period ended September 30, 2010.

LIQUIDITY AND CAPITAL RESOURCES

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

(RUB million)	Nine months periods ended September 30,	
	2011	2010
Net cash provided by operating activities	1,067,752	1,018,359
Net cash used for investing activities	(1,069,354)	(748,776)
Net cash used for financing activities	(58,652)	(199,856)

Net cash provided by operating activities

Net cash provided by operating activities amounted to RUB 1,067,752 million in the nine months period ended September 30, 2011 compared to RUB 1,018,359 million in the nine months period ended September 30, 2010. The increase was primarily due to the growth of our operating profit in the nine months period ended September 30, 2011 in comparison with the same period of the prior year. This effect was partly offset by the negative dynamics of changes in working capital in the nine months period ended September 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 RUB 320,578 million, or 43%, to RUB 1,069,354 million in the nine months period ended September 30, 2011 compared to RUB 748,776 million in the nine months period ended September 30, 2010. The increase was primarily due to the increase in total capital expenditures in the nine months period ended September 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 nine months period ended September 30, 2011 in comparison with the same period of the prior year.

Net cash used for financing activities

Net cash used for financing activities amounted to RUB 58,652 million in the nine months period ended September 30, 2011 compared to RUB 199,856 million in the nine months period ended September 30, 2010. This change was mainly due to the increase in proceeds from long-term borrowings in the nine months period ended September 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 nine months periods ended September 30, 2011 and 2010 in nominal RUB terms, amounted to the following:

(RUB million)	Nine months periods ended September 30,	
	2011	2010
Transport	446,273	249,669
Production of gas	179,189	173,614
Refining	75,236	51,641
Production of crude oil and gas condensate	62,519	62,173
Electric and heat energy generation and sales	51,004	33,587
Distribution	24,626	25,089
Gas storage	10,764	8,352
All other segments	<u>22,966</u>	<u>16,426</u>
Total	<u>872,577</u>	<u>620,551</u>

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) increased by RUB 252,026 million, or 41%, from RUB 620,551 million in the nine months period ended September 30, 2010 to RUB 872,577 million in the nine months period ended September 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, Pochinki-Gryazovets, Pipeline Uhta-Torzhok, and also Sakhalin-Khabarovsk-Vladivostok and Nord Stream. The increase of our capital expenditures in the Refining segment was primarily due to increased capital expenditures of Gazprom Neft Group and OOO Novourengoysky GCC. The increase of our capital expenditures in the Electric and heat energy generation and sales segment was primarily due to increased capital expenditures on the OOO Gazprom investproekt construction of Adlerskaya TPS and increased capital expenditures of OAO Mosenergo.

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 RUB 173,413 million, or 20%, from RUB 870,993 million as of December 31, 2010 to RUB 1,044,406 million as of September 30, 2011. This growth resulted from raising of new long-term borrowings, depreciation of RUB against USD and Euro and decrease in cash and cash equivalents.