

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 three months ended 31 March, 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

(RR million)

	Three months periods ended March 31,	
	2011	2010
Sales	1,316,747	954,327
Net loss from trading activity	(330)	(196)
Operating expenses	<u>(817,909)</u>	<u>(614,830)</u>
Operating profit	498,508	339,301
Finance income	73,968	71,502
Finance expense	(20,278)	(18,965)
Share of net income of associated undertakings and jointly controlled entities	38,519	28,229
Gains on disposal of available-for-sale financial assets	<u>349</u>	<u>1,629</u>
Profit before profit tax	591,066	421,696
Current profit tax expense	(108,864)	(55,053)
Deferred profit tax expense	<u>(3,702)</u>	<u>(29,794)</u>
Profit tax expense	(112,566)	(84,847)
Profit for the period	478,500	336,849
Other comprehensive income		
Gains arising from change in fair value of available-for-sale financial assets, net of tax	7,173	9,793
Share of other comprehensive (loss) income of associated undertakings and jointly controlled entities	(5,579)	11
Translation differences	<u>(19,624)</u>	<u>(22,214)</u>
Other comprehensive loss for the period, net of tax	(18,030)	(12,410)
Total comprehensive income for the period	460,470	324,439
Profit attributable to:		
owners of OAO Gazprom	467,969	324,953
non-controlling interest	<u>10,531</u>	<u>11,896</u>
	478,500	336,849
Total comprehensive income attributable to:		
owners of OAO Gazprom	451,528	314,630
non-controlling interest	<u>8,942</u>	<u>9,809</u>
	460,470	324,439

Sales

The following table sets out our volumes and realized prices for the three months periods March 31, 2011 and 2010.

(RR million unless indicated otherwise)	Three months periods ended March 31,	
	2011	2010
Sales of gas		
<i>Europe and other countries</i>		
Gross sales ⁽¹⁾	468,121	365,482
Customs duties	(69,588)	(79,734)
Net sales	398,533	285,748
Volumes in billion cubic meters (bcm)	46.6	41.7
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	343.1	293.5
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties)	10,041.5	8,771.5
<i>FSU (Former Soviet Union)</i>		
Gross sales (net of value added tax (VAT))	220,243	118,393
Customs duties	(14,849)	(24,564)
Net sales	205,394	93,829
Volumes in bcm	29.2	17.0
Gross average price, U.S.\$ per mcm ⁽²⁾ (including customs duties, net of VAT) ⁽³⁾	258.0	232.9
Gross average price, RR per mcm ⁽²⁾ (including customs duties, net of VAT)	7,552.3	6,961.4
<i>Russian Federation</i>		
Gross sales (net of VAT)	266,042	232,783
Net sales	266,042	232,783
Volumes in bcm	102.5	102.5
Gross average price, RR per mcm ⁽²⁾ (net of VAT)	2,596.1	2,271.6
<i>Total sales of gas</i>		
Gross sales (net of VAT)	954,406	716,658
Customs duties	(84,437)	(104,298)
Net sales	869,969	612,360
Volumes in bcm	178.3	161.2
Net sales of refined products (net of excise tax, VAT and customs duties)	214,887	153,545
Net sales of electric and heat energy (net of VAT)	112,536	93,397
Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties)	57,345	44,584
Gas transportation net sales (net of VAT)	28,796	25,147
Other revenues (net of VAT)	33,214	25,294
Total sales (net of excise tax, VAT and customs duties)	1,316,747	954,327

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 RR 362,420 million, or 38%, to RR 1,316,747 million in the three months period ended March 31, 2011 compared to the same period of the prior year.

Net sales of gas accounted for 66% and 64% of total net sales in the three months periods ended March 31, 2011 and 2010, respectively.

Net sales of gas increased from RR 612,360 million in the three months period ended March 31, 2010 to RR 869,969 million in the three months period ended March 31, 2011 or by 42%.

Net sales of gas to Europe and other countries increased in the three months period ended March 31, 2011 compared to the three months period ended March 31, 2010, by RR 112,785 million, or 39%, to RR 398,533 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 RR price (including excise tax and customs duties) increased by 14% in the three months

period ended March 31, 2011, compared to the three months period ended March 31, 2010. In addition, volume of gas sold in the three months period ended March 31, 2011 increased by 12% compared to the same period of the prior year.

Net sales of gas to FSU countries increased in the three months period ended March 31, 2011 compared to the three months period ended March 31, 2010, by RR 111,565 million, or 119%, to RR 205,394 million. This increase was mainly due to the increase in volumes of gas sold to FSU countries by 72% in the three months period ended March 31, 2011 compared to the three months period ended March 31, 2010. In addition, the gross average RR price (including customs duties, net of VAT) increased by 8% in the three months period ended March 31, 2011 compared to the same period of the prior year.

Net sales of gas in the Russian Federation increased in the three months period ended March 31, 2011 compared to the same period of the prior year, by RR 33,259 million, or 14%, to RR 266,042 million. This increase was due to the increase in the gross average price for domestic gas sales by 14% in the three months period ended March 31, 2011 compared to the same period of the prior year due to the increase in tariffs which are set by the Federal Tariffs Service (FTS).

Net sales of refined products (net of excise tax, VAT and customs duties) increased by RR 61,342 million, or 40%, to RR 214,887 million in the three months period ended March 31, 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 three months period ended March 31, 2011 compared to the same period of the prior year. In the three months periods ended March 31, 2011 and 2010 Gazprom Neft Group's sales comprised 83% and 82% of the total amount of our net sales of refined products, respectively.

Net sales of electric and heat energy (net of VAT) increased by RR 19,139 million, or 20%, to RR 112,536 million in the three months period ended March 31, 2011 compared to the same period of the prior year. This increase was mainly due to the increase in tariffs.

Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties) increased by RR 12,761 million, or 29%, to RR 57,345 million in the three months period ended March 31, 2011 compared to RR 44,584 million in the three months period ended March 31, 2010. The increase was mainly caused by the increase in oil and gas condensate prices in the three months period ended March 31, 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 three months period ended March 31, 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 RR 48,362 million and RR 38,503 million in the three months periods ended March 31, 2011 and 2010, respectively.

Gas transportation net sales (net of VAT) increased by RR 3,649 million, or 15%, to RR 28,796 million in the three months period ended March 31, 2011 from RR 25,147 million in the three months period ended March 31, 2010. The increase was mainly caused by the increase in gas transportation tariffs for independent gas suppliers in the three months period ended March 31, 2011 compared to the same period of the prior year.

Other revenues increased by RR 7,920 million, or 31%, to RR 33,214 million in the three months period ended March 31, 2011 compared to RR 25,294 million in the three months period ended March 31, 2010.

Net loss from trading activity increased by RR 134 million, or 68%, to RR 330 million in the three months period ended March 31, 2011 compared to RR 196 million in the three months period ended March 31, 2010.

Operating expenses

Operating expenses increased by 33% in the three months period ended March 31, 2011 to RR 817,909 million from RR 614,830 million in the three months period ended March 31, 2010. Operating expenses as a percentage of sales decreased from 64% in the three months period ended March 31, 2010 to 62% in the three months period ended March 31, 2011. The table below presents a breakdown of operating expenses in each period:

(RR million)	Three months periods ended 31 March,	
	2011	2010
Purchased gas and oil	263,513	130,891
Taxes other than on income	101,886	71,417
Staff costs	87,812	75,461
Depreciation	66,968	61,502
Transit of gas, oil and refined products	63,746	76,386
Repairs and maintenance	31,644	27,626
Materials	25,050	24,141
Cost of goods for resale, including refined products	24,092	6,216
Electricity and heating expenses	21,248	17,580
Exchange rate differences on operating items	20,434	20,513
Transportation services	9,046	4,431
Social expenses	7,242	5,303
Rental expenses	4,404	5,074
Insurance expenses	4,142	3,912
Research and development expenses	3,822	5,243
Processing services	2,105	1,842
Charge for impairment provisions	391	4,242
Other	<u>38,823</u>	<u>50,968</u>
	776,368	592,748
Changes in inventories of finished goods, work in progress and other effects	<u>41,541</u>	<u>22,082</u>
Total operating expenses	817,909	614,830

Purchased gas and oil

Cost of purchased gas and oil increased by 101% to RR 263,513 million in the three months period ended March 31, 2011 from RR 130,891 million in the three months period ended March 31, 2010. Cost of purchased gas increased by RR 120,803 million, or 139%. 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 RR 11,819 million, or 27%, and amounted to RR 56,045 million in the three months period ended March 31, 2011 in comparison with RR 44,226 million in the three months period ended March 31, 2010 due to the increase in oil prices as well as the increase in volumes of purchased oil.

Taxes other than on income

Taxes other than on income consist of:

(RR million)	Three months periods ended March 31,	
	2011	2010
Natural resources production tax	65,993	43,999
Excise tax	21,605	14,241
Property tax	11,506	10,718
Other taxes	<u>2,782</u>	<u>2,459</u>
Taxes other than on income	101,886	71,417

The natural resources production tax increased by 50% to RR 65,993 million in the three months period ended March 31, 2011 from RR 43,999 million in the three months period ended March 31, 2010. The increase mainly resulted from the general increase of natural resources production tax rate for gas from RR 147 to RR 237 per thousand cubic meters from 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 16% to RR 87,812 million in the three months period ended March 31, 2011 from RR 75,461 million in the three months period ended March 31, 2010. The increase mainly resulted from the salary indexation.

Depreciation

Depreciation increased by 9% or RR 5,466 million to RR 66,968 million in the three months period ended March 31, 2011 from RR 61,502 million in the three months period ended March 31, 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 17% to RR 63,746 million in the three months period ended March 31, 2011 from RR 76,386 million in the three months period ended March 31, 2010. This decrease mainly relates to the decrease in costs of transportation through Ukraine.

Repairs and maintenance

Cost of repairs and maintenance increased by 15% to RR 31,644 million in three months period ended March 31, 2011 from RR 27,626 million in the three months period ended March 31, 2010. This increase was caused by the increase of volume of repair services rendered by third parties to the Group in three months period ended March 31, 2011.

Materials

Cost of materials increased by 4% to RR 25,050 million in the three months period ended March 31, 2011 from RR 24,141 million in the three months period ended March 31, 2010. The increase mainly resulted from the increase in prices for purchased materials.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products increased by 288% to RR 24,092 million in the three months period ended March 31, 2011 from RR 6,216 million in the three months period ended March 31, 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.

Electricity and heating expenses

Electricity and heating expenses increased by 21% to RR 21,248 million in the three months period ended March 31, 2011 from RR 17,580 million in the three months period ended March 31, 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 three months periods ended March 31, 2011 and 2010 amounted to a net loss of RR 20,434 million and of RR 20,513 million, respectively. The change was primarily driven by appreciation of RUR against USD and EURO by 7% and 1%, respectively, in the three months ended March 31, 2011, compared to appreciation of RUR against USD and EUR by 3% and 8%, respectively, in the same period of the prior year.

Other operating expenses

Other operating expenses decreased by 24% to RR 38,823 million in the three months period ended March 31, 2011 from RR 50,968 million in the three months period ended March 31, 2010. Other expenses include heat energy transmission expenses, bank charges, security services, legal and consulting services, charity and finance aid and advertising.

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 88% to RR 41,541 million in the three months period ended March 31, 2011 from RR 22,082 million in the three months period ended March 31, 2010. Positive amount of changes in inventories of finished goods, work in progress and other effects in the

three months period ended March 31, 2011 relates mainly to the decrease in the balances of finished goods as of March 31, 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 RR 159,207 million, or 47%, to RR 498,508 million in the three months period ended March 31, 2011 from RR 339,301 million in the same period of the prior year. Our operating profit margin increased from 36% in the three months period ended March 31, 2010 to 38% in the three months period ended March 31, 2011.

Net finance income

(RR million)	Three months periods ended March 31,	
	2011	2010
Exchange gains	69,830	63,940
Exchange losses	(3,360)	(4,686)
Net exchange gain	66,470	59,254
Interest income	4,042	7,560
Interest expense	(16,918)	(14,279)
Gains on extinguishment of restructured liabilities	96	2
Net finance income	53,690	52,537

Exchange gains increased by RR 5,890 million to RR 69,830 million in the three months period ended March 31, 2011, compared to RR 63,940 million in the three months period ended March 31, 2010. Exchange losses decreased by RR 1,326 million to RR 3,360 million in the three months period ended March 31, 2011 from RR 4,686 million in the three months period ended March 31, 2010. The increase in net exchange gains resulted from higher fluctuation of USD exchange rate against RUR in the three months ended March 31, 2011 in comparison with the same period of the prior year.

Interest income decreased by 47% to RR 4,042 million in the three months period ended March 31, 2011 from RR 7,560 million in the three months period ended March 31, 2010, mainly due to deconsolidation of ZAO Gazenergoprombank in the second quarter 2010.

Interest expense increased by 18% to RR 16,918 million in the three months period ended March 31, 2011 from RR 14,279 million in the three months period ended March 31, 2010, mainly due to the increased share of borrowings, for which interest is expensed.

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 10,290 million, or 36%, to RR 38,519 million in the three months ended March 31, 2011 compared to RR 28,229 million in the same period of the prior year. The increase of the Group's share of net income of associated undertakings and jointly controlled entities in the three months period ended March 31, 2011 relates mainly to the increase in net income of Gazprombank Group and the increase in net income of Sakhalin Energy Investment Company Ltd. due to the increase of liquefied natural gas sales in the three months period ended March 31, 2011 compared to the same period of the prior year.

Profit tax

Total profit tax expense increased by RR 27,719 million, or 33%, to RR 112,566 million in the three months period ended March 31, 2011 compared to RR 84,847 million in the three months period ended March 31, 2010. The effective profit tax rate was 19.0% and 20.1% in the three months periods ended March 31, 2011 and 2010, respectively. Change of the effective profit tax rate mainly resulted from a relative decrease of non-deductible expenses and increase of non-taxable share of net income of associated undertakings and jointly controlled entities in the three months period ended March 31, 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 RR 143,016 million or 44%, from RR 324,953 million in the three months period ended March 31, 2010 to RR 467,969 million in the three months period ended March 31, 2011.

Profit for the period attributable to non-controlling interest

Profit for the period attributable to non-controlling interest decreased by RR 1,365 million or 11% to RR 10,531 million in the three months period ended March 31, 2011 compared to RR 11,896 million in the three months period ended March 31, 2010.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our statements of cash flows for the three months ended March 31, 2011 and 2010:

(RR million)	Three months periods ended March 31,	
	2011	2010
Net cash provided by operating activities	390,425	483,116
Net cash used for investing activities	(408,766)	(250,061)
Net cash provided by (used for) financing activities	25,671	(48,882)

Net cash provided by operating activities

Net cash provided by operating activities amounted to RR 390,425 million in the three months period ended March 31, 2011 compared to RR 483,116 million in the three months period ended March 31, 2010. The decrease was primarily due to the negative dynamics of changes in working capital. This effect was partly offset by the growth of our operating profit in the three months period ended March 31, 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 RR 158,705 million, or 63%, to RR 408,766 million in the three months period ended March 31, 2011 compared to RR 250,061 million in the three months period ended March 31, 2010. The increase was primarily due to the increase in total capital expenditures in the three months period ended March 31, 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 three months period ended March 31, 2011 in comparison with the same period of the prior year.

Net cash provided by (used for) financing activities

Net cash provided by financing activities amounted to RR 25,671 million in the three months period ended March 31, 2011 compared to net cash used for financing activities in amount RR 48,882 million in the three months period ended March 31, 2010. This change was mainly due to the increase in proceeds of long-term borrowings in the three months period ended March 31, 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 three months periods ended March 31, 2011 and 2010 in nominal RR terms, amounted to the following:

(RR million)	Three months periods ended March 31,	
	2011	2010
Transport	87,547	78,771
Production of gas	54,926	58,947
Production of crude oil and gas condensate	18,978	18,510
Refining	16,751	10,063
Distribution	11,287	7,737
Electric and heat energy generation and sales	9,668	7,229
Gas storage	1,408	1,409
All other segments	4,294	4,129
Total	204,859	186,795

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) increased by RR 18,064 million, or 10%, from RR 186,795 million in the three months period ended March 31, 2010 to RR 204,859 million in the three months period ended March 31, 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 and Pipeline Sakhalin-Khabarovsk-Vladivostok. The increase of our capital expenditures in the Refining segment was primarily due to increased capital expenditures Of Gazprom Neft Group and OOO Novourengovsky GCC. The decrease of our capital expenditures in the Production of gas segment was primarily due to decreased capital expenditures on the construction of Obskaya-Bovanenkovo railway, which was partly compensated by acquisition of property of OAO RUSIA Petroleum.

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 30,493 million, or 4%, from RR 870,993 million as of December 31, 2010 to RR 840,500 million as of March 31, 2011. This decrease resulted mainly from the decrease in short-term and long-term borrowings caused by appreciation of RUR against Euro and USD.