

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, 2007. The 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, 2006 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; and
- Refining – processing of oil, gas condensate and other hydrocarbons, and sales of refined products.

Other businesses primarily comprise banking, electricity and media.

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 were 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

(RR million)

	Nine months ended September 30	
	2007	2006
Sales (net of excise tax, VAT and customs duties)	1,660,069	1,581,328
Operating expenses	(1,163,243)	(1,012,913)
Operating profit	496,826	568,415
Deconsolidation of NPF Gazfund	44,692	-
Finance income	115,001	82,320
Finance expenses	(87,021)	(51,576)
Share of net income of associated undertakings and jointly controlled entities	22,489	19,869
Gains on disposal of available-for-sale financial assets	19,586	3,531
Profit before profit tax	611,573	622,559
Current profit tax expense	(150,366)	(156,684)
Deferred profit tax expense	(6,717)	(5,610)
Total profit tax expense	(157,083)	(162,294)
Profit for the period	454,490	460,265
Attributable to:		
Equity holders of OAO Gazprom	426,268	442,296
Minority interest	28,222	17,969
	454,490	460,265

Sales

The following table sets out our volumes and realized prices for the nine months ended September 30, 2007 and 2006.

	Nine months ended September 30	
	2007	2006
(RR million unless indicated otherwise)		
Sales of gas		
<i>Far Abroad</i>		
Gross sales ⁽¹⁾	782,631	830,830
Excise tax	(96)	(484)
Customs duties	(186,188)	(226,115)
Net sales	596,347	604,231
Volumes in billion cubic meters (bcm)	117.1	118.8
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	258.1	255.4
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties)	6,683.6	6,995.4
<i>FSU (Former Soviet Union)</i>		
Gross sales (net of value added tax (VAT))	204,666	184,350
Excise tax	-	-
Customs duties	(14,292)	(27,067)
Net sales	190,374	157,283
Volumes in bcm	72.0	75.5
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties, net of VAT) ⁽³⁾	109.8	89.2
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties, net of VAT)	2,842.3	2,441.7
<i>Russia</i>		
Gross sales (net of VAT)	275,677	247,668
Excise tax	-	(846)
Net sales	275,677	246,822
Volumes in bcm	211.5	219.6
Gross average price, RR per mcm ⁽²⁾ (including excise tax, net of VAT)	1,303.5	1,128.0
<i>Total sales of gas</i>		
Gross sales (net of VAT)	1,262,974	1,262,848
Excise tax	(96)	(1,330)
Customs duties	(200,480)	(253,182)
Net sales	1,062,398	1,008,336
Volumes in bcm	400.6	413.9
Net sales of refined products (net of excise tax, VAT and customs duties)	351,954	333,216
Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties)	117,956	141,049
Gas transportation sales (net of VAT)	30,560	25,141
Other revenues (net of VAT)	97,201	73,586
Total sales (net of excise tax, VAT and customs duties)	1,660,069	1,581,328

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 RR78,741 million, or 5%, to RR1,660,069 million in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006.

Net sales of gas accounted for 64% of total net sales in the nine months ended September 30, 2007 and 2006.

Net sales of gas increased from RR1,008,336 million in the nine months ended September 30, 2006 to RR1,062,398 million in the nine months ended September 30, 2007, or by 5%.

Net sales of gas to Far Abroad countries decreased in the nine months, ended September 30, 2007 compared to the nine months ended September 30, 2006 by RR7,884 million, or 1%. The decrease resulted primarily from a 1% decrease in sales volumes. The decrease in sales volumes was primarily due to a warmer winter in 2007 compared to 2006, and the related decline in volumes sold to customers in Germany, Italy, Slovakia, France, Poland, Czech and Serbia. The 4% decrease in gross average prices (including excise tax and customs duties) was offset by the decrease in effective rate of customs duties. This decrease in effective rate of customs duties was caused by the increase in share of sales of gas, purchased outside Russia. Such sales are not subject to customs duties.

Net sales of gas to FSU countries increased in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006 by RR33,091 million, or 21%, to RR190,374 million. This increase was mainly due to a 27% increase in net average prices in RR terms (net of excise tax, customs duties and VAT), which was partly offset by 5% decrease in sales volumes. The increase in prices in RR terms was primarily due to the increase in sales prices to customers in Belarus, Kazakhstan, Lithuania, Moldova and Georgia. The increase in net average prices (net of excise tax, VAT and customs duties) was caused by the increase in gross average prices (including excise tax and customs duties, net of VAT) by 16% and decrease in effective rate of customs duties. This decrease was preliminary caused by the increasing share of sales of gas from Middle Asia. Such sales are not subject to customs duties.

Net sales of gas in the domestic market increased by RR28,855 million, or 12%, to RR275,677 million in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006. This increase was mainly due to the increase in domestic gas tariffs set by the Federal Tariffs Service by 15%, which was partly offset by decrease in sales volumes of 4%, or 8.1 bcm.

Net sales of refined products increased by RR18,738 million, or 6%, to RR351,954 million in the nine months ended September 30, 2007 compared to RR333,216 million in the nine months ended September 30, 2006. The increase mainly relates to the sales of OAO Sibur Holding and its consolidated subsidiaries, which accounted for 26% and 24% of the total sales of refined products for the nine months ended September 30, 2007 and 2006, respectively. Sales of refined products (net of excise tax, VAT and customs duties) accounted for 21% of our total sales (net of excise tax, VAT and customs duties) in the nine months ended September 30, 2007 and 2006.

Sales of crude oil and gas condensate (net of excise tax, VAT and customs duties) decreased by RR23,093 million, or 16%, to RR117,956 million in the nine months ended September 30, 2007 compared to RR141,049 million in the nine months ended September 30, 2006. Sales of crude oil included in net sales of crude oil and gas condensate, amounted to RR103,159 million and RR126,153 million in the nine months ended September 30, 2007 and 2006, respectively. The decrease mainly related to Gazprom Neft activities where more crude oil was used to produce refined products.

Gas transportation sales increased by RR5,419 million, or 22%, to RR30,560 million in the nine months ended September 30, 2007 from RR25,141 million in the nine months ended September 30, 2006. This increase was due to an increase in both transportation tariffs and volumes of gas transported.

Other revenues increased by RR23,615 million, or 32%, to RR97,201 million in the nine months ended September 30, 2007 compared to RR73,586 million in the nine months ended September 30, 2006. Other revenues represent activities including media and sales of other services and goods, including electricity.

Operating expenses

Operating expenses increased by 15% in the nine months ended September 30, 2007 to RR1,163,243 million from RR1,012,913 million in the nine months ended September 30, 2006. Operating expenses as a percentage of sales increased from 64% in the nine months ended September 30, 2006 to 70% in the nine months ended September 30, 2007. The table below presents a breakdown of operating expenses in each period:

(RR million)	Nine months ended September 30	
	2007	2006
Purchased oil and gas	272,058	189,951
Staff costs	156,754	130,270
Taxes other than on income	146,570	144,811
Depreciation	137,057	120,875
Transit of gas, oil and refined products	112,851	127,691
Repairs and maintenance	70,336	54,799
Materials	66,610	61,415
Cost of goods for resale, including refined products	36,478	42,568
Electricity and heating expenses	32,056	30,072
Social expenses	11,836	13,782
Insurance expenses	8,787	7,251
Research and development	7,798	9,287
(Release of)/charge for impairment provisions	(618)	6,580
Other	104,670	73,561
Total operating expenses	1,163,243	1,012,913

Purchased oil and gas

Cost of purchased oil and gas increased by 43% to RR272,058 million in the nine months ended September 30, 2007 from RR189,951 million in the nine months ended September 30, 2006. Purchased oil and gas include RR213,550 million and RR131,104 million of purchased gas for the nine months ended 30 September, 2007 and 2006, respectively. The increase primarily relates to the increase in prices of gas purchased in Middle Asia, mainly for further reselling. One of the major consumers of this gas is RosUkrEnergO AG.

Staff costs

Staff costs increased by 20% to RR156,754 million in the nine months ended September 30, 2007 from RR130,270 million in the nine months ended September 30, 2006. The increase mainly resulted from the growth of average base salaries and an increase in expenses associated with pension obligations.

Taxes other than on income

Taxes other than on income consist of:

(RR million)	Nine months ended September 30	
	2007	2006
Natural resources production tax	114,751	115,032
Property tax	16,012	16,069
Other taxes	15,807	13,710
Taxes other than on income	146,570	144,811

Depreciation

Depreciation increased by 13% to RR137,057 million in the nine months ended September 30, 2007 from RR120,875 million in the nine months ended September 30, 2006. 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 decreased by 12% to RR112,851 million in the nine months ended September 30, 2007 from RR127,691 million in the nine months ended September 30, 2006. This decrease mainly relates to the decrease in volumes of gas transported through Ukraine and Eastern Europe countries and depreciation of U.S. dollar against the RR in the nine months of 2007 compared to the respective period of 2006.

Materials

Cost of materials increased by 8% to RR66,610 million in the nine months ended September 30, 2007 from RR61,415 million in the nine months ended September 30, 2006. The increase was primarily related to higher prices of materials and increased volumes of purchases by the Transport and Refining segments.

Repairs and maintenance

Cost of repairs and maintenance increased by 28% to RR70,336 million in the nine months ended September 30, 2007 from RR54,799 million in the nine months ended September 30, 2006. The increase was primarily due to an increase in volume of repairs and maintenance services rendered by third party providers mainly in Transport segment.

Electricity and heating expenses

Electricity and heating expenses increased by 7% to RR32,056 million in the nine months ended September 30, 2007 from RR30,072 million in the nine months ended September 30, 2006, mainly due to an increase in electricity consumption in certain Group entities and higher electricity tariffs, which are set by the FTS.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products decreased by 14% to RR36,478 million in the nine months ended September 30, 2007 from RR42,568 million in the nine months ended September 30, 2006. The decrease is mostly due to decrease in cost of purchased refined products in Gazprom Neft.

Other operating expenses

Other operating expenses increased by 42% to RR104,670 million in the nine months ended September 30, 2007 from RR73,561 million in the nine months ended September 30, 2006. Other operating expenses include bank charges, security services, legal and consulting services and advertising.

Operating profit

As a result of the factors discussed above, our operating profit decreased by RR71,589 million, or 13%, from RR568,415 million in the nine months ended September 30, 2006 to RR496,826 million in the nine months ended September 30, 2007. Our operating profit margin decreased from 36% in the nine months ended September 30, 2006 to 30% in the nine months ended September 30, 2007.

Deconsolidation of NPF Gazfund

In 1994, Gazprom founded the Non-State pension fund NPF Gazfund. Historically, Gazprom consolidated NPF Gazfund primarily due to the fact that Gazprom management exhibited control over the financial and investment decisions of NPF Gazfund. Gazprom used NPF Gazfund as the Group's primary investment vehicle for purchasing strategic investments and NPF Gazfund did not have any other significant operations or investments.

During the first quarter of 2007, there were changes in legislation relating to pension funds, specifically Regulation No. 63 dated 1 February 2007, which introduced stringent requirements on pension fund's investment policies and on the composition of investment portfolios. After evaluating and assessing the specific provisions of the new legal requirements, executive management met in March 2007 and decided to discontinue the use of Gazfund as the Group's primary investment vehicle.

Based on the new legislation and management's decisions, NPF Gazfund was deconsolidated from the consolidated financial information of OAO Gazprom in first quarter of 2007. As a result of this deconsolidation, the Gazfund investment assets are now accounted for as plan assets under IAS 19. The principal balance sheet line items affected are short term financial assets, other non-current assets, provisions for liabilities and charges, minority interest and equity including treasury shares. In addition, where NPF Gazfund continues to hold ownership interests in OAO Gazprom subsidiaries (for example, OAO Gazprombank, OAO Sibur-Holding), those interests are reflected as minority interest in the accompanying financial information.

This transaction resulted in the recognition of income in the amount of RR44,692 million and increase in retained earnings in the amount of RR111,015 million due to recognition of fair value of the pension assets on the balance sheet of the Group.

Finance income and expenses

(RR million)	Nine months ended September 30	
	2007	2006
Exchange gain	57,033	54,521
Exchange loss	(32,144)	(17,391)
Interest income	56,933	27,229
Interest expense	(54,877)	(34,185)
Gain on and extinguishment of restructured liabilities	<u>1,035</u>	<u>570</u>
Net finance income	27,980	30,744

Exchange gain increased by 5% to RR57,033 million in the nine months ended September 30, 2007, compared to RR54,521 million in the nine months ended September 30, 2006. The change reflects the impact of the increase of volume of loans and borrowings denominated in U.S. dollar and appreciation of the RR against the U.S. dollar in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006.

Exchange loss increased by 85% to RR32,144 million in the nine months ended September 30, 2007 from RR17,391 million in the nine months ended September 30, 2006. The changes reflect the impact of the increase of volume of loans and borrowings denominated in euro and appreciation of the euro against the RR in the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006.

Interest income increased by 109% to RR56,933 million in the nine months ended September 30, 2007 from RR27,229 million in the nine months ended September 30, 2006 mainly due to an increase in loans issued by OAO Gazprombank and bank current accounts. Interest expense increased by 61% from RR34,185 million in the

nine months ended September 30, 2006 to RR54,877 million in the nine months ended September 30, 2007 mainly due to increased 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 RR2,620 million, or 13%, to RR22,489 million in the nine months ended September 30, 2007 compared to RR19,869 million in the nine months ended September 30, 2006. The increase was primarily due to increase in our share of net profit in Sakhalin Energy Investment Company Ltd. for the nine months ended September 30, 2007 compared to nine months ended September 30, 2006 in amount of RR2,503 million. Share in Sakhalin Energy Investment Company Ltd. was acquired in April, 2007.

Profit tax

Total profit tax expense decreased by RR5,211 million, or 3%, to RR157,083 million in the nine months ended September 30, 2007 compared to RR162,294 million in the nine months ended September 30, 2006. Our effective profit tax rate in the nine months ended September 30, 2007 and 2006 was approximately 26%.

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 decreased by RR16,028 million, or 4%, from RR442,296 million in the nine months ended September 30, 2006 to RR426,268 million in the nine months ended September 30, 2007.

Profit for the period attributable to minority interest

Minority interest increased by 57% to RR28,222 million in the nine months ended September 30, 2007 compared to RR17,969 million in the nine months ended September 30, 2006 due to the increase in the extent of minority interest in OAO Gazprombank, OAO Sibur-Holding and its subsidiaries, caused by the deconsolidation of NPF Gazfund.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our statements of cash flows for the nine months ended September 30, 2007 and 2006:

(RR million)	Nine months ended September 30	
	2007	2006
Net cash provided by operating activities	880,058	290,306
Net cash used for investing activities	(606,452)	(276,029)
Net cash provided by (used for) financing activities	238,505	(4,888)

Net cash provided by operating activities

Net cash provided by operating activities amounted to RR880,058 million in the nine months ended September 30, 2007 compared to RR290,306 million in the nine months ended September 30, 2006. This was primarily due to working capital changes in OAO Gazprombank in the amount of RR675,509 million.

Net cash used for investing activities

Net cash used for investing activities amounted to RR606,452 million in the nine months ended September 30, 2007 compared to RR276,029 million in the nine months ended September 30, 2006. The increase was primarily due to the acquisition of an interest in Sakhalin Energy Investment Company Ltd. and higher capital expenditures on field development and gas transportation infrastructure.

Net cash provided by (used for) financing activities

Net cash provided by financing activities amounted to RR238,505 million in the nine months ended September 30, 2007 compared to net cash used for financing activities in the amount of RR4,888 million in the nine months ended September 30, 2006. This change was primarily due to early repayment of a portion of the loan from Dresdner Bank AG, that was received to finance the purchase of Gazprom Neft in the nine months ended September 30, 2006, and proceeds from new borrowings received in the nine months ended September 30, 2007.

CAPITAL EXPENDITURES

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) by segment for the nine months ended September 30, 2007 and 2006 in nominal RR terms, amounted to the following:

(RR million)	Nine months ended September 30	
	2007	2006
Transport	118,107	130,635
Production of gas	116,811	67,114
Production of crude oil and gas condensate	41,993	37,388
Distribution	26,140	10,184
Refining	24,161	12,173
Other ⁽¹⁾	<u>31,387</u>	<u>8,723</u>
Total	358,599	266,217

Note:

(1) Primarily includes expenditures for construction and acquisition of non-production assets.

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) increased by RR92,382 million, or 35%, from RR266,217 million in the nine months ended September 30, 2006 to RR358,599 million in the nine months ended September 30, 2007. 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 the Bovanenkovskoye, Kharasaveiskoye, Kharvutinskoye and Yuzhno-Russkoye fields. The increase of our capital expenditures in the Other segment was caused by capital expenditures of OAO Mosenergo in the third quarter of 2007.

DEBT OBLIGATIONS

Our 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 RR224,379 million, or 28%, from RR807,814 million as of 31 December 2006 to RR583,435 million as of 30 September 2007. This decrease can be explained by a significant increase of our cash and cash equivalents in bank accounts primarily due to temporary placement of funds in OAO Gazprombank from third parties. In October 2007, RR472,206 million of the cash held in deposit accounts of OAO Gazprombank was transferred to the Government of the Russian Federation.