

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

You should read the following management's discussion in conjunction with our unaudited consolidated interim condensed financial information as of and for the six months ended June 30, 2008. 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, 2007 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 five main business segments:

- Production of gas – exploration and production of gas;
- Transport – transportation of gas;
- Distribution – domestic and export sales of gas;
- 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.

Other businesses primarily comprise electric and heat energy generation and banking.

Our five 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 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 ongoing global liquidity crisis which commenced in the middle of 2007 has resulted in, among other things, a lower level of capital market funding, lower liquidity levels across the banking sector, and, at times, higher interbank lending rates. The uncertainties in the global financial market, have also led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the ability of the Group to obtain new borrowings and re-finance its existing borrowings at terms and conditions similar to those applied to earlier transactions. The borrowers of the Group may also be affected by the lower liquidity situation which could in turn impact their ability to repay their outstanding loans. Deteriorating operating conditions for borrowers may also have an impact on management's cash flow forecasts and assessment of the impairment of financial and non-financial assets. To the extent that information is available, management has reflected revised estimates of expected future cash flows in their impairment assessments.

The uncertainty in the global markets combined with other local factors has during 2008 led to very high volatility in the Russian Stock Markets and at times much higher than normal interbank lending rates.

Management is unable to estimate reliably the effects on the Group's financial position of any further deterioration in the liquidity of the financial markets and the increased volatility in the currency and equity markets. Management believes it is taking all the necessary measures to support the sustainability and growth of the Group's business in the current circumstances.

RESULTS OF OPERATIONS

(RR million)

	Six months ended June 30	
	2008	2007
Sales (net of excise tax, VAT and customs duties)	1,743,196	1,143,894
Operating expenses	<u>(1,026,576)</u>	<u>(792,215)</u>
Operating profit	716,620	351,679
Gain from change in fair value of call option	28,375	-
Deconsolidation of NPF Gazfund	-	44,692
Finance income	85,605	63,229
Finance expenses	(71,925)	(51,128)
Share of net income of associated undertakings and jointly controlled entities	25,392	15,194
Gains on disposal of available-for-sale financial assets	<u>11,476</u>	<u>18,447</u>
Profit before profit tax	795,543	442,113
Current profit tax expense	(180,530)	(105,834)
Deferred profit tax expense	<u>(5,660)</u>	<u>(6,229)</u>
Total profit tax expense	(186,190)	(112,063)
Profit for the period	609,353	330,050
Attributable to:		
Equity holders of OAO Gazprom	573,757	313,180
Minority interest	<u>35,596</u>	<u>16,870</u>
	609,353	330,050

Sales

The following table sets out our volumes and realized prices for the six months ended June 30, 2008 and 2007.

	Six months ended June 30	
	2008	2007
(RR million unless indicated otherwise)		
Sales of gas		
<i>Far Abroad</i>		
Gross sales ⁽¹⁾	873,585	533,738
Excise tax	-	(54)
Customs duties	(212,031)	(123,478)
Net sales	661,554	410,206
Volumes in billion cubic meters (bcm)	99.7	79.4
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	366.0	257.7
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties)	8,762.4	6,721.7
<i>FSU (Former Soviet Union)</i>		
Gross sales (net of value added tax (VAT))	177,231	145,401
Customs duties	(13,594)	(11,614)
Net sales	163,637	133,787
Volumes in bcm	49.5	50.4
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties, net of VAT) ⁽³⁾	149.4	110.6
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties, net of VAT)	3,578.2	2,884.6
<i>Russia</i>		
Gross sales (net of VAT)	264,273	214,300
Net sales	264,273	214,300
Volumes in bcm	159.9	165.1
Gross average price, RR per mcm ⁽²⁾ (including excise tax, net of VAT)	1,652.7	1,298.1
<i>Total sales of gas</i>		
Gross sales (net of VAT)	1,315,089	893,439
Excise tax	-	(54)
Customs duties	(225,625)	(135,092)

(RR million unless indicated otherwise)	Six months ended June 30	
	2008	2007
Net sales	1,089,464	758,293
Volumes in bcm	309.1	294.9
Net sales of refined products (net of excise tax, VAT and customs duties)	353,324	221,784
Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties)	134,616	74,994
Gas transportation sales (net of VAT)	31,048	21,059
Other revenues (net of VAT)	<u>134,744</u>	<u>67,764</u>
Total sales (net of excise tax, VAT and customs duties)	<u>1,743,196</u>	<u>1,143,894</u>

Notes:

- (1) VAT is not charged on sales to Far Abroad countries.
- (2) One mcm is equivalent to 35,316 cubic feet.
- (3) Calculated on the basis of average rate.

Total sales (net of excise tax, VAT and customs duties) increased by RR 599,302 million, or 52%, to RR 1,743,196 million in the six months ended June 30, 2008 compared to the same period of the prior year.

Net sales of gas accounted for 62% of total net sales in the six months ended June 30, 2008 (66% in the same period of the prior year).

Net sales of gas increased from RR 758,293 million in the six months ended June 30, 2007 to RR 1,089,464 million in the six months ended June 30, 2008, or by 44%.

Net sales of gas to Far Abroad countries increased in the six months, ended June 30, 2008 compared to the same period of the prior year by RR 251,348 million, or 61%, to RR 661,554 million. The overall increase in Far Abroad sales was driven both by volume and price. Gross average RR price (including excise tax and customs duties) grew by 30% for the six months, ended 30 June 2008, compared to the same period of the prior year, at the same time volumes for the six months ended June 30, 2008 increased by 26% compared to the same period of the prior year. The increase in export gas prices reflects the increase in world prices for hydrocarbons that are used as price-determinants in most gas supply contracts. In the majority of contracts hydrocarbons prices of prior periods are used as price determinants.

Net sales of gas to FSU countries increased in the six months ended June 30, 2008 compared to the same period of the prior year by RR 29,850 million, or 22%, to RR 163,637 million. This increase was mainly due to a 24% increase in prices in RR terms (net of excise tax, customs duties and VAT), which was partly offset by 2% decrease in sales volumes.

Net sales of gas in the domestic market increased by RR 49,973 million, or 23%, in the six months ended June 30, 2008 compared to the same period of the prior year. This increase was mainly due to the increase in domestic gas tariffs set by the Federal Tariffs Service (FTS).

Sales of refined products (net of excise tax, VAT and customs duties) increased by RR 131,540 million, or 59%, to RR 353,324 million in the six months ended June 30, 2008 compared to RR 221,784 million in the same period of the prior year. The increase mainly related to increase in world prices for refined products in the six months, ended June 30, 2008 compared to the same period of the prior year. In the six months, ended June 30, 2008 and 2007 Gazprom Neft's sales comprised 60% and 57% of the total amount of refined products sales of Gazprom Group, respectively.

Sales of crude oil and gas condensate (net of excise tax, customs duties and VAT) increased by RR 59,622 million, or 80%, to RR 134,616 million in the six months ended June 30, 2008 compared to RR 74,994 million in the same period of the prior year. Sales of crude oil included in net sales of crude oil and gas condensate (net of customs duties and VAT), amounted to RR 120,129 million and RR 64,866 million in the six months ended June 30, 2008 and 2007, respectively.

Gas transportation sales increased by RR 9,989 million, or 47%, to RR 31,048 million in the six months ended June 30, 2008 from RR 21,059 million in the same period of the prior year. This increase was due to an increase in transportation tariffs set by FTS.

Other revenues increased by RR 66,980 million, or 99%, to RR 134,744 million in the six months ended June 30, 2008 compared to RR 67,764 million in the same period of the prior year. Increase in other revenues was mainly

due to sales of OAO Mosenergo, consolidated since June 2007. Other sales represent activities including electricity sales, media and sales of other services and goods.

Operating expenses

Operating expenses increased by 30% in the six months ended June 30, 2008 to RR 1,026,576 million from RR 792,215 million in the same period of the prior year. Operating expenses as a percentage of sales decreased from 69% in the six months ended June 30, 2007 to 59% in the six months ended June 30, 2008. The table below presents a breakdown of operating expenses in each period:

(RR million)	Six months ended June 30	
	2008	2007
Purchased oil and gas	284,048	188,436
Staff costs	130,125	108,399
Taxes other than on income	124,389	98,074
Depreciation	99,747	93,024
Transit of gas, oil and refined products	93,157	77,063
Cost of goods for resale, including refined products	59,072	21,178
Repairs and maintenance	56,801	45,479
Materials	44,890	45,554
Electricity and heating expenses	29,285	22,748
Charge for impairment provisions	8,506	2,778
Social expenses	8,317	6,981
Insurance expenses	7,257	5,673
Rental expenses	6,305	8,153
Other operating expenses	<u>74,677</u>	<u>68,675</u>
Total operating expenses	1,026,576	792,215

Purchased oil and gas

Cost of purchased oil and gas increased by 51% to RR 284,048 million in the six months ended June 30, 2008 from RR 188,436 million in the same period of the prior year. The increase primarily relates to the increase in the amount of gas sales and purchase transactions in the European market and, therefore, the volume of purchased gas. These transactions are executed at market prices and are related mainly to Gazprom Germania Group. The cost of purchased oil included in the cost of purchased oil and gas increased by RR 45,841 or 131% and amounted to RR 80,746 million in the six months ended June 30, 2008 from RR 34,905 in the same period of the prior year.

Staff costs

Staff costs increased by 20% to RR 130,125 million in the six months ended June 30, 2008 from RR 108,399 million in the same period of the prior year. The increase mainly resulted from the growth of average base salaries and staff costs of OAO Mosenergo, which is consolidated as a subsidiary from June 2007.

Taxes other than on income

Taxes other than on income consist of:

(RR million)	Six months ended June 30	
	2008	2007
Natural resources production tax	102,740	76,992
Property tax	12,622	10,639
Other taxes	<u>9,027</u>	<u>10,443</u>
Taxes other than on income	124,389	98,074

Natural resources production tax increased by 33% to RR 102,740 million in the six months ended June 30, 2008 from RR 76,992 million in the same period of the prior year. The increase mainly related to the crude oil production activity and was caused by increase in the world oil prices and, as consequence, in tax rate.

Depreciation

Depreciation increased by 7% to RR 99,747 million in the six months ended June 30, 2008 from RR 93,024 million in the same period of the prior year. The increase primarily relates to the growth in our fixed asset base.

Transit of gas, oil and refined products

Transit of gas, oil and refined products increased by 21% to RR 93,157 million in the six months ended June 30, 2008 from RR 77,063 million in the same period of the prior year. This increase mainly relates to the increase in volumes of gas transportation through the territories of Ukraine and Eastern Europe.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products increased by 179% to RR 59,072 million in the six months ended June 30, 2008 from RR 21,178 million in the same period of the prior year. The increase is mainly caused by the increase in prices for refined products and increase in volumes of refined products purchased.

Repairs and maintenance

Cost of repairs and maintenance increased by 25% to RR 56,801 million in the six months ended June 30, 2008 from RR 45,479 million in the same period of the prior year. This growth resulted from the increase in volumes of repair services rendered by third parties.

Materials

Cost of materials decreased by 1% to RR 44,890 million in the six months ended June 30, 2008 from RR 45,554 million in the same period of the prior year. The decrease was primarily caused by less materials used for repair purposes. In the six months, ended June 30, 2008 more repairs were performed by third parties.

Electricity and heating expenses

Electricity and heating expenses increased by 29% to RR 29,285 million in the six months ended June 30, 2008 from RR 22,748 million in the same period of the prior year. The increase was mainly caused by the increase in electricity consumption and increase in share of electricity, purchased at market (not regulated) prices.

Other operating expenses

Other operating expenses increased by 9% to RR 74,677 million in the six months ended June 30, 2008 from RR 68,675 million in the same period of the prior year. Other operating expenses include research and development expenses, processing services, transportation services, bank charges, security services, legal and consulting services, and advertising. OAO Mosenergo, which is consolidated as a subsidiary from June 1, 2007, also contributed to the increase. Other expenses of OAO Mosenergo for the six months ended June 30, 2008, including heating transportation expenses, are equal to RR 10,815 million.

Operating profit

As a result of the factors discussed above, our operating profit increased by RR 364,941 million, or 104%, to RR 716,620 in the six months ended June 30, 2008 from RR 351,679 million in the same period of the prior year. Our operating profit margin increased from 31% in the six months ended June 30, 2007 to 41% in the six months ended June 30, 2008.

Gain from change in fair value of call option

In April 2007, ENI S.P.a. (Eni) offered the Group an option to acquire its 20% interest in OAO Gazprom Neft by April 2009, at a price of USD 3.7 billion plus certain financial expenses. For the six months, ended June 30, 2008 the fair value of the option increased from RR 50,738 million as of December 31, 2007 to RR 79,113 million as of June 30, 2008. The change in fair value in the amount of RR 28,375 million was recognized in the statement of income for the six months, ended June 30, 2008.

Finance income and expenses

(RR million)	Six months ended June 30	
	2008	2007
Exchange gains	48,699	23,943
Exchange losses	(32,424)	(15,900)
Interest income	36,890	38,274
Interest expense	(39,501)	(35,228)
Gains on and extinguishment of restructured liabilities	<u>16</u>	<u>1,012</u>
Net finance income/(expense)	13,680	12,101

Exchange gains increased by 103% to RR 48,699 million in the six months ended June 30, 2008, compared to RR 23,943 million in same period of the prior year. Exchange losses increased by 104% to RR 32,424 million in the six months ended June 30, 2008 from RR 15,900 million in the same period of the prior year. The increase in exchange gains was caused by the increase in borrowings and loans denominated in USD and depreciation of USD against RR in the six months ended June 30, 2008 in comparison with the same period of the prior year. The increase in exchange losses resulted from higher appreciation rate of EURO against RR in the six months ended June 30, 2008 in comparison with the same period of the prior year.

Interest income decreased by 4% to RR 36,890 million in the six months ended June 30, 2008 from RR 38,274 million in the same period of the prior year mainly due to decrease in interest income of OAO Gazprombank by 2,559 million in the six months ended June 30, 2008, in comparison with the same period of the prior year. This was due to the decrease in the amounts of loans issued to organizations and banks in the year 2008. Interest expense increased by 12% from RR 35,228 million in the six months ended June 30, 2007 to RR 39,501 million in the same period of the current year mainly due to increased loans and borrowings.

Share of net income of associated undertakings and jointly controlled entities

Share of net income of associated undertakings and jointly controlled entities increased by RR 10,198 million or 67%, to RR 25,392 million in the six months ended June 30, 2008 compared to RR 15,194 million in the same period of the prior year. The increase was caused by the increase in share of net income of RosUkrEnergo AG by RR 13,909 million and share of net income of OAO Tomskneft and its subsidiaries in the amount of RR 2,216 million. The group acquired 50% of OAO Tomskneft in December 2007. The increase was partly offset by our loss from Sakhalin Energy Investment Company Ltd. in the amount of RR 7,778 million. The group acquired 50% plus one share in Sakhalin Energy Investment Company Ltd. in April 2007. Losses of Sakhalin Energy Investment Company Ltd. were due to the fact that the company did not start production of hydrocarbons.

Profit tax

Total profit tax expense increased by RR 74,127 million, or 66%, to RR 186,190 million in the six months ended June 30, 2008 compared to RR 112,063 million in the same period of the prior year. Our effective profit tax rate in the six months ended June 30, 2008 compared to the same period of the prior year decreased from 25% to 23% mainly due to recognition of non-deductible gain from the increase in the fair value of option with ENI in the six months ended June 30, 2008 and one-time recognition of non-taxable income related to the NPF Gazfund deconsolidation during the same period of the prior year.

Profit for the period attributable to equity holders of OAO Gazprom

As a result of the factors discussed above, our profit for the period attributable to equity holders of OAO Gazprom increased by RR 260,577 million or 83%, from RR 313,180 million in the six months ended June 30, 2007 to RR 573,757 million in the six months ended June 30, 2008.

Profit for the period attributable to minority interest

Minority interest increased by 111% to RR 35,596 million in the six months ended June 30, 2008 compared to RR 16,870 million in the same period of the prior year.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our statements of cash flows for the six months ended June 30, 2008 and 2007:

(RR million)	Six months ended June 30	
	2008	2007
Net cash provided by operating activities	498,161	712,698
Net cash used for investing activities	(473,093)	(433,485)
Net cash (used for) provided by financing activities	(22,916)	229,220

Net cash provided by operating activities

Net cash provided by operating activities amounted to RR 498,161 million in the six months ended June 30, 2008 compared to RR 712,698 million in the same period of the prior year. This decrease was primarily due to less positive changes in the working capital during six months ended June 30, 2008 in comparison with the same period of the prior year, which was caused by cash inflow in OAO Gazprombank from temporary cash deposits from participants of the auctions in the amount of RR 420,279 in the six months ended June 30, 2007.

Net cash used for investing activities

Net cash used for investing activities amounted to RR 473,093 million in the six months ended June 30, 2008 compared to RR 433,485 million in the same period of the prior year. The increase was primarily due to higher capital expenditures on field development and gas transportation infrastructure (see Capital Expenditures), as well as additional investments in Sakhalin Energy Investment Company Ltd., OAO TGC-1, and OAO Beltransgaz.

Net cash (used for) provided by financing activities

Net cash used for financing activities amounted to RR 22,916 million in six months ended June 30, 2008 compared to net cash provided by financing activities in the amount of RR 229,220 million in the same period of the prior year. This change was primarily due to repayment of a portion of long-term borrowings.

CAPITAL EXPENDITURES

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) by segment for the six months ended June 30, 2008 and 2007 in nominal RR terms, amounted to the following:

	Six months ended June 30	
	2008	2007
(RR million)		
Production of gas	99,334	68,544
Transport	84,389	78,841
Production of crude oil and gas condensate	44,833	26,548
Refining	22,233	15,698
Distribution	20,208	13,201
Other	<u>24,371</u>	<u>4,896</u>
Total	295,368	207,728

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) increased by RR 87,640 million, or 42%, from RR 207,728 million in the six months ended June 30, 2007 to RR 295,368 million in the six months ended June 30, 2008. 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, Kharasaveiskoye, Kharvutinskoye and Yuzhno-Russkoye fields. The increase of our capital expenditures in the Production of crude oil and gas condensate segment was primarily due to increased capital expenditure of Gazprom Neft. The increase of our capital expenditures in the Other segment was mainly caused by 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) decreased by RR 391,633 million, or 32%, from RR 1,228,583 million as of December 31, 2007 to RR 836,950 million as of June 30, 2008. This decline can be explained by a significant decrease of long-term and short-term borrowings due to deconsolidation of Gazprombank Group.