

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 30 September, 2009. The consolidated interim condensed financial information has been prepared in accordance with International Accounting Standard 34 "Interim financial reporting" ("IAS 34"). This unaudited consolidated interim condensed financial information should be read together with the consolidated financial statements for the year ended December 31, 2008, 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 principal businesses:

- Production of gas – exploration and production of gas;
- Transport – transportation of gas;
- Distribution – domestic and export sales of gas;
- Gas storage – storage of gas in underground gas storages;
- 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; and
- Electric and heat energy generation and sales.

Other businesses primarily comprise banking.

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.

RECENT VOLATILITY IN GLOBAL AND RUSSIAN FINANCIAL MARKETS

The change in market conditions caused by the global financial crisis have resulted in significant uncertainties in the banking sector and wider economy. The global financial crisis has led to bank failures and bank rescues in the United States of America, Western Europe and in Russia. Such circumstances could affect the terms of new borrowings and our ability to re-finance our existing borrowings at terms and conditions similar to those applied to earlier transactions. Our debtors and borrowers may also be affected by the recent market volatility which could in turn impact their ability to repay their outstanding debts to us.

These market conditions have an impact on medium term cash flow forecast and assessment of potential impairment of financial and non-financial assets.

We are unable to estimate reliably the effects on our financial position of any further volatility in financial markets. We believe we are taking all the necessary measures to support the sustainability and growth of our business in the current circumstances.

RESULTS OF OPERATIONS

(RR million)

	Nine months periods ended September 30,	
	2009	2008
Sales (net of excise tax, VAT and customs duties)	2,410,490	2,594,276
Operating expenses	<u>(1,821,656)</u>	<u>(1,571,577)</u>
Operating profit	588,834	1,022,699
Purchase of non-controlling interest in OAO Gazprom neft	13,865	-
Gain from change in fair value of call option	-	(41,973)
Finance income	339,679	114,692
Finance expenses	(383,245)	(141,236)
Share of net income of associated undertakings and jointly controlled entities	43,040	41,215
Gains on disposal of available-for-sale financial assets	<u>2,321</u>	<u>20,889</u>
Profit before profit tax	604,494	1,016,286
Current profit tax expense	(120,112)	(259,348)
Deferred profit tax	<u>(5,093)</u>	<u>(5,262)</u>
Profit tax expense	<u>(125,205)</u>	<u>(264,610)</u>
Profit for the period	479,289	751,676
Other comprehensive income		
Gains (losses) arising from change in fair value of available-for-sale financial assets, net of tax	22,831	(57,840)
Share of other comprehensive income of associated undertakings and jointly controlled entities	4,331	(1,593)
Translation differences	(3,337)	2,005
Revaluation of equity interest	<u>9,911</u>	<u>-</u>
Other comprehensive income (loss) for the period, net of tax	33,736	(57,428)
Total comprehensive income for the period	513,025	694,248
Profit attributable to:		
owners of OAO Gazprom	470,874	705,410
non-controlling interest	<u>8,415</u>	<u>46,266</u>
	479,289	751,676
Total comprehensive income attributable to:		
owners of OAO Gazprom	509,265	647,618
non-controlling interest	<u>3,760</u>	<u>46,630</u>
	513,025	694,248

Sales

The following table sets out our volumes and realized prices for the nine months periods ended September 30, 2009 and 2008.

(RR million unless indicated otherwise)	Nine months periods ended September 30,	
	2009	2008
Sales of gas		
<i>Europe and other countries</i>		
Gross sales ⁽¹⁾	1,202,564	1,294,769
Excise tax	(290)	(80)
Customs duties	(206,458)	(301,779)
Net sales	995,816	992,910
Volumes in billion cubic meters (bcm)	123.3	139.3
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	300.3	386.4
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties)	9,752.9	9,291.9
<i>FSU (Former Soviet Union)</i>		
Gross sales (net of value added tax (VAT))	253,389	267,677
Customs duties	(27,631)	(18,362)
Net sales	225,758	249,315
Volumes in bcm	36.3	71.9
Gross average price, U.S.\$ per mcm ⁽²⁾ (including excise tax and customs duties, net of VAT) ⁽³⁾	214.8	154.8
Gross average price, RR per mcm ⁽²⁾ (including excise tax and customs duties, net of VAT)	6,976.2	3,723.4
<i>Russia</i>		
Gross sales (net of VAT)	325,964	340,186
Net sales	325,964	340,186
Volumes in bcm	183.7	205.4
Gross average price, RR per mcm ⁽²⁾ (including excise tax, net of VAT)	1,774.7	1,655.8
<i>Total sales of gas</i>		
Gross sales (net of VAT)	1,781,917	1,902,632
Excise tax	(290)	(80)
Customs duties	(234,089)	(320,141)
Net sales	1,547,538	1,582,411
Volumes in bcm	343.3	416.6
Net sales of refined products (net of excise tax, VAT and customs duties)	402,361	552,859
Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties)	122,336	191,085
Net sales of electric and heat energy (net of VAT)	209,221	130,903
Gas transportation sales (net of VAT)	41,563	46,964
Other revenues (net of VAT)	87,471	90,054
Total sales (net of excise tax, VAT and customs duties)	2,410,490	2,594,276

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) decreased by RR 183,786 million, or 7%, to RR 2,410,490 million in the nine months period ended September 30, 2009 compared to the same period of the prior year.

Net sales of gas accounted for 64% and 61% of total net sales in the nine months period ended September 30, 2009 and 2008, respectively.

Net sales of gas decreased from RR 1,582,411 million in the nine months period ended September 30, 2008 to RR 1,547,538 million in the nine months period ended September 30, 2009 or by 2%.

Net sales of gas to Europe and other countries increased in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008, by RR 2,906 million, to RR 995,816 million. The overall increase in net sales of gas to Europe and other countries was primarily driven by price, denominated in Russian rubles. The gross average RR price (including excise and customs duties) increased by 5% for the nine months period ended September 30, 2009, compared to the nine months period ended September 30, 2008. At the same time volume of gas sold for the nine months period ended September 30, 2009 decreased by 11% compared to the nine months period ended September 30, 2008. In addition the increase in net sales of gas to this geographical segment is achieved mainly by the increase in prices during the first quarter of 2009.

Net sales of gas to FSU countries decreased in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008, by RR 23,557 million, or 9%, to RR 225,758 million. This decrease was mainly due to decrease in volumes of gas sold to FSU countries by 50% in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008. This decrease was partly offset by the price increase of 87% in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008.

Net sales of gas in the domestic market decreased in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008, by RR 14,222 million, or 4%, to RR 325,964 million. This decrease was mainly due to the decrease in the volume of gas sold by 11% in the nine months period ended September 30, 2009 compared to nine months period ended September 30, 2008. At the same time the gross average price for domestic gas sales increased by 7% in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008 due to 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) decreased by RR 150,498 million, or 27%, to RR 402,361 million in the nine months period ended September 30, 2009 compared to RR 552,859 million in the nine months period ended September 30, 2008. The decrease mainly resulted from the deconsolidation of Sibur Group as of September 30, 2008 and the decrease in world prices for refined products in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008. In the nine months period ended September 30, 2009 and 2008 Gazprom Neft Group's sales comprised 81% and 65% of the total amount of our net sales of refined products, respectively.

Net sales of crude oil and gas condensate (net of excise tax, VAT and customs duties) decreased by RR 68,749 million, or 36%, to RR 122,336 million in the nine months period ended September 30, 2009 compared to RR 191,085 million in the nine months period ended September 30, 2008. The decrease was mainly caused by the decrease of oil price in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008. Sales of crude oil included in net sales of crude oil and gas condensate (net of excise tax, customs duties and VAT), amounted to RR 113,506 million and RR 170,308 million in the nine months period ended September 30, 2009 and 2008, respectively.

Net sales of electric and heat energy (net of VAT) increased by RR 78,318 million, or 60% in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008. This increase was mainly due to sales by WGC-2 and WGC-6, which were consolidated in the second half of 2008, and also due to the sales of Mosenergo and Gazprom Germania Group.

Gas transportation sales decreased by RR 5,401 million, or 12%, to RR 41,563 million in the nine months period ended September 30, 2009 from RR 46,964 million in the nine months period ended September 30, 2008. The decrease was mainly due to the fact that transportation of Turkmen and Russian gas through RosUkrEnergO AG to the Ukraine was discontinued after 2008. During 2008 these services were rendered to RosUkrEnergO AG acting as the operator in supplies of central Asian and Russian gas to Ukraine.

Operating expenses

Operating expenses increased by 16% in the nine months period ended September 30, 2009 to RR 1,821,656 million from RR 1,571,577 million in the nine months period ended September 30, 2008. Operating expenses as a percentage of sales increased from 61% in the nine months period ended September 30, 2008 to 76% in the nine months period ended September 30, 2009. The table below presents a breakdown of operating expenses in each period:

(RR million)	Nine months ended 30 September	
	2009	2008
Purchased gas and oil	656,198	464,941
Staff costs	184,201	184,801
Taxes other than on income	171,881	207,072
Transit of gas, oil and refined products	167,617	138,185
Depreciation	155,749	145,538
Cost of goods for resale, including refined products	127,347	92,286
Repairs and maintenance	93,724	101,136
Materials	58,612	63,033
Electricity and heating expenses	31,182	39,127
Charge for impairment provisions	19,002	12,140
Social expenses	14,309	13,619
Rental expenses	12,969	9,017
Insurance expenses	11,243	11,182
Other	<u>117,622</u>	<u>89,500</u>
Total operating expenses	1,821,656	1,571,577

Purchased oil and gas

Cost of purchased oil and gas increased by 41% to RR 656,198 million in the nine months period ended September 30, 2009 from RR 464,941 million in the nine months period ended September 30, 2008. The increase primarily relates to the increase in the gas purchase price from Central Asian suppliers. During the first quarter of 2009 the cost of purchased gas amounted to RR 281,103 million, during the second quarter of 2009 the cost of purchased gas amounted to RR 135,287 million and during the third quarter of 2009 the cost of purchased gas amounted to RR 128,390 million. The cost of purchased oil included in the cost of purchased oil and gas decreased by RR 22,289 million, or 17%, and amounted to RR 111,418 million in the nine months period ended September 30, 2009 in comparison with RR 133,707 million in the nine months period ended September 30, 2008 due to decrease in oil price.

Staff costs

Staff costs decreased insignificantly to RR 184,201 million in the nine months period ended September 30, 2009 from RR 184,801 million in the nine months period ended September 30, 2008. The decrease resulted from the deconsolidation of the Gazprombank Group (including Sibur Group and Gazprom Media Group), which was offset by an increase mainly from the growth of average base salaries.

Taxes other than on income

Taxes other than on income consist of:

(RR million)	Nine months periods ended September 30,	
	2009	2008
Natural resources production tax	98,719	152,575
Property tax	26,215	20,695
Other taxes	<u>46,947</u>	<u>33,802</u>
Taxes other than on income	171,881	207,072

The natural resources production tax decreased by 35% to RR 98,719 million in the nine months period ended September 30, 2009 from RR 152,575 million in the nine months period ended September 30, 2008. The decrease mainly related to our crude oil production activity and was caused by a decrease in average world oil prices, which resulted in a lower effective production tax rate.

Transit of gas, oil and refined products

Transit of gas, oil and refined products increased by 21% to RR 167,617 million in the nine months period ended September 30, 2009 from RR 138,185 million in the nine months period ended September 30, 2008. This increase mainly relates to increased costs of transportation through Kazakhstan and Uzbekistan in the nine months period ended September 30, 2009 in comparison with the nine months period ended September 30, 2008.

Depreciation

Depreciation increased by 7% or RR 10,211 million to RR 155,749 million in the nine months period ended September 30, 2009 from RR 145,538 million in the nine months period ended September 30, 2008. The increase primarily relates to the growth in our fixed asset base.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products increased by 38% to RR 127,347 million in the nine months period ended September 30, 2009 from RR 92,286 million in the nine months period ended September 30, 2008. The increase in cost of goods for resale, including refined products, mainly results from operations of the Gazprom Germania Group (purchase and sale of electricity).

Repairs and maintenance

Cost of repairs and maintenance decreased by 7% to RR 93,724 million in nine months period ended September 30, 2009 from RR 101,136 million in the nine months period ended September 30, 2008.

Materials

Cost of materials decreased by 7% to RR 58,612 million in the nine months period ended September 30, 2009 from RR 63,033 million in the nine months period ended September 30, 2008. The decrease mainly resulted from the deconsolidation of the Sibur Group and was partly offset by increase mainly resulted from consolidation of WGC-2, WGC-6.

Electricity and heating expenses

Electricity and heating expenses decreased by 20% to RR 31,182 million in the nine months period ended September 30, 2009 from RR 39,127 million in the nine months period ended September 30, 2008. The decrease mainly resulted from the deconsolidation of the Sibur Group.

Other operating expenses

Other operating expenses increased by 31% to RR 117,622 million in the nine months period ended September 30, 2009 from RR 89,500 million in the nine months period ended September 30, 2008. The increase in other operating expenses mainly results from growth in other third party services and Gazprom Neft Group other operating expenses. This effect was partly offset by a gain from revaluation of assets and liabilities (excluding loans and borrowings) denominated in foreign currency in the amount of RR 31,076 million in nine months period ended September 30, 2009, compared to a gain in the amount of RR 2,684 million in nine months period ended September 30, 2008. Other operating expenses also include research and development expenses, refining services, transportation expenses, bank charges, security services, legal and consulting services, charity and financial aid, and advertising.

Operating profit

As a result of the factors discussed above, our operating profit decreased by RR 433,865 million, or 42%, to RR 588,834 million in the nine months period ended September 30, 2009 from RR 1,022,699 million in the nine months period ended September 30, 2008. Our operating profit margin decreased from 39% in the nine months period ended September 30, 2008 to 24% in the nine months period ended September 30, 2009.

Net finance expense

(RR million)	Nine months periods ended September 30,	
	2009	2008
Exchange gains	312,367	73,066
Exchange losses	<u>(326,258)</u>	<u>(92,633)</u>
Net exchange loss	(13,891)	(19,567)
Interest income	27,230	41,605
Interest expense	(56,987)	(48,603)
Gains on extinguishment of restructured liabilities	<u>82</u>	<u>21</u>
Net finance expense	(43,566)	(26,544)

Exchange gains increased by RR 239,301 million to RR 312,367 million in the nine months period ended September 30, 2009, compared to RR 73,066 million in the nine months period ended September 30, 2008. Exchange losses increased by RR 233,625 million to RR 326,258 million in the nine months period ended September 30, 2009 from RR 92,633 million in the nine months period ended September 30, 2008. The increase in exchange gains and exchange losses resulted from higher fluctuation of rate of USD and EURO against RR in the nine months ended September 30, 2009 in comparison with the same period of the prior year.

Interest income decreased by 35% to RR 27,230 million in the nine months period ended September 30, 2009 from RR 41,605 million in the nine months period ended September 30, 2008, mainly due to deconsolidation of Gazprombank Group.

Interest expense increased by 17% to RR 56,987 million in the nine months period ended September 30, 2009 from RR 48,603 million in the nine months period ended September 30, 2008, mainly due to attraction of new loans and credits. The decrease was partly offset by Gazprombank Group deconsolidation.

Gains on disposal of available-for-sale financial assets

Gains on disposal of available-for-sale financial assets decreased by 89%, or RR 18,568 million to RR 2,321 million in the nine months ended September 30, 2009 compared to RR 20,889 million in the same period of the prior year. The decrease is mainly affected by disposal of number of non-core entities by the Group in the nine months period ended September 30, 2008 and deconsolidation of Gazprombank Group.

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 1,825 million, or 4%, to RR 43,040 million in the nine months ended September 30, 2009 compared to RR 41,215 million in the same period of the prior year.

Profit tax

Total profit tax expense decreased by RR 139,405 million, or 53%, to RR 125,205 million in the nine months period ended September 30, 2009 compared to RR 264,610 million in the nine months period ended September 30, 2008. The effective income tax rate was 20.7% in the nine months period ended September 30, 2009, compared to 26.0% in the same period of the prior year. The decrease of effective tax rate is mainly affected by change of the tax rate from 24% to 20% starting from January 1, 2009, and one-time recognition of non-taxable income related to the purchase of an additional interest in OAO Gazprom neft in the nine months period ended September 30, 2009 and recognition of non-deductible loss from the change in the fair value of option with ENI S.p.A. in 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 decreased by RR 234,536 million or 33%, from RR 705,410 million in the nine months period ended September 30, 2008 to RR 470,874 million in the nine months period ended September 30, 2009.

Profit for the period attributable to non-controlling interest

Profit for the period attributable to non-controlling interest decreased by RR 37,851 million or 82% to RR 8,415 million in the nine months period ended September 30, 2009 compared to RR 46,266 million in the nine months period ended September 30, 2008 mainly due to the deconsolidation of Gazprombank Group and purchase of non-controlling interest in OAO Gazprom neft in April 2009.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our statements of cash flows for the nine months ended September 30, 2009 and 2008:

(RR million)	Nine months periods ended September 30,	
	2009	2008
Net cash provided by operating activities	587,048	710,687
Net cash used for investing activities	(808,400)	(667,295)
Net cash provided by (used for) financing activities	161,067	(28,277)

Net cash provided by operating activities

Net cash provided by operating activities amounted to RR 587,048 million in the nine months period ended September 30, 2009 compared to RR 710,687 million in the nine months period ended September 30, 2008. The decrease was primarily due to reduction of our operating profit in the nine months period ended September 30, 2009 in comparison with the nine months period ended September 30, 2008, which was offset by dynamics of changes of working capital.

Net cash used for investing activities

Net cash used for investing activities increased by RR 141,105 million or 21% to RR 808,400 million in the nine months period ended September 30, 2009 compared to RR 667,295 million in the nine months period ended September 30, 2008. The increase was primarily due to acquisition of non-controlling interest in OAO Gazprom neft in the amount of RR 138,527 million.

Net cash provided by (used for) financing activities

Net cash provided by financing activities amounted to RR 161,067 million in the nine months period ended September 30, 2009 compared to net cash used for financing activities in the amount of RR 28,277 million in the nine months period ended September 30, 2008. This change was primarily due to increase in proceeds from long-term borrowings in the nine months period ended September 30, 2009 compared to the nine months period ended September 30, 2008.

CAPITAL EXPENDITURES

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) by segment for the nine months periods ended September 30, 2009 and 2008 in nominal RR terms, amounted to the following:

(RR million)	Nine months periods ended September 30,	
	2009	2008
Transport	200,291	157,117
Production of gas	177,136	164,911
Production of crude oil and gas condensate	54,350	67,301
Refining	43,417	29,310
Distribution	17,113	16,010
Electric and heat energy generation and sales	17,183	23,923
Gas storage	7,616	6,673
All other segments	13,435	18,857
Total	530,541	484,102

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) increased by RR 46,439 million, or 10%, from RR 484,102 million in the nine months period ended September 30, 2008 to RR 530,541 million in the nine months period ended September 30, 2009. The increase of our capital expenditures in the Transportation segment was primarily due to increased capital expenditure on the construction of major transportation projects, including Bovanenkovo-Uhta, Pochinki-Gryazovets and Gryazovets-Vyborg. 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 and Kharasaveyskoye fields.

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 RR 450,745 million, or 44%, from RR 1,018,346 million as of December 31, 2008 to RR 1,469,091 million as of September 30, 2009. This growth resulted mainly from procurement of new long-term borrowings.