

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

The following discussion and analysis should be read in conjunction with our unaudited consolidated interim condensed financial information as of and for the nine months ended September 30, 2013. 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, 2012, 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 various goods, works, and 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 were a stand-alone business. For this reason, we do not analyze any of our main segments separately in the discussion that follows.

Changes in significant accounting policies

Starting from January 1, 2013 the Group adopted a set of new standards on consolidation: IFRS 10 "Consolidated Financial Statements" ("IFRS 10"), IFRS 11 "Joint Arrangements" ("IFRS 11"), IFRS 12 "Disclosure of Interests in Other Entities" ("IFRS 12"). As a result of the application of the set, IFRS 11 "Joint Arrangements" in particular, the Group has changed its method of accounting for OAO Tomskneft VNK, Salym Petroleum Development N.V. and Blue Stream Pipeline company B.V. from the equity method of accounting to accounting for the assets and liabilities relating to the Group's interest in the particular assets and liabilities of these companies.

IAS 19 "Employee Benefits" (IAS 19) (revised) makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits, and to the disclosures for all employee benefits for the year.

The operational information below is restated (including prior period) to offer a clear comparison with these new accounting methods.

For more information on adoption of new standards, refer to the Note 4 of the IFRS consolidated interim condensed financial information for the nine months ended September 30, 2013.

RESULTS OF OPERATIONS

(RUB million)

	Nine month period ended September 30,	
	2013	2012 (restated)
Sales	3,772,668	3,352,788
Net gain from trading activity	7,073	5,798
Operating expenses	<u>(2,596,841)</u>	<u>(2,464,208)</u>
Operating profit	1,182,900	894,378
Finance income	88,019	253,286
Finance expense	(209,834)	(204,567)
Share of net income of associated undertakings and joint ventures	35,799	113,522
Gains (losses) on disposal of available-for-sale financial assets	<u>92</u>	<u>(35)</u>
Profit before profit tax	1,096,976	1,056,584
Current profit tax expense	(112,669)	(211,997)
Deferred profit tax (expense) benefit	<u>(107,976)</u>	<u>2,005</u>
Profit tax expense	(220,645)	(209,992)
Profit for the period	876,331	846,592
Other comprehensive income (loss):		
Items that will not be reclassified to profit or loss:		
Remeasurements of post-employment benefit obligations	<u>61,490</u>	<u>(6,025)</u>
Total items that will not be reclassified to profit or loss	61,490	(6,025)
Items that will be reclassified to profit or loss:		
Gains (losses) arising from change in fair value of available-for-sale financial assets, net of tax	9,027	(13,424)
Share of other comprehensive income (loss) of associated undertakings and joint ventures	7,785	(8,919)
Translation differences	47,630	(22,330)
Losses from cash flow hedges, net of tax	<u>(3,059)</u>	<u>(2,518)</u>
Total items that will be reclassified to profit or loss	61,383	(47,191)
Other comprehensive income (loss) for the period, net of tax	122,873	(53,216)
Total comprehensive income for the period	999,204	793,376
Profit attributable to:		
Owners of OAO Gazprom	858,773	827,188
Non-controlling interest	<u>17,558</u>	<u>19,404</u>
	876,331	846,592
Total comprehensive income attributable to:		
Owners of OAO Gazprom	978,691	775,023
Non-controlling interest	<u>20,513</u>	<u>18,353</u>
	999,204	793,376

Sales

The following table summarises volumes and prices:

	Nine month period ended September 30,	
	2013	2012 (restated)
(RUB million unless indicated otherwise)		
Sales of gas		
<i>Europe and Other Countries</i>		
Gross sales ⁽¹⁾	1,535,996	1,312,759
Customs duties	(311,681)	(243,944)
Net sales	1,224,315	1,068,815
Volumes in billion cubic meters (bcm)	126.8	111.4
Gross average price, U.S.\$ per mcm ⁽²⁾ (including customs duties) ⁽³⁾	382.5	379.0
Gross average price, RUB per mcm ⁽²⁾ (including customs duties)	12,114.8	11,781.1
<i>FSU (Former Soviet Union)</i>		
Gross sales ⁽¹⁾	350,258	456,715
Customs duties	(60,543)	(71,071)
Net sales	289,715	385,644
Volumes in bcm	42.2	47.9
Gross average price, U.S.\$ per mcm ⁽²⁾ (including customs duties) ⁽³⁾	262.1	306.6
Gross average price, RUB per mcm ⁽²⁾ (including customs duties)	8,301.7	9,531.0
<i>Russian Federation</i>		
Gross sales (net of VAT)	536,925	508,260
Net sales	536,925	508,260
Volumes in bcm	170.8	183.3
Gross average price, RUB per mcm ⁽²⁾ (net of VAT)	3,143.0	2,772.8
<i>Total sales of gas</i>		
Gross sales (net of VAT)	2,423,179	2,277,734
Customs duties	(372,224)	(315,015)
Retroactive gas price adjustments	73,430	(133,186)
Net sales	2,124,385	1,829,533
Volumes in bcm	339.8	342.6
Net sales of refined products (net of excise tax, VAT and customs duties)	1,002,091	874,373
Net sales of electric and heat energy (net of VAT)	250,972	243,745
Net sales of crude oil and gas condensate (net of VAT and customs duties)	155,429	200,416
Gas transportation net sales (net of VAT)	120,727	90,314
Other revenues (net of VAT)	119,064	114,407
Total sales (net of excise tax, VAT and customs duties)	3,772,668	3,352,788

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 exchange rate between rouble and U.S. dollar.

Total sales (net of VAT, excise tax and customs duties) increased by RUB 419,880 million, or 13%, to RUB 3,772,668 million in the nine month period ended September 30, 2013 compared to the same period of the prior year.

Net sales of gas accounted for 56% and 55% of total net sales in the nine month period ended September 30, 2013 and 2012, respectively.

Net sales of gas increased by RUB 294,852 million, or 16%, from RUB 1,829,533 million in the nine month period ended September 30, 2012 to RUB 2,124,385 million in the nine month period ended September 30, 2013.

Net sales of gas to Europe and Other Countries increased by RUB 155,500 million, or 15%, to RUB 1,224,315 million in the nine month period ended September 30, 2013 as compared to the nine month period ended September 30, 2012. Overall increase in gas sales to Europe and Other countries was caused by an increase in volumes of gas sold by 14% as compared to the same period of the prior year. The gross average rouble price (including customs duties) increased by 3% in the nine month period ended September 30, 2013, compared to the same period of the prior year.

Retroactive gas price adjustments were recognized in the financial information for the nine month period ended September 30, 2013 as a RUB 73,430 million increase in sales reflecting a decrease in a previously recognized accrual.

Net sales of gas to FSU countries decreased by RUB 95,929 million, or 25% to RUB 289,715 million in the nine month period ended September 30, 2013 compared to the nine month period ended September 30, 2012. The change was due to a 13% decrease in gross average rouble price (including customs duties) and a 12% decrease in volumes of gas sold in the nine month period ended September 30, 2013, compared to the same period of the prior year.

Net sales of gas in the Russian Federation increased by RUB 28,665 million, or 6%, to RUB 536,925 million in nine month period ended September 30, 2013 compared to the same period of the prior year due to a 13% increase in the gross average domestic gas prices. Volume of gas sold decreased by 7% in the nine month period ended September 30, 2013 compared to the nine month period ended September 30, 2012.

Net sales of refined products (net of excise tax, VAT and customs duties) increased by RUB 127,718 million, or 15%, to RUB 1,002,091 million in the nine month period ended September 30, 2013 in comparison with the same period of the prior year primarily due to an increase in volumes sold by Gazprom Neft Group to customers in Europe and Other Countries as well as an increase in prices. In the nine month period ended September 30, 2013 and 2012 Gazprom Neft Group's sales comprised 77% and 80% of the total amount of net sales of refined products, respectively. Increase in net sales of refined products was also due to inclusion of OAO Gazprom Neftkhim Salavat in the consolidated financial statements from June 2012.

Net sales of electric and heat energy (net of VAT) increased by RUB 7,227 million, or 3%, to RUB 250,972 million in the nine month period ended September 30, 2013 compared to the same period of the prior year mainly due to an increase in sales of energy sector companies.

Net sales of crude oil and gas condensate (net of VAT and customs duties) decreased by RUB 44,987 million, or 22%, to RUB 155,429 million in the nine month period ended September 30, 2013 compared to RUB 200,416 million in the nine month period ended September 30, 2012. Sales of crude oil included in net sales of crude oil and gas condensate (net of VAT and customs duties), amounted to RUB 129,466 million and RUB 167,726 million in the nine month period ended September 30, 2013 and 2012, respectively. The change is mainly due to a decrease in crude oil volumes sold to customers in Europe and Other Countries. Sales of gas condensate decreased due to reallocation of revenue between operating segments related to inclusion of OAO Gazprom Neftkhim Salavat in the consolidated financial statements from June 2012.

Gas transportation net sales (net of VAT) increased by RUB 30,413 million, or 34%, to RUB 120,727 million in the nine month period ended September 30, 2013 from RUB 90,314 million in the nine month period ended September 30, 2012 primarily due to an increase in transportation volumes and gas transportation tariffs for independent suppliers.

Other revenues increased by RUB 4,657 million, or 4%, to RUB 119,064 million in the nine month period ended September 30, 2013 compared to RUB 114,407 million in the nine month period ended September 30, 2012.

Operating expenses

Operating expenses increased by 5% in the nine month period ended September 30, 2013 to RUB 2,596,841 million from RUB 2,464,208 million in the nine month period ended September 30, 2012. Operating expenses as a percentage of sales decreased from 73% in the nine month period ended September 30, 2012 to 69% in the nine month period ended September 30, 2013. The table below presents a breakdown of operating expenses in each period:

	Nine month period ended September 30,	
	2013	2012
Purchased gas and oil	558,311	598,950
Taxes other than on income	518,035	469,369
Staff costs	345,998	294,180
Depreciation	310,907	250,885
Transit of gas, oil and refined products	259,517	236,145
Materials	169,244	102,301
Repairs and maintenance	133,556	140,603
Cost of goods for resale, including refined products	102,408	87,009
Electricity and heating expenses	57,497	55,200
Charge for impairment provisions	33,947	32,147
Social expenses	30,790	15,400
Transportation services	22,239	26,186
Rental expenses	18,386	16,380
Insurance expenses	17,673	16,060
Processing services	11,734	10,650
Research and development expenses	10,516	17,234
Heat transmission	5,171	16,951
Derivatives (gains) losses	(5,481)	8,912
Exchange rate differences on operating items	(37,792)	4,577
Other	<u>151,560</u>	<u>155,158</u>
	<u>2,714,216</u>	<u>2,554,297</u>
Changes in inventories of finished goods, work in progress and other effects	<u>(117,375)</u>	<u>(90,089)</u>
Total operating expenses	<u>2,596,841</u>	<u>2,464,208</u>

Purchased gas and oil

Cost of purchased gas and oil decreased by RUB 40,639 million to RUB 558,311 million in the nine month period ended September 30, 2013 from RUB 598,950 million in the nine month period ended September 30, 2012. Cost of purchased gas decreased by RUB 4,684 million, or 1%. This decrease mainly relates to the decrease in volumes purchased from third parties in and outside of the Russian Federation. The cost of purchased oil included in the cost of purchased gas and oil decreased by RUB 35,955 million, or 19%, and amounted to RUB 156,083 million in the nine month period ended September 30, 2013 in comparison with RUB 192,038 million in the nine month period ended September 30, 2012 due to the decrease in volumes of purchased oil.

Taxes other than on income

Taxes other than on income consist of:

(RUB million)	Nine month period ended September 30,	
	2013	2012
Natural resources production tax	369,293	338,675
Property tax	57,876	42,457
Other taxes	<u>90,866</u>	<u>88,237</u>
Taxes other than on income	<u>518,035</u>	<u>469,369</u>

The natural resources production tax increased by 9% to RUB 369,293 million in the nine month period ended September 30, 2013 from RUB 338,675 million in the nine month period ended September 30, 2012. The increase is mainly due to an increase in the tax rate for gas from RUB 509 to RUB 582 per thousand cubic meters since January 1, 2013 and to RUB 622 per thousand cubic meters since July 1, 2013. The natural resources production tax

on oil extraction changed insignificantly. The increase in natural resources production tax on oil extraction results mainly from growth of base tax rate for oil from RUB 446 to RUB 470 per ton.

Staff costs

Staff costs increased by 18% to RUB 345,998 million in the nine month period ended September 30, 2013 from RUB 294,180 million in the nine month period ended September 30, 2012. The increase is mainly due to the average salary indexation and increase in average number of personnel.

Depreciation

Depreciation increased by 24%, or RUB 60,022 million, to RUB 310,907 million in the nine month period ended September 30, 2013 from RUB 250,885 million in the nine month period ended September 30, 2012. The increase is primarily due to the growth in the fixed asset base.

Transit of gas, oil and refined products

Transit of gas, oil and refined products increased by 10% to RUB 259,517 million in the nine month period ended September 30, 2013 from RUB 236,145 million in the nine month period ended September 30, 2012. This increase mainly relates to growth of oil and refined products transit due to inclusion of OAO Gazprom neftekhim Salavat in the consolidated financial statements from June 2012, as well as to increase in transportation volumes through the "Nord Stream" pipeline.

Materials

Cost of materials increased by 65% to RUB 169,244 million in the nine month period ended September 30, 2013 from RUB 102,301 million in the nine month period ended September 30, 2012. The increase mainly relates to inclusion of OAO Gazprom neftekhim Salavat in the consolidated financial statements from June 2012, as well as to an increase in purchases of materials from third parties.

Repairs and maintenance

Cost of repairs and maintenance decreased by 5% to RUB 133,556 million in nine month period ended September 30, 2013 from RUB 140,603 million in the nine month period ended September 30, 2012. The decrease was mainly caused by decline in volume of repair services rendered by third parties to the Group during the nine months ended September 30, 2013.

Cost of goods for resale, including refined products

Cost of goods for resale, including refined products increased by 18% to RUB 102,408 million in the nine month period ended September 30, 2013 from RUB 87,009 million in the nine month period ended September 30, 2012. The increase is mainly due to the growth in volumes of refined products purchased externally by the Gazprom neft Group.

Electricity and heating expenses

Electricity and heating expenses increased by 4% to RUB 57,497 million in the nine month period ended September 30, 2013 from RUB 55,200 million in the nine month period ended September 30, 2012. The increase mainly resulted from an increase in electricity consumption volumes and tariffs.

Exchange rate differences on operating items

Exchange rate differences on operating items amounted to a net gain of RUB 37,792 million for the nine months ended September 30, 2013 compared to a net loss of RUB 4,577 million for the nine months ended September 30, 2012. The change was primarily driven by appreciation of U.S. dollar against rouble by 6% and appreciation of euro against rouble by 9% in the nine month ended September 30, 2013, compared to depreciation of U.S. dollar against rouble by 4% and depreciation of euro against rouble by 4% in the same period of the prior year.

Other operating expenses

Other operating expenses decreased by 2% to RUB 151,560 million in the nine month period ended September 30, 2013 from RUB 155,158 million in the nine month period ended September 30, 2012. Other expenses include 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

Change in inventories of finished goods, work in progress and other effects increased by RUB 27,286 to RUB 117,375 million in the nine month period ended September 30, 2013 compared to RUB 90,089 million in the

nine month period ended September 30, 2012. The negative amount of the line item is mainly due to an increase in the balances of finished goods as of September 30, 2013 compared to the balances as of December 31, 2012.

Operating profit

As a result of the factors discussed above, our operating profit increased by RUB 288,522 million, or 32%, to RUB 1,182,900 million in the nine month period ended September 30, 2013 from RUB 894,378 million in the nine month period ended September 30, 2012. Operating profit margin increased from 27% in the nine month period ended September 30, 2012 to 31% in the nine month period ended September 30, 2013.

Net finance (expense) income

(RUB million)	Nine month period ended September 30,	
	2013	2012 (restated)
Exchange gains	62,252	233,037
Exchange losses	(177,652)	(178,464)
Net exchange (loss) gain	(115,400)	54,573
Interest income	25,767	20,249
Interest expense	(32,182)	(26,103)
Net finance (expense) income	(121,815)	48,719

The net exchange loss of RUB 115,400 million in the nine month period ended September 30, 2013 in comparison with net exchange gain of RUB 54,573 million in the same period of the prior year is mainly explained by appreciation of U.S. dollar against rouble by 6% and appreciation of euro against rouble by 9% in the nine month period ended September 30, 2013, compared to depreciation of U.S. dollar against rouble by 4% and depreciation of euro against rouble by 4% in the same period of the prior year.

Interest income increased by 27% to RUB 25,767 million in the nine month period ended September 30, 2013 from RUB 20,249 million in the same period of the prior year, mainly due to an increase of interest accrued on Group's cash held with banks.

Interest expense increased by 23% to RUB 32,182 million in the nine month period ended September 30, 2013 from RUB 26,103 million in the same period of the prior year, mainly due to an increase in average borrowings balance during the nine month period ended September 30, 2013 in comparison with the same period of the prior year.

Share of net income of associated undertakings and joint ventures

Share of net income of associated undertakings and joint ventures decreased by RUB 77,723 million, or 68%, to RUB 35,799 million in the nine month period ended September 30, 2013 compared to the share of net income in the same period of the prior year in the amount of RUB 113,522 million. The decrease in the Group's share of net income of associated undertakings and joint ventures in the nine month period ended September 30, 2013 relates mainly to the decline in net income of Sakhalin Energy Investment Company Ltd. by RUB 21,946 million due to a decrease of revenue from crude oil and liquefied natural gas sales as a result of production output decline and the initial recognition of variable obligation on irredeemable preferred share (class R) attributable to the Russian Federation. The Group's share of net income of associated undertakings and joint ventures for the nine month period ended September 30, 2013 includes additional expense of RUB 25,961 million recognized for OAO NGK Slavneft and its subsidiaries as a result of a one-time adjustment to correct the prior understatement of depreciation on the basis difference for property, plant and equipment since the Group's acquisition of interest in OAO NGK Slavneft.

Profit tax

Total profit tax expense increased by RUB 10,653 million, or 5%, to RUB 220,645 million in the nine month period ended September 30, 2013 compared to RUB 209,992 million in the nine month period ended September 30, 2012. The effective profit tax rate was 20.1% and 19.9% in the nine month period ended September 30, 2013 and 2012, respectively.

Profit for the period attributable to owners of OAO Gazprom

As a result of the factors discussed above, our profit for the period attributable to owners of OAO Gazprom increased by RUB 31,585 million, or 4%, from RUB 827,188 million in the nine month period ended September 30, 2012 to RUB 858,773 million in the nine month period ended September 30, 2013.

Profit for the period attributable to non-controlling interest

Profit for the period attributable to non-controlling interest decreased by RUB 1,846 million, or 10%, to RUB 17,558 million in the nine month period ended September 30, 2013 compared to RUB 19,404 million in the nine month period ended September 30, 2012.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our statements of cash flows for the nine month ended September 30, 2013 and 2012:

(RUB million)	Nine month period ended September 30,	
	2013	2012 (restated)
Net cash from operating activities	1,297,768	1,006,901
Net cash used in investing activities	(1,104,742)	(900,222)
Net cash used in financing activities	(69,686)	(125,283)

Net cash from operating activities

Net cash from operating activities amounted to RUB 1,297,768 million in the nine month period ended September 30, 2013 compared to RUB 1,006,901 million in the nine month period ended September 30, 2012. The increase was primarily due to an increase in operating profit in the nine month period ended September 30, 2013 in comparison with the same period of the prior year.

Net cash used in investing activities

Net cash used in investing activities increased by RUB 204,520 million, or 23%, to RUB 1,104,742 million in the nine month period ended September 30, 2013 compared to RUB 900,222 million in the nine month period ended September 30, 2012. The increase was primarily due to an increase in cash used for capital expenditure, acquisition of subsidiaries and a decrease in proceeds from associated undertakings and joint ventures in the nine month period ended September 30, 2013 in comparison with the same period of the prior year.

Net cash used in financing activities

Net cash used in financing activities amounted to RUB 69,686 million in the nine month period ended September 30, 2013 compared to net cash used in financing activities in the amount of RUB 125,283 million in the nine month period ended September 30, 2012. This change is mainly due to a decrease in dividends paid to owners of OAO Gazprom.

CAPITAL EXPENDITURES

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) by segment for the nine month period ended September 30, 2013 and 2012 in nominal rouble terms, amounted to the following:

(RR million)	Nine month period ended September 30,	
	2013 ⁽¹⁾	2012 ⁽¹⁾
Transport	253,454	462,711
Production of natural gas	209,370	193,442
Production of crude oil and gas condensate	192,702	97,400
Refining	90,470	97,536
Electric and heat energy generation and sales	58,998	36,225
Distribution	23,417	34,135
Gas storage	17,147	12,863
All other segments	<u>54,770</u>	<u>10,687</u>
Total	900,328	944,999

Note:

(1) The capital expenditures in the present analysis differ from the capital additions disclosed within the Group's business segments in IFRS consolidated interim condensed financial information of OAO Gazprom primarily due to VAT.

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) decreased by RR 44,671 million, or 5%, from RR 944,999 million in the nine month period ended September 30, 2012 to RR 900,328 million in the nine month period ended September 30, 2013.

The decrease in capital expenditures in the Transport segment was primarily due to putting into operation of Bovanenkovo-Ukhta and Ukhta-Torzhok pipelines following the launch of the Bovanenkovskoye field. The increase in capital expenditures in the segment of Production of crude oil and gas condensate is due to capital expenditures of Gazprom Neft Group. The increase in capital expenditures in the Electric and heat energy generation and sales segment was primarily due to increase in capital expenditures of OAO Mosenergo in construction of modern steamgas power-generating units at TPP-12, TPP-16 and TPP-20. The increase in capital investment in other segments is mainly due to construction of facilities provided by the Program of Construction of Olympic Venues and the Development of Sochi as a Mountain Climate Resort.

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, net of cash and cash equivalents and balances of cash and cash equivalents restricted as to withdrawal under the terms of certain borrowings and other contractual obligations) increased by RUB 86,528 million, or 8%, from RUB 1,071,214 million as of December 31, 2012 to RUB 1,157,742 million as of September 30, 2013. This increase resulted from obtaining new long-term and short-term borrowings, depreciation of rouble against U.S. dollar and euro that was partially offset by increase in cash and cash equivalents.