

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with the unaudited consolidated interim condensed financial information for the three months ended March 31, 2019. This consolidated interim condensed financial information is prepared in accordance with International Accounting Standard 34 Interim Financial Reporting. The consolidated interim condensed financial information for the three months ended March 31, 2019 should be read in conjunction with the consolidated financial statements for the year ended December 31, 2018 prepared in accordance with International Financial Reporting Standards.

OVERVIEW

We are one of the world's largest gas and oil companies in terms of volume of reserves, production of gas and market capitalisation. Our sales are primarily derived from sales of natural gas, crude oil and other hydrocarbon products to countries of Western and Central Europe, the Russian Federation and other Former Soviet Union countries.

We are involved in the following activities:

- exploration and production of gas;
- transportation of gas;
- sales of gas within the Russian Federation and abroad;
- gas storage;
- production of crude oil and gas condensate;
- processing of oil, gas condensate and other hydrocarbons and sales of refined products;
- electric and heat energy generation and sales.

Other activities include production of other goods, other works and rendering of other services.

The official Russian Ruble ("RUB") to US Dollar foreign exchange rate as determined by the Central Bank of the Russian Federation was as follows:

- as of March 31, 2019 – 64.7347 (as of March 31, 2018 – 57.2649);
- as of December 31, 2018 – 69.4706 (as of December 31, 2017 – 57.6002).

The official RUB to Euro foreign exchange rate as determined by the Central Bank of the Russian Federation was as follows:

- as of March 31, 2019 – 72.7230 (as of March 31, 2018 – 70.5618);
- as of December 31, 2018 – 79.4605 (as of December 31, 2017 – 68.8668).

The average exchange rates of RUB for the three months ended March 31, 2019 and for the three months ended March 31, 2018 were:

- to US Dollar – 66.1271 and 56.8803, respectively;
- to Euro – 75.1715 and 69.8727, respectively.

RESULTS OF OPERATION

(in RUB million)	Three months ended March 31,	
	2019	2018
Sales	2,291,821	2,138,331
Net (loss) gain from trading activity	(6,595)	7,001
Operating expenses	(1,782,216)	(1,651,346)
Impairment loss on financial assets	<u>(44,248)</u>	<u>(26,405)</u>
Operating profit	458,762	467,581
Finance income	258,223	91,380
Finance expense	(68,991)	(107,423)
Share of profit of associates and joint ventures	<u>63,932</u>	<u>43,680</u>
Profit before profit tax	711,926	495,218
Current profit tax expense	(120,264)	(46,842)
Deferred profit tax expense	<u>(32,149)</u>	<u>(56,207)</u>
Profit tax	(152,413)	(103,049)
Profit for the period	559,513	392,169
Other comprehensive income (loss):		
Items that will not be reclassified to profit or loss:		
(Loss) gain arising from changes in fair value of financial assets measured at fair value through other comprehensive income, net of tax	(23,167)	28,077
Remeasurement of provision for post-employment benefits	<u>(24,113)</u>	<u>(11,363)</u>
Total other comprehensive (loss) income that will not be reclassified to profit or loss	(47,280)	16,714
Items that may be reclassified subsequently to profit or loss:		
Share of other comprehensive (loss) income of associates and joint ventures	(1,896)	1,488
Translation differences	(115,965)	12,463
Gain from hedging operations, net of tax	<u>5,356</u>	<u>7,084</u>
Total other comprehensive (loss) income that may be reclassified subsequently to profit or loss	(112,505)	21,035
Total other comprehensive (loss) income for the period, net of tax	(159,785)	37,749
Comprehensive income for the period	399,728	429,918
Profit for the period attributable to:		
Owners of PJSC Gazprom	535,908	371,623
Non-controlling interest	<u>23,605</u>	<u>20,546</u>
	559,513	392,169
Comprehensive income for the period attributable to:		
Owners of PJSC Gazprom	383,210	406,874
Non-controlling interest	<u>16,518</u>	<u>23,044</u>
	399,728	429,918

Sales

The following table sets out volumes and sales prices:

(in RUB million unless indicated otherwise)	Three months ended March 31,	
	2019	2018
Sales of gas		
<i>Europe and other countries</i>		
Gross sales ⁽¹⁾	1,064,207	940,098
Customs duties	(207,796)	(167,388)
Excise tax	(19,015)	(14,403)
Net sales	837,396	758,307
Volumes in bcm	62.4	71.5
Average price, US Dollar per mcm ⁽²⁾ (including excise tax and customs duties) ⁽³⁾	259.1	231.5
Average price, RUB per mcm ⁽²⁾ (including excise tax and customs duties)	17,053.8	13,155.2
<i>Former Soviet Union countries</i>		
Gross sales ⁽¹⁾	133,950	123,813
Customs duties	(16,453)	(12,334)
Net sales	117,497	111,479
Volumes in bcm	12.2	14.1
Average price, US Dollar per mcm ⁽²⁾ (including customs duties) ⁽³⁾	167.4	155.0
Average price, RUB per mcm ⁽²⁾ (including customs duties)	11,015.7	8,809.8
<i>Russian Federation</i>		
Gross sales (net of VAT)	348,930	350,547
Net sales	348,930	350,547
Volumes in bcm	84.3	88.2
Average price, RUB per mcm ⁽²⁾ (net of VAT)	4,141.0	3,974.2
<i>Total gas sales</i>		
Gross sales (net of VAT)	1,547,087	1,414,458
Customs duties	(224,249)	(179,722)
Excise tax	(19,015)	(14,403)
Retroactive gas price adjustments	-	192
Net sales	1,303,823	1,220,525
Volumes in bcm	158.9	173.8
Net sales of refined products (net of excise tax, VAT and customs duties)	506,909	469,544
Net sales of crude oil and gas condensate (net of VAT and customs duties)	190,389	150,472
Electric and heat energy net sales (net of VAT)	173,413	175,486
Gas transportation net sales (net of VAT)	55,501	58,653
Other sales (net of VAT)	<u>61,786</u>	<u>63,651</u>
Total sales (net of excise tax, VAT and customs duties)	<u>2,291,821</u>	<u>2,138,331</u>

Notes:

⁽¹⁾ VAT is not charged on sales to Europe and other countries as well as Former Soviet Union countries.

⁽²⁾ One mcm is equivalent to 35,316 cubic feet.

⁽³⁾ Calculated on the basis of average exchange rate between the RUB and US Dollar.

Total sales (net of excise tax, VAT and customs duties) increased by RUB 153,490 million, or 7 %, to RUB 2,291,821 million for the three months ended March 31, 2019 compared to the same period of the prior year. The increase in sales was mainly due to an increase in sales of gas to Europe and other countries and sales of crude oil and gas condensate and refined products.

Net sales of gas accounted for 57 % of total net sales for the three months ended March 31, 2019 (57 % for the same period of the prior year).

Net sales of gas increased by RUB 83,298 million, or 7 %, from RUB 1,220,525 million for the three months ended March 31, 2018 to RUB 1,303,823 million for the three months ended March 31, 2019.

Net sales of gas to Europe and other countries increased by RUB 79,089 million, or 10 %, to RUB 837,396 million for the three months ended March 31, 2019 compared to the same period of the prior year. The change was due to the increase in average prices (including excise tax and customs duties) denominated in the Russian Ruble by 30 % that was partially compensated by the decrease in volumes of gas sold by 13 % for the three months ended March 31, 2019 compared to the same period of the prior year. At the same time average prices denominated in US Dollar increased by 12 % compared to the same period of the prior year.

Net sales of gas to Former Soviet Union countries increased by RUB 6,018 million, or 5 %, to RUB 117,497 million for the three months ended March 31, 2019 compared to the same period of the prior year. The change was due to the increase in average prices (including customs duties) denominated in the Russian Ruble by 25 % and the decrease in volumes of gas sold by 13 % for the three months ended March 31, 2019 compared to the same period of the prior year. At the same time average prices denominated in US Dollar increased by 8 % compared to the same period of the prior year.

Net sales of gas in the Russian Federation decreased by RUB 1,617 million to RUB 348,930 million for the three months ended March 31, 2019 compared to the same period of the prior year. This change is explained by the decrease in volumes of gas sold by 4 % and the increase in average prices (net of VAT) denominated in the Russian Ruble by 4 %.

Net sales of refined products (net of excise tax, VAT and customs duties) increased by RUB 37,365 million, or 8 %, to RUB 506,909 million for the three months ended March 31, 2019 compared to the same period of the prior year. The increase in net sales of refined products was mainly due to an increase in average prices denominated in the Russian Ruble in all geographic segments.

Net sales of crude oil and gas condensate (net of VAT and customs duties) increased by RUB 39,917 million, or 27 %, to RUB 190,389 million for the three months ended March 31, 2019 compared to the same period of the prior year. The change was mainly due to an increase in average prices denominated in the Russian Ruble in all geographic segments and an increase in Gazprom Neft Group's sales volumes to customers in Europe and other countries and in the Russian Federation.

Operating expenses

Operating expenses increased by RUB 130,870 million, or 8 %, to RUB 1,782,216 million for the three months ended March 31, 2019 compared to RUB 1,651,346 million for the same period of the prior year. Operating expenses as a percentage of sales increased from 77 % for the three months ended March 31, 2018 to 78 % for the three months ended March 31, 2019. The table below presents a breakdown of operating expenses in each period.

(in RUB million)	Three months ended March 31,	
	2019	2018
Purchased gas and oil	403,862	398,776
Taxes other than on profit	376,305	322,619
Staff costs	186,819	189,761
Depreciation	172,652	158,286
Transit of gas, oil and refined products	168,702	146,589
Materials	63,843	54,875
Cost of goods for resale, including refined products	56,066	62,124
Foreign exchange rate differences on operating items	47,251	(18,612)
Electricity and heating expenses	33,196	32,486
Repairs and maintenance	18,067	19,733
Insurance expenses	7,522	7,507
Rental expenses	7,303	9,767
Derivatives loss	7,064	12,452
Social expenses	6,793	9,097
Transportation services	6,268	9,106
Processing services	5,367	4,158
Research and development expenses	5,215	5,815
Impairment loss on non-financial assets	2,153	3,653
Other	<u>138,612</u>	<u>98,665</u>
	1,713,060	1,526,857
Change in balances of finished goods, work in progress and other effects	<u>69,156</u>	<u>124,489</u>
Total operating expenses	<u>1,782,216</u>	<u>1,651,346</u>

Purchased gas and oil

Cost of purchased gas and oil increased by RUB 5,086 million, or 1 %, to RUB 403,862 million for the three months ended March 31, 2019 compared to RUB 398,776 million for the same period of the prior year.

Cost of purchased gas included in the purchased gas and oil decreased by RUB 14,296 million, or 5 %, to RUB 287,718 million for the three months ended March 31, 2019 compared to RUB 302,014 million for the same period of the prior year. The change was mainly due to a decrease in volumes of purchased gas that was partially compensated by an increase in average prices denominated in the Russian Ruble.

Cost of purchased oil included in the purchased gas and oil increased by RUB 19,382 million, or 20 %, to RUB 116,144 million for the three months ended March 31, 2019 compared to RUB 96,762 million for the same period of the prior year. This change was mainly due to an increase in prices of oil and volumes of purchased oil on the domestic market.

Taxes other than on profit

Taxes other than on profit consist of:

(in RUB million)	Three months ended March 31,	
	2019	2018
Mineral extraction tax	299,672	233,422
Property tax	37,068	41,906
Excise tax	34,407	44,847
Other taxes	<u>5,158</u>	<u>2,444</u>
Total taxes other than on profit	<u>376,305</u>	<u>322,619</u>

Mineral extraction tax (MET) increased by RUB 66,250 million, or 28 %, to RUB 299,672 million for the three months ended March 31, 2019 compared to RUB 233,422 million for the same period of the prior year. MET for the three months ended March 31, 2019 increased compared to the same period of the prior year mainly as a result of an increase in coefficient values in the MET formula for gas.

Excise tax decreased by RUB 10,440 million, or 23 %, to RUB 34,407 million for the three months ended March 31, 2019 compared to RUB 44,847 million for the same period of the prior year. Excise tax decreased due to an implementation of crude oil materials excise duty deduction including dempfer part since January 1, 2019. The excise tax decrease was trimmed by an excise rates increase for several petroleum products since January 2019.

Depreciation

Depreciation increased by RUB 14,366 million, or 9 %, to RUB 172,652 million for the three months ended March 31, 2019 compared to RUB 158,286 million for the same period of the prior year. The change was mainly due to charging of depreciation of right-of-use assets caused by the application of IFRS 16 Leases since January 1, 2019.

Transit of gas, oil and refined products

Transit of gas, oil and refined products increased by RUB 22,113 million, or 15 %, to RUB 168,702 million for the three months ended March 31, 2019 compared to RUB 146,589 million for the same period of the prior year.

Foreign exchange rate differences on operating items

Foreign exchange rate loss on operating items amounted to RUB 47,251 million for the three months ended March 31, 2019 compared to the foreign exchange gain in the amount of RUB 18,612 million for the same period of the prior year. This change was mainly due to the depreciation of US Dollar and Euro against the Russian Ruble by 7 % and 8 %, respectively, for the three months ended March 31, 2019 compared to the depreciation of US Dollar against the Russian Ruble by 1 % and the appreciation of Euro against the Russian Ruble by 2 % for the same period of the prior year.

Other operating expenses

Other operating expenses increased by RUB 39,947 million, or 40 %, to RUB 138,612 million for the three months ended March 31, 2019 compared to RUB 98,665 million for the same period of the prior year. Other expenses include gas and gas condensate production expenses, services from gas distribution companies, bank charges, security services, legal and consulting services, charity and financial aid and advertising.

Change in balances of finished goods, work in progress and other effects

The line item Change in balances of finished goods, work in progress and other effects decreased by RUB 55,333 million, or 44 %, to RUB 69,156 million for the three months ended March 31, 2019 compared to RUB 124,489 million for the same period of the prior year. The change in this line item is explained by the fact that a decrease in the balances of finished goods for the three months ended March 31, 2019 was less than a decrease in the balances of finished goods for the same period of the prior year.

Impairment loss on financial assets

Impairment loss on financial assets increased by RUB 17,843 million, or 68 %, to RUB 44,248 million for the three months ended March 31, 2019 compared to RUB 26,405 million for the same period of the prior year. The change is mainly due to an increase in the accrual of the allowance for expected credit losses on accounts receivable due from debtors from south regions of the Russian Federation and NJSC Naftogaz of Ukraine for the three months ended March 31, 2019 compared to the same period of the prior year.

Operating profit

As a result of the factors discussed above, operating profit decreased by RUB 8,819 million, or 2 %, to RUB 458,762 million for the three months ended March 31, 2019 compared to RUB 467,581 million for the same period of the prior year. The operating profit margin decreased from 22 % for the three months ended March 31, 2018 to 20 % for the three months ended March 31, 2019.

Net finance income (expense)

(in RUB million)	Three months ended March 31,	
	2019	2018
Foreign exchange gain	234,603	73,311
Foreign exchange loss	(50,618)	(94,409)
Net foreign exchange gain (loss)	183,985	(21,098)
Interest income	23,620	18,069
Interest expense	(18,373)	(13,014)
Net finance income (expense)	189,232	(16,043)

The net foreign exchange gain of RUB 183,985 million for the three months ended March 31, 2019 compared to the net foreign exchange loss of RUB 21,098 million for the same period of the prior year were explained by the depreciation of US Dollar and Euro against the Russian Ruble by 7 % and 8 %, respectively, for the three months ended March 31, 2019 compared to the depreciation of US Dollar against the Russian Ruble by 1 % and the appreciation of Euro against the Russian Ruble by 2 % for the same period of the prior year.

Interest income increased by RUB 5,551 million, or 31 %, to RUB 23,620 million for the three months ended March 31, 2019 compared to RUB 18,069 million for the same period of the prior year.

Interest expense increased by RUB 5,359 million, or 41 %, to RUB 18,373 million for the three months ended March 31, 2019 compared to RUB 13,014 million for the same period of the prior year.

Share of profit of associates and joint ventures

Share of profit of associates and joint ventures increased by RUB 20,252 million, or 46 %, to RUB 63,932 million for the three months ended March 31, 2019 compared to RUB 43,680 million for the same period of the prior year. This change was mainly caused by an increase in the share of profit of Sakhalin Energy Investment Company Ltd., JSC Arcticgas, PJSC NGK Slavneft and its subsidiaries and JSC Achimgaz.

Profit tax

Total profit tax increased by RUB 49,364 million, or 48 %, to RUB 152,413 million for the three months ended March 31, 2019 compared to RUB 103,049 million for the same period of the prior year. The effective profit tax rate was 21.4 % and 20.8 % for the three months ended March 31, 2019 and for the three months ended March 31, 2018, respectively.

Profit for the period attributable to owners of PJSC Gazprom

As a result of the factors discussed above, profit attributable to owners of PJSC Gazprom increased by RUB 164,285 million, or 44 %, to RUB 535,908 million for the three months ended March 31, 2019 compared to RUB 371,623 million for the same period of the prior year.

Profit for the period attributable to non-controlling interest

Profit attributable to non-controlling interest increased by RUB 3,059 million, or 15 %, to RUB 23,605 million for the three months ended March 31, 2019 compared to RUB 20,546 million for the same period of the prior year.

Liquidity and capital resources

The following table summarises the cash flows for the three months ended March 31, 2019 and March 31, 2018:

(in RUB million)	Three months ended March 31,	
	2019	2018
Net cash from operating activities	684,920	461,940
Net cash used in investing activities	(667,573)	(432,142)
Net cash from financing activities	236,525	47,527

Net cash from operating activities

Net cash from operating activities increased by RUB 222,980 million, or 48 %, to RUB 684,920 million for the three months ended March 31, 2019 compared to RUB 461,940 million for the same period of the prior year. This change was mainly driven by a decrease in short-term deposits within working capital for the three months ended March 31, 2019 compared to their increase for the same period of the prior year.

Net cash used in investing activities

Net cash used in investing activities increased by RUB 235,431 million, or 54 %, to RUB 667,573 million for the three months ended March 31, 2019 compared to RUB 432,142 million for the same period of the prior year. The change was mainly due to an increase in loans issued for the three months ended March 31, 2019 compared to the same period of the prior year.

Net cash from financing activities

Net cash from financing activities increased by RUB 188,998 million, or 398 %, to RUB 236,525 million for the three months ended March 31, 2019 compared to RUB 47,527 million for the same period of the prior year. This change was mainly due to an increase in proceeds from long-term borrowings.

Capital expenditures

Total capital expenditures (excluding the effect of acquisitions of subsidiaries) by segments for the three months ended March 31, 2019 and for the three months ended March 31, 2018 denominated in the Russian Ruble, amounted to the following:

(in RUB million)	Three months ended March 31,	
	2019	2018
Transportation	82,456	132,322
Production of crude oil and gas condensate	56,254	46,689
Refining	50,878	45,428
Production of gas	41,515	31,646
Electric and heat energy generation and sales	9,663	8,838
Gas storage	2,626	988
Distribution of gas	1,109	2,018
All other segments	<u>51,949</u>	<u>21,523</u>
Total	296,450	289,452

Total capital expenditures increased by RUB 6,998 million, or 2 %, to RUB 296,450 million for the three months ended March 31, 2019 compared to RUB 289,452 million for the same period of the prior year.

Debts obligation

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) decreased by RUB 168,282 million, or 6 %, from RUB 3,014,403 million as of December 31, 2018 to RUB 2,846,121 million as of March 31, 2019. This change was mainly due to an increase in cash and cash equivalents balances.