**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS
FOR THE THREE MONTHS ENDED 31 MARCH 2005**

*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 2005. The interim condensed financial information has been prepared in accordance with International Accounting Standard 34 "Interim financial reporting" ("IAS 34"). These financial statements should be read together with the consolidated financial statements for the year ended 31 December 2004 prepared in accordance with International Financial Reporting Standards ("IFRS").*

## OVERVIEW

We are the world's largest natural gas company, and the world's largest publicly-traded hydrocarbons company, in terms of reserves, transportation and production volumes. Our revenues are primarily derived from sales of natural gas to western and central Europe, Russia and other former Soviet Union countries.

We divide our operations into the following four main business segments:

- Production: exploration, development and production operations relating to natural gas and other hydrocarbons. These activities are primarily located within Russia.
- Refining: processing and refining of natural gas, gas condensate and other hydrocarbons (including crude oil), and sales of hydrocarbon products.
- Transportation: transportation of natural gas through the world's largest high-pressure trunk pipeline system (151,600 km). We own and operate a single centrally controlled system for natural gas production, processing, transportation, storage and deliveries. Beginning in the late 1990s, we began acquiring interests in regional gas distribution companies that own and operate medium-and low-pressure pipelines.
- Distribution: domestic and export sale of gas. We are the world's largest exporter of natural gas.

Other businesses primarily comprise banking, construction and media. These businesses are not separately reflected in our financial information because they do not represent individually material segments.

Our four main business segments are mutually dependent, with a significant portion of the revenues of one segment being a part of the costs of another segment. In particular, our Distribution and Refining segments purchase natural gas from our Production segment and transportation services from our Transportation segment. We establish internal transfer prices to provide funding requirements of the individual segments. Accordingly, the separate financial position and results of operations of these segments do not necessarily represent that 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' millions) | Three months ended 31 March 2005 | 2004 |
|---|---|---|
| Sales (net of excise tax, VAT and customs duties) | 339,181 | 255,845 |
| Operating expenses | (220,414) | (181,928) |
| **Operating profit** | **118,767** | **73,917** |
| Finance income | 14,969 | 24,174 |
| Finance expenses | (14,252) | (11,521) |
| Share of net income of associated undertakings | 4,214 | 2,847 |
| Gains on available-for-sale investments | 815 | 2,634 |
| **Profit before profit tax** | **124,513** | **92,051** |
| Current profit tax expense | (28,568) | (15,471) |
| Deferred profit tax expense | (3,548) | (7,645) |
| Profit tax expense | (32,116) | (23,116) |
| **Profit for the period** | **92,397** | **68,935** |

| (RR' millions) | Three months ended 31 March 2005 | 2004 |
|---|---|---|
| **Attributable to:** | | |
| Equity holders of OAO Gazprom | 91,628 | 68,353 |
| Minority interest | 769 | 582 |
| | **92,397** | **68,935** |

The following tables set out our volumes and realized prices for the three months ended 31 March 2005 and 2004.

| (RR' millions, unless indicated otherwise) | Three months ended 31 March 2004 | 2004 |
|---|---|---|
| *Europe* | | |
| Gross sales | 208,022 | 151,454 |
| Excise tax | - | (380) |
| Customs duties | (55,450) | (42,278) |
| Net sales | 152,572 | 108,796 |
| Volumes in billion cubic meters (bcm) | 43.9 | 41.8 |
| Gross average price, RR per mcm [(1)] (including excise tax and customs duties) | 4,739.6 | 3,627.6 |
| Net average price, RR per mcm [(1)] (net of excise tax and customs duties) | 3,473.0 | 2,604.6 |
| *FSU* | | |
| Gross sales (net of value added tax (VAT)) | 29,233 | 20,108 |
| Excise tax | (88) | (469) |
| Customs duties | (4,963) | (5,274) |
| Net sales | 24,182 | 14,365 |
| Volumes in bcm | 19.2 | 14.1 |
| Gross average price, RR per mcm [(1)] (including excise tax and customs duties, net of VAT) | 1,520.2 | 1,423.1 |
| Net average price, RR per mcm [(1)] (net of excise tax, VAT and customs duties) | 1,257.6 | 1,016.7 |
| *Russia* | | |
| Gross sales (net of VAT) | 106,520 | 86,872 |
| Excise tax | (1,124) | (1,367) |
| Net sales | 105,396 | 85,505 |
| Volumes in bcm | 106.2 | 105.3 |
| Gross average price, RR per mcm [(1)] (including excise tax, net of VAT) | 1,003.1 | 824.7 |
| Net average price, RR per mcm [(1)] (net of excise tax and VAT) | 992.6 | 811.2 |
| *Total sales of gas* | | |
| Gross sales (net of VAT) | 343,775 | 258,434 |
| Excise tax | (1,212) | (2,216) |
| Customs duties | (60,413) | (47,552) |
| Net sales | 282,150 | 208,666 |
| Volumes in bcm | 169.3 | 161.2 |
| Sales of gas condensate and oil and gas products (net of excise tax, VAT and customs duties) | 36,032 | 27,323 |
| Gas transportation sales (net of VAT) | 6,601 | 9,528 |
| Other sales (net of VAT) | 14,398 | 10,328 |
| **Total sales (net of excise tax, VAT and customs duties)** | 339,181 | 255,845 |

[(1)] Mcm is the equivalent of thousand cubic meters.

Net sales revenues increased by RR83,336 million, or 33%, to RR339,181 million in the three months ended 31 March 2005 compared to the three months ended 31 March 2004. Net sales of gas accounted for 83% of total sales in the three months ended 31 March 2005 (82% in the three months ended 31 March 2004) and were RR73,484 million, or 35%, higher than in the same period of 2004.

Net sales of natural gas to Europe increased by RR43,776 million, or 40% to RR152,572 million in the three months ended 31 March 2005 compared to the three months ended 31 March 2004. This was primarily due to a 33% increase in net prices in RR terms, and a 5%, or 2.1 bcm, increase in sales volumes. Average net prices in RR terms for export gas to Europe increased by 33% to RR3,473.0 per mcm primarily as a result of a 35% increase of average realized U.S. dollar export gas prices (including excise and customs duties) which more than offset the 3% appreciation of the RR against the U.S. dollar (based on the three months average exchange rates) in the three months ended 31 March 2005 compared to the three months ended 31 March 2004. The increase in sales volumes was primarily due to increased volumes sold to Italy and Turkey under existing long-term contracts and commencement of gas sales to Croatia in May 2004.

Net sales of natural gas to FSU countries increased by RR9,817 million, or 68%, to RR24,182 million in the three months ended 31 March 2005 compared to the three months ended 31 March 2004. This was due to a 24% increase in net prices in RR terms and a 36%, or 5.1 bcm increase in volumes. The 24% increase in the net average RR price of gas to RR1,257.6 per mcm was primarily due to changes in VAT rate to zero on sales to certain FSU countries as average realized U.S. dollar price (including excise tax and customs duties) remained almost flat. Zero VAT rate on sales to Ukraine and Belarus became effective in January 2005, and on sales to Kazakhstan became effective in February 2005. The effect of VAT elimination on sales to certain FSU countries more than offset the 3% appreciation of the RR against the U.S. dollar for the three months ended 31 March 2005 compared to the three months ended 31 March 2004. The increase in volumes of gas sold to FSU countries was primarily due to a 5.3 bcm increase in volumes of gas sales to Belarus due to contract disputes in the three months ended 31 March 2004, and a 1.5 bcm increase in shipments of gas to Armenia, Georgia and Azerbaijan in the three months ended 31 March 2005 compared to the three months ended 31 March 2004, which together more than offset a decrease in volumes of gas sales to Ukraine, Kazakhstan and other FSU countries. In 2005 we continued to restrict our shipments to Ukraine to those required to cover transportation services, so called "transit-gas", which mitigates our collection risk. Shipments to Ukraine in the three months ended 31 March 2005 were 7.7 bcm compared to 8.2 bcm in the three months ended 31 March 2004.

Net sales of natural gas in the domestic market increased by RR19,891 million, or 23%, to RR105,396 million in the three months ended 31 March 2005 compared to the three months ended 31 March 2004. This was primarily due to the increase in domestic gas tariffs set by the Federal Tariffs Service, and a 1%, or 0.9 bcm, increase in sales volumes. Average domestic prices, including excise tax, increased by 22%.

Sales of gas condensate and oil and gas products increased by RR8,709 million, or 32%, to RR36,032 million in the three months ended 31 March 2005 compared to RR27,323 million in the three months ended 31 March 2004. The increase was primarily due to the increase in domestic and export prices of oil and gas products sales. Sibur and its affiliated petrochemical companies accounted for 59% and 62% of the total sales of gas condensate and oil and gas products in the three months ended 31 March 2005 and 2004, respectively.

Gas transportation sales decreased by RR2,927 million, or 31%, to RR6,601 million in the three months ended 31 March 2005 from RR9,528 million in the three months ended 31 March 2004. This was primarily due to the fact that effective January 2005 we no longer provide transportation services to Eural Trans Gas, and due to a RR1,600 million decrease in transportation sales to Trans Nafta, which supplied gas to Belarus during our contract disputes in the first six months of 2004. In the three months ended 31 March 2004 gas transportation sales to Eural Trans Gas amounted to RR3,706 million. These two factors more than offset the commencement of transportation services to RosUkrEnergo, an associated undertaking, from January 2005, which amounted to RR1,632 million in the three months ended 31 March 2005.

Other sales increased by RR4,070 million, or 39%, to RR14,398 million in the three months ended 31 March 2005 compared to RR10,328 million in the three months ended 31 March 2004. Other sales represent activities such as media, construction works, refinery services and sales of other services and goods.

**Operating expenses**

Operating expenses increased by 21% in the three months ended 31 March 2005 to RR220,414 million from RR181,928 million in the three months ended 31 March 2004. Operating expenses decreased as a percentage of sales from 71% in the three months ended 31 March 2004 to 65% in the three months ended 31 March 2005. The table below presents a breakdown of operating expenses in each period:

| (RR' millions) | **Three months ended 31 March** **2005** | **2004** |
|---|---|---|
| Staff costs | 36,480 | 32,790 |
| Depreciation | 35,188 | 31,825 |
| Transit costs | 28,117 | 26,301 |
| Taxes other than on income | 27,697 | 20,819 |
| Purchased gas | 19,791 | 13,897 |
| Materials | 14,657 | 12,712 |
| Repairs and maintenance | 12,065 | 6,789 |
| Electricity | 8,905 | 6,949 |
| Cost of goods for resale, including refined products | 3,367 | 3,700 |
| Social expenses | 3,292 | 2,241 |
| Provisions for liabilities and charges | 2,098 | 1,283 |
| Provisions for impairment of assets | 1,537 | (737) |
| Other | 27,220 | 23,359 |
| **Total operating expenses** | **220,414** | **181,928** |

*Staff costs*

Staff costs increased by 11% to RR36,480 million in the three months ended 31 March 2005 from RR32,790 million in the three months ended 31 March 2004. The increase primarily resulted from a decrease in the amount of staff costs being capitalized in the cost of gas in storage and increase in average base salaries in April 2004, which was partially offset by the reduction of social contributions. The decrease in the amount of staff costs included in the cost of gas in storage was due to the increase in the volume of gas pumped out from storage in the three months ended 31 March 2005 compared to the three months ended 31 March 2004. Social contributions decreased primarily as a result of new scale of unified social tax rates in the Russian Federation effective 1 January 2005.

*Depreciation*

Depreciation increased by 11% to RR35,188 million in the three months ended 31 March 2005 from RR31,825 million in the three months ended 31 March 2004. The increase primarily resulted from our growing fixed assets base and from a decrease in the amount of depreciation being capitalized in the cost of gas in storage. The decrease in the amount of depreciation included in the cost of gas in storage was due to the increase in the volume of gas pumped out from storage in the three months ended 31 March 2005 compared to the three months ended 31 March 2004.

*Transit costs*

Transit costs increased by 7% to RR28,117 million in the three months ended 31 March 2005 from RR26,301 million in the three months ended 31 March 2004. Transit costs relate principally to fees charged by Ukraine, Poland and other Eastern Europe and Central Asian countries for the transit of gas to markets in Europe. The increase primarily resulted from an increase in transit costs for transportation of gas across Poland primarily due to an increase of a U.S. dollar denominated effective average gas transportation tariff from January 2005, partially offset by the 3% appreciation of the RR against the U.S. dollar.

*Taxes other than on income*

Taxes other than on income consist of:

| (RR' millions) | **Three months ended 31 March** **2004** | **2004** |
|---|---|---|
| Natural resources production tax | 22,731 | 16,383 |
| Property tax | 3,730 | 3,013 |
| Other taxes | 1,236 | 1,423 |
| **Taxes other than on income** | 27,697 | 20,819 |

Taxes other than on income increased by 33% to RR27,697 million in the three months ended 31 March 2005 from RR20,819 million in the three months ended 31 March 2004. The increase was primarily attributable to the change in tax legislation. From 1 January 2005, the fixed natural resources production tax rate for natural gas increased from

RR107 per mcm to RR135 per mcm. Natural resources production tax rate for gas condensate was 17.5% of the value of gas condensate produced for the three months ended 31 March 2005 and 2004.

*Purchased gas*

Cost of purchased gas increased by 42% or RR5,894 million to RR19,791 million in the three months ended 31 March 2005 from RR13,897 million in the three months ended 31 March 2004. The increase was primarily related to increased volumes of purchases of gas, both in Central Asia and in Europe, for resale to customers in western Europe and the FSU. Purchases of gas from RosUkrEnergo accounted for RR4,800 million of the RR5,894 million total increase in the cost of purchased gas.

*Materials*

Cost of materials increased by 15% to RR14,657 million in the three months ended 31 March 2005 from RR12,712 million in the three months ended 31 March 2004. The increase was primarily related to higher purchase prices.

*Repairs and maintenance*

Cost of repairs and maintenance increased by 78% to RR12,065 million in the three months ended 31 March 2005 from RR6,789 million in the three months ended 31 March 2004. The increase was primarily due to an increase in the volume of repairs and maintenance services rendered by external providers primarily in the transportation segment due to the ageing of pipeline assets.

*Electricity*

Electricity expense increased by 28%, or RR1,956 million, to RR8,905 million in the three months ended 31 March 2005 from RR6,949 million in the three months ended 31 March 2004, primarily due to higher electricity tariffs, set by the Federal Tariffs Service.

*Provisions for impairment of assets*

We recognized a net charge of provisions for impairment of assets of RR1,537 million in the three months ended 31 March 2005 compared to a net release of RR737 million in the three months ended 31 March 2004. This was primarily due to a net charge of impairment provision for accounts receivable and prepayments of RR2,238 million partially offset by a release of impairment provision for investments and other long-term assets and of provision for impairment of assets under construction in the three months ended 31 March 2005. Net charge of impairment provision for accounts receivable and prepayments in the three months ended 31 March 2005 was primarily due to the increase in provision against older domestic gas receivables.

*Other expenses*

Other expenses increased by 17% to RR27,220 million in the three months ended 31 March 2005 from RR23,359 million in the three months ended 31 March 2004. Other expenses include rental expenses, auto transportation services, exploration expenses, processing expenses, storage and oil products transportation expenses and other services.

**Finance income and expenses**

| | **Three months ended 31 March** | |
|---|---|---|
| (RR' millions) | **2005** | **2004** |
| Exchange gains | 9,778 | 21,520 |
| Interest income | 4,383 | 2,361 |
| Gains on and extinguishment of restructured liabilities | 808 | 293 |
| **Finance income** | 14,969 | 24,174 |

| | **Three months ended 31 March** | |
|---|---|---|
| (RR' millions) | **2005** | **2004** |
| Exchange losses | 7,680 | 5,998 |
| Interest expense | 6,572 | 5,523 |
| **Finance expenses** | 14,252 | 11,521 |

We incurred an exchange gain of RR9,778 million in the three months ended 31 March 2005 compared to RR21,520 million in the three months ended 31 March 2004. The change reflects primarily the impact on foreign currency denominated borrowings of a 0.3% depreciation of the RR against the U.S. dollar and a 5% appreciation of the RR against the Euro in the three months ended 31 March 2005 compared to a 3% appreciation of the RR against the U.S. dollar and a 5% appreciation of the RR against the Euro in the three months ended 31 March 2004.

Interest expense increased by RR1,049 million to RR6,572 million in the three months ended 31 March 2005 compared to RR5,523 the three months ended 31 March 2004 primarily due to the increase in the average total debt in the three months ended 31 March 2005 compared to the three months ended 31 March 2004 and the increase in the average variable interest rates, which was partially offset by the reduction of average fixed interest rates and the increase in the capitalized interest in the three months ended 31 March 2005 compared to 31 March 2004 resulting from the increase in construction in progress.

**Share of net income of associated undertakings**

Share in net income of associates increased by RR1,367 million to RR4,214 million in the three months ended 31 March 2005 compared to RR2,847 million in the three months ended 31 March 2004. The increase was primarily due to higher net profits recorded by OAO Mosenergo and commencement of operations of RosUkrEnergo from January 2005 which we accounted for as an associate for the first time in the three months ended 31 March 2005, which together more than offset a decrease in profits recorded by certain other associated undertakings in the three months ended 31 March 2005 compared to the three months ended 31 March 2004.

**Gains on available-for-sale investments**

Gain on available-for-sale investments decreased by RR1,819 million to RR815 million in the three months ended 31 March 2005 compared to RR2,634 million in the three months ended 31 March 2004. The change was primarily due to the decrease in realized gains on available-for-sale investments recorded by AB Gazprombank (ZAO) and the impairment provision charge related to third party promissory notes primarily held by the affiliated companies of OAO AK Sibur.

**Profit tax expense**

Profit tax expense increased by RR9,000 million, or 39%, to RR32,116 million in the three months ended 31 March 2005 compared to RR23,116 million in the three months ended 31 March 2004.

Our current profit tax expense increased by RR13,097 million, or 85%, to RR28,568 million in the three months ended 31 March 2005 from RR15,471 million in the three months ended 31 March 2004. Our effective current profit tax rate increased to 23% in the three months ended 31 March 2005 compared to 17% for the three months ended 31 March 2004 primarily as a result of our ability to benefit in the three months ended 31 March 2004 from a tax loss carry forward of OAO Gazprom, and due to a decrease in taxable temporary difference in respect of property, plant and equipment which resulted in higher current profit tax expense in the three months ended 31 March 2005 compared to 31 March 2004.

Our overall effective profit tax rate was 26% in the three months ended 31 March 2005 compared to 25% in the three months ended 31 March 2004.

**Profit for the period**

As a result of the factors discussed above, our profit for the period increased by RR23,462 million, or 34%, from RR68,935 million in the three months ended 31 March 2004 to RR92,397 million in the three months ended 31 March 2005.

## LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes the statements of cash flows for the three months ended 31 March 2005 and 2004.

| | **Three months ended 31 March** | |
|---|---|---|
| (RR' millions) | **2005** | **2004** |
| Net cash provided by operating activities | 129,075 | 76,368 |
| Net cash used for investing activities | (53,681) | (69,089) |
| Net cash (used for) provided by financing activities | (16,443) | 4,085 |

*Net cash provided from operating activities*

Net cash provided by operating activities amounted to RR129,075 million in the three months ended 31 March 2005 compared to RR76,368 million in the three months ended 31 March 2004. This was primarily due to higher operating income generated by our gas sales during the three months ended 31 March 2005, lower net unrealized foreign exchange gains, net decrease in long-term accounts receivable and lower negative changes in our net working capital position, which together were partially offset by higher profit tax paid in the three months ended 31 March 2005 compared to the three months ended 31 March 2004.

*Net cash flow used for investing activities*

Net cash used for investing activities amounted to RR 53,681 million in the three months ended 31 March 2005 compared to RR69,089 million in the three months ended 31 March 2004. Although our cash capital expenditures increased reflecting our ability to utilize higher cash flows generated by our operating activity during the three months ended 31 March 2005 for a number of major construction projects, the increase was more than offset by the increase in the interest received and the fact that in the three months ended 31 March 2004 high investing activity cash outflow was primarily due to the acquisition of a 5.2% interest in RAO UES in January 2004.

*Net cash (used for) provided by financing activities*

Net cash used for financing activities amounted to RR16,443 million in the three months ended 31 March 2005 compared to RR4,085 million of net cash provided by financing activity in the three months ended 31 March 2004. This was primarily due to the increase in cash and cash equivalents restricted on borrowings, net cash outflow from treasury shares transactions in the three months ended 31 March 2005 compared to the net cash inflow for the three months ended 31 March 2004, increase in the net repayment of the long-term borrowings and increase in the interest paid, which together were partially offset by higher net proceeds from short-term borrowings and lower net redemption of promissory notes in the three months ended 31 March 2005 compared to the three months ended 31 March 2004.

**Capital expenditures**

Total capital expenditures (excluding the effect of acquisitions of subsidiaries and reclassifications) decreased from RR48,685 million in the three months ended 31 March 2004 to RR38,953 million in the three months ended 31 March 2005. Our cash capital expenditures increased by RR10,819 million, or 22%, from RR49,814 million in the three months ended 31 March 2004 to RR60,633 million in the three months ended 31 March 2005 primarily due to the increase in cash settlements for capital expenditures of prior periods.

Most of our capital expenditures during these periods were for production assets and transportation infrastructure. In the three months ended 31 March 2005 capital expenditures on production assets were RR15,454 million, or 40% of total capital expenditure in the three months ended 31 March 2005, decreasing from RR20,861 million, or 43% in the three months ended 31 March 2004. Capital expenditures in the production segment in the three months ended 31 March 2005 primarily include capital expenditures for the development of Pestsovoye and Yen-Yakhinskoe fields and Aneryakhinskoe and Kharvutinskaya areas of Yamburgskoye field. Capital expenditures on the transportation infrastructure comprised RR17,775 million, or 46% of total capital expenditure in the three months ended 31 March 2005, decreasing from RR22,981 million, or 47% of total capital expenditure in the three months ended 31 March 2004. The major portion of these expenditures were for the construction of a pipeline from the northern region of the Tyumen Oblast to Torzhok, extension of the Urengoy gas transportation block and construction of Pochinki-Izobilnoe pipeline.

Total capital expenditures by segment for the three months ended 31 March 2005 and 2004 and budgeted total capital expenditure by segment for the year ending 31 December 2005 (excluding expenditures for Sibur, Vostokgazprom and Purgaz) are as follows:

| (RR' millions) | Three months ended 31 March 2005 | Three months ended 31 March 2004 | Budget for the year ending 31 December 2005[(1)(3)] |
|---|---|---|---|
| Production | 15,454 | 20,861 | 63,468 |
| Transportation | 17,775 | 22,981 | 145,623 |
| Refining | 2,277 | 1,093 | 10,900 |
| Distribution | 783 | 1,037 | 8,397 |
| Other [(2)] | 2,664 | 2,713 | 8,515 |
| Total | 38,953 | 48,685 | 236,903 |

[(1)] The Board of Directors approved a capital expenditure budget for 2005 of RR236,903 million, including RR57,574 million for construction of a pipeline from the northern region of the Tyumen Oblast to Torzhok, RR16,305 million for construction of a pipeline from Torzhok to Belostok, RR6,312 million for the extension of the Urengoy gas transportation block, RR17,496 million for the construction of Pochinki-Izobilnoe pipeline, RR7,961 million for the development of the Pestsovoye field, RR13,092 million for the development of the Aneryakhenskaya and Kharvutinskaya areas of the Yamburgskoe field, RR8,808 million for restoration of helium plant in Orenburg.

(2) Primarily includes expenditures for service activities such as drilling and automobile transport and repair.

(3) Includes VAT

The actual amount and timing of capital expenditures made are subject to change depending on economic and political conditions. Management cannot rule out strategic acquisitions if opportunities arise.

**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 RR 68,340 million, or 14%, from RR 499,855 million as of 31 December 2004 to RR 431,515 million as of 31 March 2005. This was primarily due to increased balance of cash and cash equivalents, resulting primarily from an increase in cash inflows from operating activities.