

A large industrial drilling rig is silhouetted against a dark, twilight sky. The rig's structure is complex, with many levels of scaffolding and ladders. A white rectangular sign with the EDC logo is attached to one of the lower sections of the rig. In the background, a large, dark industrial building is visible, with a few lights glowing from its windows. The overall scene is dimly lit, with the primary light source being the ambient light of dusk or dawn.

Delivering on  
our strategy...  
...driving  
opportunities

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Eurasia Drilling Company is the largest independent provider of drilling services in Russia.

We supply onshore integrated well construction services and workover services to national and international oil and gas companies and offshore drilling services in the Russian, Kazakh and Turkmen sectors of the Caspian Sea.

We have a strong growth record and our objective is to transform our already dominant Russian business into a significant international player.

These interim consolidated financial statements were prepared by Eurasia Drilling Company Limited in accordance with US GAAP and have not been audited by our independent auditor. If these financial statements are audited in the future, the audit could reveal differences in our consolidated financial results and we can not assure that any such differences would not be material.

# Highlights

## REVENUES US \$ MILLION

# 862

## EBITDA US \$ MILLION

# 206

## NET INCOME US \$ MILLION

# 105

## EARNINGS PER SHARE US \$

# 0.75

## NET INCOME MARGIN

# 12.2%

## Operational

- Achieved drilling output of 1,974 thousand metres for the first six months of 2010, 2% above the output achieved in the corresponding period of 2009 (1,927 thousand metres);
- Further diversified our customer portfolio by commencing drilling operations for TNK-BP in May 2010;
- Reduced our reliance on our largest customer in the first six months of 2010 with its' share comprising 60% of our total drilling volumes compared to 63% in the corresponding period of 2009;
- Ordered five new rigs with projected delivery times commencing in late 2010 for expected onshore operations outside of the CIS, and two additional rigs for our operations in Russia;
- Fully employed our jack-up rig, *ASTRA*, in Turkmen and Russian waters of the Caspian Sea; three directional production wells were drilled and completed;
- Continued operations on LUKOIL's Yuri Korchagin field platform in the Caspian Sea where we drilled three wells;
- Remained active with two drilling rigs in Kazakhstan; two wells were completed and another two drilled for the first six months of 2010;
- In March 2010 we completed fabrication of our first own-built rig, a 450 tonne walking design named named 'YERMAK'.

## Financial

- Revenue for the six months ended June 30, 2010 was US \$862 million which is US \$189 million above the corresponding period of 2009 (1H09 Revenue was US \$673 million);
- EBITDA margin improved to 23.9% for the six months period ended June 30, 2010, which is two percentage points above the corresponding period of 2009 (1H09 EBITDA margin was 21.9%)
- Net Income for the six months ended June 30, 2010 was US \$105 million which is US \$27 million above the corresponding period of 2009 (1H09 Net Income was US \$78 million);
- Diluted earnings per share for six months period ended June 30, 2010 were US \$0.75 (1H09 diluted earnings per share were US \$0.57);
- Net income margin for the first six months of 2010 was 12.2% which is 0.6 percentage points above the corresponding period of 2009 (1H09 net income margin was 11.6%);
- The six months 2010 average US dollar exchange rate was slightly over 30 rubles as compared to slightly over 33 rubles in the respective 2009 period, a percentage change of 9.1%.

## Management's discussion and analysis of financial condition and results of operations

Eurasia Drilling Company Limited is the largest independent provider of onshore drilling services in Russia, as measured by the number of metres drilled, providing onshore integrated well construction services and workover services. In addition, we provide offshore drilling services in the Caspian Sea. We offer our onshore integrated well construction and workover services to local and international oil and gas companies primarily in Russia and our offshore drilling services to Russian and international oil and gas companies in the Russian, Kazakh and Turkmen sectors of the Caspian Sea. Our customers include a number of the major Russian and international oil and gas companies operating in Russia and the Caspian Sea, such as LUKOIL, Rosneft, Gazpromneft, TNK-BP, Shell, KazMunaiGaz affiliates, Samara-Nafta and Naryanmarneftegaz, a joint venture between LUKOIL and ConocoPhillips.

The following report represents management's discussion and analysis of financial condition and results of operations for the six month period ended June 30, 2010 (the Interim Period) and is intended to help our shareholders and other users of our financial statements better understand our operations and attendant financial results and current financial condition. This information is provided as a supplement to, and should be read in conjunction with our reviewed 2010 Interim Consolidated Financial Statements and the accompanying notes, prepared in accordance with US GAAP. As used in this report, 'Company', 'we,' 'us,' 'our' and 'EDC' means Eurasia Drilling Company Limited and, where the context requires, includes our subsidiaries.

This report contains forward-looking statements that involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements.

### Overview of operations during 1H 2010

In the first six months of 2010, CDU TEK data indicates that the overall drilling market in Russia was up 14% as compared to the corresponding period of 2009. Drilling volumes started to accelerate at the end of the first quarter after a slow start at the beginning of the year caused by harsh weather conditions. Exploration drilling volumes as per CDU TEK data increased by 46% as compared to the corresponding period of 2009 coming closer to pre-crisis levels. In general in the first six months of 2010 we witnessed a revival in the drilling activity of almost all the Russian oil majors, except for our major client.

Our Interim Period 2010 operating results include:

- Achieved drilling output of 1,974 thousand metres for the first six months of 2010, 2% above the output achieved in the corresponding period of 2009 (1,927 thousand metres);
- Further diversified our customer portfolio by commencing drilling operations for TNK-BP in May 2010;
- Reduced our reliance on our largest customer in the first six months of 2010 with its' share comprising 60% of our total drilling volumes compared to 63% in the corresponding period of 2009;
- Ordered five new rigs with projected delivery times commencing in October 2010 for expected onshore operations outside of the CIS and two rigs for our operations in Russia;
- Employed fully our jack-up rig, *ASTRA*, in Turkmen and Russian waters of the Caspian Sea; three directional production wells were drilled and completed;
- Continued our operations on LUKOIL's Yuri Korchagin field platform in the Caspian Sea where we drilled three wells;
- Remained active with two drilling rigs in Kazakhstan; two wells were completed and another two drilled for the first six months of 2010;
- Completed in March 2010 fabrication of our first 450 tonne rig named 'YERMAK'.

Demand for drilling services depends on a variety of factors, including worldwide demand for oil and gas, the ability of OPEC to set and maintain production levels and pricing, the level of production of non-OPEC countries and the policies of the various governments regarding exploration and development of their oil and gas reserves.

Our results of operations depend on the levels of activity in Russia and countries of the Caspian Sea, and the prices of crude oil and natural gas in Russia. While world prices for crude oil are characterised by significant fluctuations, determined by the global balance of supply and demand, Russian natural gas prices are regulated by the Russian government. While Russian natural gas prices have increased in recent years, and are expected to continue to rise to a level closer to parity with export netbacks, they are still significantly below world levels. To date most of our drilling activities have been in oil provinces rather than gas provinces. This business mix may slowly change over time if we obtain new clients whose activities are more heavily weighted to drilling natural gas wells. The results of our workover operations tend to be less sensitive to the fluctuations in crude oil and natural gas prices, as our clients require such services both during periods of high and low oil prices.



## Increase market share

# 1

We are determined to continue growing our market share in Russia, both organically and through targeted acquisitions.



### Project

EDC is actively drilling development wells for Rosneft in their Vankor oil & gas field, the largest field to have been discovered and brought into production in Russia in the last 25 years. Two of our newest high-spec rigs are currently deployed at Vankor, contributing to our growing business with Rosneft.

### Location

Turukhansky District, Krasnoyarsk Territory, East Siberia, Russia

### Customer/Partner

CJSC Vankorneft, subsidiary of Rosneft

## Management's discussion and analysis of financial condition and results of operations continued

For the first six months ended of 2010, the Company is on its way to achieving its 2010 targets, supported by excellent performance from all business segments. During the first half of 2010 our business benefited from market conditions characterised by quite stable oil prices and ruble to US dollar exchange rates that lead to increases in capital spending by all the Russian oil majors, except for our major client.

Our Russian onshore drilling volumes were 1,974 thousand metres which is 2% above volumes achieved in 2009. The drilling volumes of our major customer declined by 3% during the first six months of 2010 as compared to the corresponding period of 2009. We gained additional volumes with other clients including GAZPROMNEFT that now accounts for 27% of our total drilling volumes as compared to 23% during the corresponding period of 2009. Our market share for the first six months of 2010 was 24% which is two percentage points below the corresponding period of 2009. This reduction was mainly caused by expansion in drilling operations by the in-house drilling divisions of many Russian oil majors, especially SURGUTNEFTEGAS.

The drilling pattern in the first half of 2010 was characterised by greater seasonality than the corresponding period of last year. There was a slow start at the beginning of the year caused by severe winter conditions in West Siberia as well as higher exploration activity (which occurs during the ice-road season and ties up rigs by isolating them in remote areas). As per CDU TEK data, exploration drilling volumes in onshore Russia during the first half of 2010 were above the corresponding period of 2009 by 46%. Drilling accelerated starting from March reaching its peak in May during the first six months of 2010. In May 2010 we drilled 398 thousand metres – a record for our operating history.

For the six months period ended June 30, 2010 we have expanded our rig fleet to a total of 208 drilling rigs as compared to 207 at the end of 2009. In March 2010 we completed the fabrication of a 450 tonne high-spec rig named 'YERMAK'. This is a unique rig in Russia that has a Quadra Moving System, enabling it to walk and turn in any direction. In addition it has a separate fixed mud block incorporating mud pumps, tanks and processing equipment; and flexible interconnecting umbilical system that conducts drilling fluids, steam and electrical energy and control systems cabling. This is the first rig of its kind designed to operate in Russia's specific environment characterised by extremely cold winter conditions combined with warm summer temperatures. Also, the rig is designed for cluster drilling which is important since approximately 95% of the production wells in Russia are drilled directionally from pad clusters. We continue to work on the design of another rig, a 320 tonne high-spec drilling rig. Having these designs in place, will allow us to fabricate high spec rigs in facilities both in Russia and outside to support our growth. Our drilling rig fleet will

expand later this year as we recently ordered five rigs for our expected operations outside of CIS and two rigs for our current operations in Russia. These are 320 tonne and 315 tonne high spec rigs with delivery times projected to start in October 2010.

One of the key factors to our success is continuous work on improving and maintaining high crew productivity. For the first six months ended June 30, 2010 our crew productivity suffered slightly from extreme weather conditions and higher exploration drilling activity. Exploration drilling is inherently much less efficient than production drilling so an increase in exploration drilling skews the overall drilling efficiency metric. Additionally, this year we began a number of new drilling contracts, where we were challenged to drill deeper wells that decreased our average drilling speed. It is important to note that without the significant upgrade and modernisation of our rig fleet performed in the past years, application of more advanced drilling technologies and the application of new standards to our drilling operations, we would not be able to win contracts for higher margin deep and horizontal drilling. Advanced crew training and application of innovative technologies allowed us to both improve Rates of Penetration (ROP) and reduce Non-Productive Time (NPT). Examples of technological advancements included wider usage of Polycrystalline Diamond Compact (PDC) drill bits, introduction of new generation drilling motors, optimisation of bottom-hole-assemblies (BHAs) and mud programs/properties, and real-time drilling navigation. The use of top-drives and four-step drilling mud cleaning systems on our high specification rigs further improved ROP and efficiency in the increasingly more challenging wells we are drilling.

Our success depends on our ability to charge clients market prices for our onshore and offshore drilling and other services. A significant proportion of our revenues are currently derived from services provided to the LUKOIL Group. The original LUKOIL Framework Agreement, which was in effect from 2005 through 2009, established a pricing adjustment formula applicable to the onshore drilling services we provided to LUKOIL. Such pricing formula effectively limited our ability to adjust the prices related to our onshore drilling services for LUKOIL in order to reflect fluctuations in the market prices occurring prior to the following annual price adjustment. However, we considered that the prices at which we provided services pursuant to the LUKOIL Framework Agreement were acceptable given the volume of services provided over the course of each year. In January 2010 we signed a new Framework Agreement with LUKOIL covering the succeeding three years and requiring us to drill a minimum of 6.7 million metres during this period. The pricing formula for this new Framework Agreement is similar to that contained in the prior Framework Agreement. In addition, we believe that the contracts we enter into with our other customers provide us with greater flexibility to adjust their contract prices to better conform to current market levels.



## Growth of customer base

# 2

A key component of our growth strategy is to expand our customer base further, and to pursue new opportunities in new geographical areas where we can add value and operate efficiently.



### Project

EDC successfully drilled a deep sub-salt exploration well utilising E-183, one of our new Lewco Heartbeat 450-tonne (2,000 horsepower) rigs. The well spudded in Q3 2009 and reached the planned depth of 5,200m more than 80 days (30%) ahead of schedule.

### Location

Karpenskiy concession, Saratov Region of central Russia

### Customer/Partner

Pre-Caspian Gas Company, subsidiary of Volga Gas

# Management's discussion and analysis of financial condition and results of operations continued

Among other strategic goals, we are aiming to diversify our customer base while building long-term relationships with our clients. In 2007 the share of our major customer, LUKOIL, was 77% of total drilling volumes. For the first half of 2010 its share went down to 60%. Of particular note is that during the Interim Period we commenced in 2010 drilling operations for TNK-BP with two rigs. Though the share of TNK-BP in our total drilling volume is not yet significant, we are determined to increase the scope of work for TNK-BP by providing best-in class equipment and high standard performance. To summarise, the list of our clients includes the four largest E&P companies in Russia which, together, accounted for 55% of the total drilling volumes in Russia during the first half of 2010 based on CDU TEK data. In 2010 we have also won important contracts with another four new clients, including Pechoraneft and Rusvietpetro.

Our offshore operations remained strong during the first half of 2010. Our jack-up rig, *ASTRA*, is fully booked and was employed in Turkmen and Russian waters of the Caspian Sea during the first half of 2010. Three wells were drilled and completed. In June 2010 our jack-up rig, *ASTRA*, participated in an international training aimed at the offshore emergency response operations for the possible oil spills in the Northern part of the Caspian Sea. Our jack-up, *ASTRA*, was used as a control centre and successfully performed as expected during the exercise.

We continue our operations on LUKOIL's Yuri Korchagin field platform and drilled three wells during the first six months of 2010 including one vertical and two directional wells.

In June 2010 we acquired a Russian workover service company in the Komi Republic, Timan Pechora region. In the beginning of August 2010 we acquired a Russian provider of cementing services with operations mainly located in West Siberia. The amount paid for the two acquisitions was approximately US \$20 million.

## Overview of financial performance during 1H 2010

During the six months period ended June 30, 2010 we achieved remarkable financial results across all lines and geographies of our business that were better than our initial expectations. We continued to concentrate on execution backed by our continuous investment in drilling rig fleet modernisation and upgrade. Our first six months 2010 results reflect revival in the overall drilling market activity as compared to first six months of 2009.

Our Interim Period 2010 financial results include:

- Revenue for the six months ended June 30, 2010 was US \$862 million which is US \$189 million above the corresponding period of 2009 (1H09 Revenue was US \$673 million);
- EBITDA margin improved to 23.9% for six months period ended June 30, 2010, which is two percentage points above the corresponding period of 2009 (1H2009 EBITDA margin was 21.9%);
- Net Income for the six months ended June 30, 2010 was US \$105 million which is US \$27 million above the corresponding period of 2009 (1H09 Net Income was US \$78 million);
- Diluted earnings per share for six months period ended June 30, 2010 were US \$0.75 (1H09 diluted earnings per share were US \$0.57);
- Net income margin for the first six months of 2010 was 12.2% which is 0.6 percentage points above the corresponding period of 2009 (1H09 net income margin was 11.6%);
- The six months 2010 average US dollar exchange rate was slightly over 30 rubles as compared to slightly over 33 rubles in the respective 2009 period, a percentage change of 9.1%.

## Reconciliation of net income to EBITDA

Earnings before Interest, Taxes, Depreciation and Amortisation (EBITDA) is computed with reference to the Company's net income for the six month period ended June 30, 2010 and the six month period ended June 30, 2009 as follows (in thousands of US dollars, unaudited):

	2010	2009
<b>Net Income</b>	<b>104,810</b>	78,392
Income tax expense	<b>37,228</b>	21,440
Gain on disposal of PP&E	<b>(5,790)</b>	(688)
Currency transaction Loss/(Gain)	<b>1,870</b>	(5,328)
Interest income	<b>(6,531)</b>	(3,655)
Interest expense	<b>7,629</b>	7,530
Depreciation	<b>67,127</b>	49,791
<b>EBITDA</b>	<b>206,343</b>	147,482





## Expansion in offshore drilling

# 3

We are well positioned to build on our successful experience in offshore activity by seizing clear strategic growth opportunities, particularly those arising in the Caspian Sea.



### Project

EDC is the General Drilling Contractor for the first phase of the Yuri Korchagin field development project. The field is being developed from an ice-resistant platform and many of the wells will require extended-reach drilling capabilities. This is the first permanent drilling and production facility in the Russian sector of the Caspian Sea.

### Location

Northern Caspian Sea

### Customer/Partner

LUKOIL

# Management's discussion and analysis of financial condition and results of operations continued

## Revenues

The following table sets forth a summary of our operating results for the first six months of 2010 and for the first six months of 2009 (for additional information, please see the accompanying 2010 Interim Consolidated Financial Statements):

Consolidated statements of income for the six months ended June 30, 2010 and 2009. (All figures in thousands of US dollars, unless otherwise noted, unaudited):

	2010	2009
<b>Revenues</b>		
Drilling and related services	853,572	666,086
Other sales and services	8,441	7,102
<b>Total revenues</b>	<b>862,013</b>	673,188
Cost of services	(555,368)	(449,022)
Selling, general and administrative expenses	(54,659)	(43,944)
Taxes other than income taxes	(45,698)	(32,376)
Depreciation	(67,127)	(49,791)
(Loss)/gain on disposal of property, plant and equipment	5,790	688
<b>Income from operating activities</b>	<b>144,951</b>	98,743
Interest expense	(7,629)	(7,530)
Interest income	6,531	3,655
Currency transaction (loss)/gain	(1,870)	5,328
Other expenses	55	(364)
<b>Income before income taxes</b>	<b>142,038</b>	99,832
Income tax expense	(37,228)	(21,440)
<b>Net income</b>	<b>104,810</b>	78,392
<b>Basic earnings per share of common stock (US dollars)</b>	<b>0.75</b>	0.58
<b>Diluted earnings per share of common stock (US dollars)</b>	<b>0.75</b>	0.57

Our total dollar-expressed revenues increased by US \$188.8 million, or 28.0%, to US \$862 million for the 2010 Interim Period from US \$673.2 million in the comparable 2009 period.

The financial results of operations in US dollars for the 2010 Interim Period were influenced by several factors including ruble appreciation (the six months 2010 average US dollar exchange rate was slightly over 30 rubles as compared to slightly over 33 rubles in the respective 2009 period, a percentage change of 9.1%), an increase in our number of metres drilled and an integration of the new workover businesses. Revenue from offshore operations also contributed to total revenue growth during the six months period ended June 30, 2010.

## Cost of services

Cost of services includes the following (in thousands of US dollars, unaudited):

	2010	2009
Services of subcontractors	208,961	158,697
Materials	102,482	112,137
Wages and salaries	159,310	110,985
Fuel and energy	42,221	32,940
Transportation of employees to drilling fields	11,764	11,553
Leasing and rent	4,247	4,729
Other	26,383	17,981
<b>Total cost of services</b>	<b>555,368</b>	449,022

Cost of services increased by US \$106.3 million, or 23.7%, to US \$555.4 million for the 2010 Interim Period from US \$449.0 million for the equivalent 2009 period. Cost of services as a percentage of total revenue decreased from 66.7% for the first six months of 2009 to 64.4% for the 2010 Interim Period. We believe the improvement of the margin was primarily attributable to sustained cost control efforts by management.

We generally subcontract with third parties to provide us with certain services in our onshore division in instances where we do not perform these services ourselves. In our onshore division, services contracted from third parties include subcontracting for technological services; transportation services; preparatory services; well facility services; petrophysical services; well services; drilling motor and drilling navigation services; cementing services; and drilling bit services. Services of subcontractors were the largest component of our cost of services for the first six months of both 2010 and 2009. For the 2010 Interim Period, services of subcontractors were US \$209.0 million, or 37.6% of total cost of services, as compared to US \$158.7 million, or 35.3% of total cost of services, for the comparable 2009 period. The increase in total dollars expended was primarily a function of the increase in dollar/ruble exchange rate and the increase in the volume of workover services provided by the group during the 2010 Interim Period. The change as a percentage of total cost of services is caused by an increase in transportation costs in the Perm region due to the sale of our own non-core transportation assets to the third party and an increase in the number of turnkey well requests from our customers.



## Expand workover capacity

# 4

Improving and expanding our capacity in workover, which is complementary and supportive to drilling, is central to achieving full-cycle balance in our business.



### Project

In late 2009 EDC acquired 100% interest in the Kogalym and Urai well workover divisions (KWWD and UWWD) of LUKOIL-Western Siberia. Combined production assets include more than 160 workover rigs and 107 active crews, supported from 7 operational facilities.

In addition to the sale and purchase agreement, LUKOIL and EDC signed a five-year Workover Framework Agreement covering pricing and work volumes for well workover, well reconditioning and well servicing operations pertaining to KWWD and UWWD activities.

### Location

West Siberia

### Customer/Partner

TPP 'Kogalymneftegaz' and TPP 'Urayneftegaz' divisions of OOO 'LUKOIL-Western Siberia', a subsidiary of LUKOIL

## Management's discussion and analysis of financial condition and results of operations continued

Expenditures for materials have been primarily influenced by our customers' particular drilling programs and projects. Materials for our onshore and offshore drilling divisions primarily include spare parts, tubular goods, chemicals and cement and drilling tools. Materials costs for the 2010 Interim Period were US \$102.5 million, or 18.5% of total cost of services as compared to US \$112.1 million, or 25.0% of total cost of services for the respective 2009 period. The significant decrease in both total dollars expended and the percentage of total costs is caused by a change to a different scheme of casing pipe financing instituted by some of our major customers beginning in 2009. Prior to 2009 casing pipe was included in the price of well construction and in cost of sales. In 2009 certain of our major customers chose to finance a portion of their casing pipe and provide it to us. In the 2010 Interim Period, even more of our major customers decided to operate under the new casing pipe financing scheme leading to the continued decrease of material costs as a percentage of total cost of services.

Employee wages and salaries include costs of our personnel directly engaged in providing onshore and offshore drilling and other services. Employee costs include amounts we pay in support of our private employee insurance and medical funds. Such expenses do not include contributions which we make to a private pension fund or social taxes we pay to the Russian government. Wages and salaries for the 2010 Interim Period were US \$159.3 million, or 28.7% of total cost of services as compared to US \$111.0 million, or 24.7% of total cost of services for the equivalent 2009 period. The significant increase in both total dollars expenses and the percentage of total cost of services were caused by the integration of the new workover and telemetry businesses acquired late in 2009 for which wages and salaries constitute the largest component of cost of services. The total dollar increase was also to a lesser extent attributed to the increase in the dollar/ruble exchange rate.

Fuel and energy costs consist primarily of oil, lubricants and electricity. Fuel and energy costs for the 2010 Interim Period were US \$42.2 million, or 7.6% of total cost of services as compared to US \$32.9 million, or 7.3% of total cost of services for the 2009 period. The change as a percentage of total cost of services is not material.

Costs relating to the transportation of employees to field locations primarily include transportation services related to the mobilisation and rotation of rig crews. Expenses relating to the transportation of employees to field locations for the 2010 Interim Period were US \$11.8 million, or 2.1% of total cost of services as compared to US \$11.5 million, or 2.6% of total cost of services for the comparable 2009 period. The change as a percentage of total cost of services is not material.

Leasing and rent costs consist primarily of the cost of renting drilling equipment. Leasing and rent costs for the 2010 Interim Period were US \$4.2 million, or 0.8% of total cost of services as compared to US \$4.7 million, or 1.1% of total cost of services for the 2009 period. The decrease in total dollars expended is primarily a function of a decrease in the number of drilling rigs we have under lease. The percentage of total cost of services change is not considered material.

The remaining portion of our cost of services, which we categorise as 'other', includes current repair expenses for fixed assets; license fees; insurance expenses; safety and environmental expenses; and maintenance expenses. Other expenses amounted to US \$26.4 million or 4.8% of our total cost of services for the 2010 Interim Period, as compared to US \$18.0 million or 4.0% of our total cost of services for the comparable 2009 period. The increase in the total amount is primarily caused by the change in the dollar/ruble exchange rate and by the integration of new workover businesses purchased in late 2009. The increase in a percentage of total cost of services is considered immaterial.

### Selling, general and administrative expenses

Selling, general and administrative expenses increased by US \$10.7 million to US \$54.7 million for the 2010 Interim Period, as compared to US \$43.9 million for the 2009 period. As a percentage of total revenues, selling, general and administrative expenses amounted to 6.3% and 6.5% for the 2010 Interim Period and the comparable 2009 period, respectively. The change as a percentage of total revenues is not material.

### Taxes other than income taxes

Taxes other than income tax include various local taxes, such as social tax, personal income tax, property tax, transport tax and others. Taxes other than income taxes increased by US \$13.3 million to US \$45.7 million for the 2010 Interim Period as compared to US \$32.4 million for the respective 2009 period. The increase in taxes other than income taxes was primarily attributable to the integration of the new workover businesses and an increase in the dollar/ruble exchange rate. As a percentage of revenue, taxes other than income taxes increased to 5.3% during the Interim Period from 4.8% for the comparable 2009 period. This difference is mostly attributable to the change in the Russian tax law and the recent adjustment in the formula for social contributions calculations.



## Broaden technology platform

# 5

**Our focus is on accessing the best technology to take full advantage of our dominant position and expertise in our core drilling and workover services.**



### Project

In 2009 EDC formed the new entity 'OOO New Technology Services' (NTS) to provide drilling support services to both internal and external customers. Technologies and service lines have been added incrementally from both existing internal resources and through acquisition.

### Location

Russia onshore

### Customer/Partner

LUKOIL, Gazprom Neft, Rosneft and Slavneft

# Management's discussion and analysis of financial condition and results of operations continued

## Depreciation

Depreciation increased by US \$17.3 million to US \$67.1 million for the 2010 Interim Period as compared to US \$49.8 million for the respective 2009 period. As a percentage of revenues, the depreciation increased to 7.8% from 7.4% for the 2010 Interim Period. The total dollar increase was mostly caused by the depreciation on the equipment and machinery acquired with the purchase of workover and telemetry businesses late in 2009 and by an increase in the dollar/ruble exchange rate. The increase as the percentage of total revenues was primarily the result of the significant capital expenditures in PP&E during the past three years, particularly the acquisition of additional drilling equipment and new drilling rigs that were placed into service in 2009 and in the 2010 Interim Period.

## Disposal of property, plant and equipment

Gain on the disposal of property, plant and equipment increased by US \$5.1 million to US \$5.8 million for the 2010 Interim Period as compared to US \$0.7 million for the equivalent 2009 period. This significant increase was primarily due to a realised gain on the sale of non-core transportation assets in the Perm region during the 2010 period.

## Income from operating activities

Income from operating activities increased by US \$46.2 million to US \$145.0 million for the 2010 Interim Period, as compared to US \$98.7 million for the comparable 2009 period. The increase in total dollars is primarily due to sustained cost control efforts. As a percentage of revenues, income from operating activities increased from 14.7% for the respective 2009 period to 16.8% for the 2010 Interim Period. This percentage increase is primarily due to percentage of total revenues decrease in cost of services as described above.

## Interest expense

Interest expense increased by US \$0.1 million to US \$7.6 million for the 2010 Interim Period as compared to US \$7.5 million for the equivalent 2009 period. The change is not considered material.

## Income before income taxes

Income before income taxes increased by US \$42.2 million to US \$142.0 million for the 2010 Interim Period, as compared to US \$99.8 million for the respective 2009 period. The increase in income before income taxes was attributable to the factors described in more detail above.

## Income tax expense

Income tax expense increased by US \$15.8 million to US \$37.2 million for the 2010 Interim Period, as compared to US \$21.4 million for the comparable 2009 period. In dollar terms, the increase in income tax expense was primarily attributable to the increase in our

income. Our effective tax rate increased to 26.2% in the 2010 Interim Period from 21.5% in the comparable 2009 period primarily due to a 5% foreign withholding tax on certain intercompany dividends declared and paid in the amount of RUR 5.0 billion during the Interim Period. Based on current tax laws, we expect our effective corporate income tax rate to be approximately 23% in the future.

## Net income

As a result of the foregoing factors, net income increased by US \$26.4 million to US \$104.8 million for the 2010 Interim Period, as compared to US \$78.4 million for the comparable 2009 period.

## Overview of financial situation as of June 30, 2010 and liquidity

Our balance sheet and cash flows remain strong. Our Interim Period 2010 financial situation highlights include:

- Cash and cash equivalents as of June 30, 2010 was US \$383 million a decrease of US \$51 million as compared to cash and cash equivalent balance of US \$434 million as of December 31, 2009;
- Our debt as of June 30, 2010 decreased to US \$164 million as compared to US \$182 million debt balance as of December 31, 2009;
- During the Interim Period of 2010 we paid dividends in the amount of US \$213 million including a US \$179 million special dividend on a treasury share sales transaction and a US \$34 million dividend resulting from our successful 2009 operations;
- Net cash position (cash reduced by all debt) was US \$ 219 million as of June 30, 2010 (December 31, 2009 net cash position was US \$252 million);
- Capital expenditures for six months ended June 30, 2010 were US \$119 million including changes in restricted cash as compared to US \$66 million incurred during the corresponding period of 2009.

## Accounts receivable

Accounts receivable increased by US \$34.8 million to US \$225.9 million as of June 30, 2010, from US \$191.1 million at the beginning of the Interim Period. The increase in total dollars is primarily due to seasonal fluctuations of the revenue. Expressed as the number of days outstanding, our trade receivable balance increased from approximately 50.7 days at the beginning of the period to approximately 53.0 days at the end of the period (both ratios are expressed in ruble terms). This increase is due to normal fluctuations in our collection cycle.

## Materials for drilling and workover

The balance for materials for drilling and workover, a component of our inventory balance, increased by US \$12.5 million from US \$110.0 million at the beginning of the Interim Period to US \$122.5 million at the end of the period. Expressed as the number of days for the total inventory to turn over, the turnover rate at the end of the Interim Period was approximately 226.3 days,

# Management's discussion and analysis of financial condition and results of operations continued

up from 175 days at the beginning of 2010, when expressed in ruble terms. This increase in turnover days is primarily attributable to seasonal fluctuations applicable to our drilling business. The increase in the balance as of June 30, 2010 is due to an increase in lower turnover items necessary for the summer drilling campaign.

## Liquidity and capital resources

The Company's primary sources of liquidity are cash generated from operating activities and debt financing. The Company's plan going forward is to finance its capital expenditures, interest payments and dividends primarily out of operating cash flows as well as to finance a portion of its capital expenditures through existing and prospective future credit facilities.

## Cash flows

The table below shows our net cash flows from operating, investing and financing activities for the six month periods ended June 30, 2010 and 2009 (in thousands of US dollars, unaudited):

	2010	2009
Net cash provided by operating activities	109,599	168,931
Net cash used in investing activities	(134,199)	(64,283)
Net cash used in financing activities	(18,673)	(103,410)

## Operating activities

Net cash provided by operating activities amounted to US \$109.6 million for the period ended June 30, 2010, as compared to US \$168.9 million for the six month ended June 30, 2009. This decrease in cash flows provided by operating activities is principally due to a net negative change in the components of operating assets and liabilities for the 2010 Interim Period compared to the equivalent 2009 period. The most significant factor contributing to this change is an increase in accounts receivable and inventory attributed to the overall increase in the volume of the drilling services during the 1H2010 as compared to the contraction of the volume during the 1H2009. Another factor causing the growth in accounts receivable is our capacity to drill ahead of the schedule.

## Investing activities

Net cash used in investing activities amounted to US \$134.2 million for the period ended June 30, 2010, as compared to US \$64.3 million for the comparable six month period of 2009. The increase is mostly attributable to our desire to capitalise on the growth opportunities in our markets by significantly increasing our investments in new property, plant and equipment for new projects as well as acquiring new businesses to diversify and expand our service lines.

## Financing activities

Net cash used in financing activities amounted to US \$18.7 million for the 2010 Interim Period, as compared to net cash used of US \$103.4 million for the respective 2009 period. During both periods, dividends were paid and principal repayments of long term debt were made. The primary difference between the periods is the result of principal repayments of short term debt and purchase of treasury stock in the six month period of 2009 as opposed to the sale of all the treasury stock in the 2010 Interim Period and payment of a special dividend in the approximate amount of the gain generated on the Company's repurchased GDRs. For further details on the transaction, refer to section Overview of other matters.

## Liquidity

The table below shows our cash and cash equivalents for the period ended June 30, 2010 and the year ended 2009 (in thousands of US dollars, unaudited):

	2010	2009
Short-term deposit Russian rubles	155,531	115,789
Short-term deposit US dollars	135,974	212,485
Cash held in banks other currencies	54,481	60,000
Cash held in banks – Russian rubles	36,895	44,110
Other	289	1,340
<b>Total cash and cash equivalents</b>	<b>383,170</b>	<b>433,724</b>

Our cash flow in the short term can be negatively affected by the level of expenditures we are required to make in the fourth and first quarter of each year to mobilise our rigs, crews and equipment to drilling sites.

## Capital expenditures

Our business is capital intensive and expenditures are primarily required to (i) purchase new drilling rigs and other equipment and (ii) upgrade and modernise the technical characteristics of our existing drilling rigs and equipment. For the period ended June 30, 2010 and for the year ended December 31, 2009 advances outstanding for property, plant and equipment amounted to the following (in thousands of US dollars, unaudited):

	2010	2009
Advances given for property, plant and equipment	8,703	15,779

The amounts represent cash advances for property, plant and equipment not yet received.

# Management's discussion and analysis of financial condition and results of operations continued

The table below presents the amounts invested in construction, which is still in progress for the above described periods (in thousands of US dollars, unaudited):

	2010	2009
Construction in progress	<b>41,230</b>	73,997

As of June 30, 2010, the Company had on deposit restricted cash of approximately US \$61.7 million to secure letters of credit opened for the purpose of purchasing new drilling rigs to be delivered in 2010-2011.

## Capital resources

For the period ended June 30, 2010 and for the year ended December 31, 2009 our short-term and long-term debt amounted to the following (in thousands of US dollars, unaudited) (please see our 2010 Interim Consolidated Financial Statements and the accompanying notes for more detail):

	2010	2009
Short-term debt and current portion of long-term debt	<b>37,432</b>	31,796
Long-term debt	<b>126,470</b>	150,379

We believe we have sufficient working capital to meet our requirements for at least the next 12 months. We also expect to meet our contractual payment obligation requirements for at least the next 12 months with cash flows from our operations and other financing arrangements.

## Overview of other matters

### Dividend policy and year-end 2009 dividend declaration

Our ability to pay dividends depends primarily on the amount of cash we have on-hand and on the receipt of dividends and distributions from our subsidiaries. The payment of dividends by our subsidiaries is contingent upon the sufficiency of their earnings, cash flows and distributable reserves and the ability of our subsidiaries to make, in accordance with relevant legislation, Company law, exchange controls and contractual restrictions, dividend payments and other types of distributions to us.

In August 2007, we adopted a dividend policy according to which we expect to declare and pay dividends each year based on the Company's earnings and the cash needs of the business.

Consistent with this policy, on December 15, 2009, we declared a dividend of US \$0.25 per share, which was included in 'Accounts payable and accrued liabilities' in the consolidated balance sheet as of December 31, 2009 and was paid in January 2010. In addition, on April 15, 2010 the Company announced a one-time special interim dividend of US \$1.22 per share which reflected the approximate gain realised by the Group during its buy-back program. Refer to next paragraph for further details.

## Treasury shares

In October 2008, we announced a stock buy-back program in response to the unprecedented reduction in the market price for our shares caused by the virtual collapse of the world-wide credit and equity markets and wholesale rotation out of Russian equities. Between the start of the program and the end of the 2008 we repurchased approximately 9.6 million shares, representing approximately 6.5% of our shares outstanding before the commencement of the program. The repurchase program continued on into the first seven months of 2009 such that by the end of July 2009 we had repurchased a cumulative total of approximately 12.5 million shares of our stock, representing approximately 8.5% of our shares outstanding before the commencement of the program.

Early in 2010 we awarded approximately 719 thousand of these shares to our officers under the Incentive Share Plan.

In April 2010 the remaining treasury shares were successfully placed back in the market using an accelerated book build process. EDC decided to pay a Special Interim Dividend in order for shareholders to benefit from the gain generated on the Company's repurchased GDRs. The size of the Special Interim Dividend was approximately equal to the gain realised by EDC during share buy back program. On April 15 the Special Dividend was announced to be US \$1.22 per share or US \$179 million. The dividend was fully paid on May 19, 2010.

## Earnings per share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the reporting periods. Diluted Earnings per Share reflect shares that may be issued contingent upon stock price performance under the terms of the Incentive Share Plan.

The calculation of earnings per share for the first six months of 2009 and 2010 was as follows:

	2010	2009
Net income available for common stockholders	<b>104,810</b>	78,392
Weighted average number of outstanding shares	<b>139,395,511</b>	135,814,029
Basic earnings per share of common stock (US dollars)	<b>0.75</b>	0.58
Contingent shares of stock incentive program	<b>588,585</b>	983,494
Weighted average number of outstanding shares, after dilution	<b>139,984,096</b>	136,797,523
Diluted earnings per share of common stock (US dollars)	<b>0.75</b>	0.57



# Management's discussion and analysis of financial condition and results of operations continued

## Related party transactions

### Shareholder loans

In the period from November 2006 through March 2007, the Company entered into loan agreements with its shareholders to partially fund the investment program of our onshore drilling services division and the purchase of our offshore drilling services business. The aggregate principal amount of such loans was US \$70.0 million. The loans mature on December 31, 2011 and incur interest at the rate of 8.6% per annum. Interest expense of US \$3 million and US \$3 million was recognised and paid on these loans during the six months ended June 30, 2010 and 2009, respectively. The loans are denominated in US dollars. Management believes the terms of these loans are no less onerous than those which would have been negotiated in an arms-length negotiation.

### Legal services

The Company's General Counsel, Douglas Stinemetz, is a partner with The Stinemetz Law Firm (the Firm). During the first six months of 2010 and 2009 the Firm billed EDC for costs and expenses of US \$0.7 million and US \$0.5 million respectively. All services were billed at a discount to the Firm's normal billing rates while expenses were billed at their actual cost. In addition the amounts paid to The Stinemetz Law Firm include considerable third party expenses and charges for the services of other lawyers. Mr. Stinemetz is not otherwise paid for his services as the Company's general counsel. Management believes the amounts paid for these legal services are no more onerous than those which would have been negotiated in an arms-length negotiation for a similar level of service and expertise.

### Off-balance sheet arrangements

The Company does not have off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on its financial condition, revenues, expenses, results of operations, liquidity, capital expenditures or capital resources.

## Certain factors affecting our financial performance

### Changes in crude oil and natural gas prices

The prices of crude oil and natural gas in Russia can have a significant impact on our results of operations. World prices for crude oil are characterised by significant fluctuations that are determined by the global balance of supply and demand. However, Russian natural gas prices are regulated by the Russian government. While Russian natural gas prices have increased in recent years, and are expected to continue to rise to a level closer to parity with export netbacks, they are still significantly below world levels. A substantial or an extended decline in crude oil and natural gas prices could result in lower capital expenditures by our customers, and consequently, a reduction in the number of wells to be drilled by oil and gas companies. Such a pattern of sequential downward and upward changes of our customers'

capital expenditures has caused the results of our drilling operations to vary significantly from year to year during the life of the Company. The results of our workover operations tend to be less sensitive to the fluctuations in crude oil and natural gas prices, as our clients require such services both during periods of high and low oil prices.

### Productivity

Our results of operations are affected by the productivity of our crews. For the period ended June 30, 2010, each of our active drilling crews drilled on average approximately 36,735 metres as compared to 39,537 metres for the period ended June 30, 2009, computed on an annualised basis. This apparent decrease in productivity per crew for the first half of 2010 was caused by a change in our clients served and in the mix of services provided to those clients. The major contributing factors were as follows:

- Our average well depth in West Siberia increased by approximately 100 metres in 2010 versus 2009. Deeper wells take disproportionately more time to drill;
- Our average well design was somewhat more complicated in 2010 than 2009 with larger step outs and longer horizontal sections. Such wells take longer to drill than wells of a more simple design;
- Our newer clients tend to develop their oil fields with smaller drilling pads. Smaller pads require more frequent moves which decreases overall drilling efficiency;
- We began to work with more new clients in 2010 than in 2009. It generally takes time with new clients to optimise efficiency;
- We drilled twice as many exploration wells in 2010 than in 2009. Exploration wells are inherently less efficient to drill than production wells;
- The beginning of 2010 was much colder than the corresponding period of 2009, resulting in lost drilling time. For more information on seasonality, refer to the paragraph on 'Seasonality' on the next page.

Overall, we believe our core productivity per crew was better in 2010 when compared to the same period of 2009. Over the medium-term to long-term we expect our efficiency to continue to improve due to the ongoing implementation and utilisation of more advanced drilling technologies and the application of new standards to our drilling operations. Advanced crew training and application of innovative technologies allowed us to both improve Rates of Penetration (ROP) and reduce Non-Productive Time (NPT). Examples of technological advancements included wider usage of Polycrystalline Diamond Compact (PDC) drill bits, introduction of new generation drilling motors, optimisation of BHAs and mud programs/properties, and real-time drilling navigation. The use of top-drives and four-step drilling mud cleaning systems on our high specification rigs further improved ROP and efficiency in the increasingly more challenging wells we are drilling.

# Management's discussion and analysis of financial condition and results of operations continued

## Operating capacity

Our revenue growth can be negatively affected by the number of drilling rigs and drilling crews available to us. During 2008 our ability to increase our onshore business depended on our ability to procure sufficient numbers of new drilling rigs and modernise our existing drilling rigs. As such, during 2008 we purchased six drilling rigs and committed to purchase a further nine drilling rigs for delivery in 2009/10 (including one to be fabricated at our Kaliningrad facility). During the first half of 2008, the global demand for new drilling rigs and rig modernisation services substantially exceeded their supply. However, as 2008 progressed, the demand for new drilling rigs and modernisation services was substantially reduced as the demand for drilling services in most areas of the world, including in Russia, declined rapidly. As demand for the drilling services recovers in Russia and as we see potential for expansion in geographic areas outside of the CIS we have placed orders for seven new rigs for delivery in 2010/11. Our drilling fleet as of June 30, 2010 consisted of 208 land drilling rigs and one offshore jack-up drilling rig in the Caspian Sea, as described above. At the end of the first half of 2010 we believed we had sufficient capacity with the addition of the new rigs to our drilling fleet and our increased drilling efficiency to drill over 4.5 million metres on an annual basis.

## Seasonality

Our revenue from onshore and offshore drilling services can be negatively affected by severe winter weather conditions in certain regions of Russia that make oil and gas operations difficult to non-operational during that season. For example, during January and February 2010, Russia experienced severely cold temperatures of approximately  $-45^{\circ}$  Celsius in certain regions where we operate and the lost drilling time during such period amounted to approximately 65 days, which was equivalent to the loss of use of one drilling crew for one calendar month, and which contributed to delays in the mobilisation of our equipment and service commencement dates. Our revenue from onshore drilling services may also be negatively affected by spring thawing because drilling rigs, equipment and materials situated in certain regions can only be transported during winter when the ground is sufficiently frozen to create access roads. As a result, a portion of our business activity in the fourth and first quarter of each year is devoted to transportation of drilling rigs, equipment and materials and we experience a decrease in revenues while continuing to incur costs. If we fail to complete a drilling contract on time or are unable to move our equipment due to adverse weather conditions, our ability to timely commence drilling at another site may be impeded. However, the effect of severe weather conditions on our operations depends on the specific type of service being provided. For instance, our onshore exploration drilling services are most affected by adverse weather conditions, as our drilling rigs, equipment, materials and crews that are required for such services are mobilised to remote locations accessible only by winter roads

or helicopters. On the other hand, onshore production drilling services tend to be less affected by adverse weather conditions due to the cluster drilling method utilised by us, which involves drilling multiple wells from a single drilling pad. With respect to such drilling method, our operations may be temporarily disrupted by adverse weather conditions in the event we are unable to operate our rigs or mobilise required supplies to rig sites. With respect to our offshore division, we are generally unable to perform drilling services in the Russian and Kazakh sectors of the Caspian Sea during winter months due to the presence of ice. However, the Yuri Korchagin platform is ice-resistant, which will allow us to drill there year-round.

## Market trends

After EDC acquired the onshore drilling assets from LUKOIL in December 2004, drilling volumes in Russia grew at a fairly steady pace through the end of 2007. According to data published by CDU TEK, during the 2005 through 2007 period total metres drilled onshore Russia grew by a Compound Annual Growth Rate (CAGR) of 17.6%. Drilling volume growth slowed in 2008, however, to 5.7% above 2007 levels. CDU TEK crude oil production figures for Russia show a similar trend, with 2.3% CAGR in total Russian oil production over the 2005 through 2007 period, and a 0.6% production decline in 2008 v. 2007. Considering the maturity of Russia's major oil producing fields, the drilling volume to oil production results of recent years as discussed above suggest that drilling volumes must continue to grow in order to stem future production declines.

During the first half of 2010, CDU TEK data indicated that overall Russian drilling volumes increased by 14% as compared to the corresponding period of 2009, while oil production increased by 2.9% during first six months of 2010 versus the corresponding period of 2009. This increase in production was primarily attributable to new Greenfield production that came on-stream in 2009, that compensated for a decrease in Brownfield oil production. As discussed above, seasonality affects drilling operations in Russia, with drilling volumes achieved in the 2nd and 3rd quarters of each year being substantially higher than 1st and 4th quarter levels in a typical year. During 2008, drilling volumes surged more than is typical in the middle portion of the year due to both seasonality effects and the run up in oil prices. During 2009 the seasonal pattern was more modest, but the first six months of 2010 were characterised by similar seasonality trends as in 2008.

## Change in mix of services

Because margins can vary significantly amongst the services we provide, our results of operations are affected by changes in the mix of onshore and offshore drilling and workover services we provide to our customers. The services we provide in our onshore division have expanded from offering primarily conventional production and exploration drilling

## Management's discussion and analysis of financial condition and results of operations continued

services in January 2005 to offering a wider range of higher margin drilling and workover services, including sidetracking and horizontal drilling.

For example, during the first six months of 2010, we drilled 171 thousand metres utilising the horizontal drilling technique, while in the corresponding period of 2009 our horizontal drilling operations were 166 thousand metres.

### Price optimisation

Our revenue growth depends on our ability to charge clients market prices for our onshore and offshore drilling and other services. The original LUKOIL Framework Agreement, valid from 2005 through 2009, established a pricing adjustment formula applicable to the onshore drilling services we provided to LUKOIL. Such pricing formula effectively limited our ability to adjust the prices related to our onshore drilling services for LUKOIL in order to reflect fluctuations in the market prices occurring prior to the following annual price adjustment. However, we considered that the prices at which we provided services pursuant to the LUKOIL Framework Agreement were acceptable given the volume of services provided. In addition, we believe that the contracts we enter into with our other customers provide us with greater flexibility to adjust such contract prices to better conform to current market levels. In January 2010 we signed a new Framework Agreement with LUKOIL as described in more detail above.

### Quantitative and qualitative disclosure about market risk

Our assessment of risks has not changed materially since the publication of 2009 Management Discussion and Analysis on April 12, 2010. Please refer to our 2009 Management Discussion and Analysis available on our website, for a thorough discussion of our risk assessment.

### Outlook

During the second half of 2009 the oil prices started to recover from their precipitous fall during the first half of 2009 and recovered and essentially stabilised during the first half of 2010. Whether the price will remain stable is unknown, but it is useful to note that the NYMEX futures prices for crude oil indicate that the price is expected to increase through the middle of this decade.

Our guidance for the 2010 remains unchanged and we expect our full year 2010 drilling volumes to increase by at least 5% and be close to four million metres. In response to this expected increase in drilling volumes we are increasing our capital expenditures budget for 2010 as compared to 2009. We expect our capital expenditures for the year to be in the range of US \$200-US \$250 million including acquisition of seven new rigs for operations onshore Russia and outside the CIS, but excluding any potential acquisitions. We continue to focus on payroll costs, inventory costs and the cost of our third party services.

Against this background the company will continue to identify growth opportunities and will follow a disciplined investment policy to capitalise on any such opportunities that may arise. The Company remains committed to technology leadership and will continue to focus its investments, complemented with strategic acquisitions, on high-value, high-growth opportunities.

We will further concentrate our efforts on increasing our customer base. Strong performance in our core areas has opened new markets and potential clients to us in Russia and the CIS. In 2009 we provided drilling services to new clients in Russia including RussNeft and Samara-Nafta. Further in 2010 we expanded our customer base with important contracts with Pechoraneft and Rusvietpetro. Contract for drilling services with TNK-BP signed in 2010 were also a significant achievement for us. We continue to differentiate ourselves from our competitors in our domestic markets to win work with new clients and in developing basins. We are aggressively targeting new international markets in the Middle East, initially in Iraq.

Many commentators believe Russian drilling volumes will continue to increase in 2010 and later years in response to the aging of oil fields, especially in Western Siberia. During the first six months of 2010 Russian drilling volumes increased by 14% over the comparable 2009 period. Our market share slightly decreased during the first six months of 2010 to 24% caused by aggressive drilling programs by in-house drilling divisions of certain exploration and production companies. We expect to maintain our current market share during the rest of the year. We are determined to resume the growth of our market share in Russia, both organically and through targeted acquisitions.

Recent appreciation in the Russian ruble with respect to the US dollar is expected to improve our reported results for 2010 over 2009 as most commentators are confident the ruble will stay relatively strong in 2010 as compared to 2009.

Lastly, we continued our operations on LUKOIL's Yuri Korchagin field platform where we spudded the fourth well. This multi-year development started in the fourth quarter of 2009 and utilises cutting-edge drilling techniques and technologies. We believe development of this field will further showcase EDC as the premier drilling company in our areas of operation.

We anticipate 2010 will continue to be a year of growth on all fronts and expect to maintain solid performance through increasing sales and improving margins in most areas of our business.

## Independent accountants' review report

### **The Board of Directors**

#### **Eurasia Drilling Company Limited**

We have reviewed the accompanying interim consolidated balance sheet of Eurasia Drilling Company Limited and its subsidiaries ('the Company') as of June 30, 2010 and the related interim consolidated statements of income and interim consolidated statements of cash flows for the six-month periods ended June 30, 2010 and 2009. This interim financial information is the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial information for them to be in conformity with accounting principles generally accepted in the United States of America.

#### **ZAO KPMG**

August 27, 2010

## Interim consolidated balance sheets

(all amounts in thousands of US dollars, unless otherwise noted)

	Note	As of June 30, 2010 (unaudited)	As of December 31, 2009
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	4	383,170	433,724
Accounts receivable, net	5	225,885	191,054
Inventories	6	140,062	116,801
Taxes receivable		25,010	35,772
Deferred income tax assets		8,484	11,227
Other current assets		15,487	6,271
<b>Total current assets</b>		<b>798,098</b>	<b>794,849</b>
Property, plant and equipment	7	656,331	684,188
Long-term accounts receivable		8,654	4,013
Deferred income tax assets		1,106	277
Goodwill	16	38,837	30,792
Other non-current assets	8	68,442	9,289
<b>Total assets</b>		<b>1,571,468</b>	<b>1,523,408</b>
<b>Liabilities and stockholders' equity</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		185,513	228,499
Advances received		21,125	37,239
Short-term debt and current portion of long-term debt	9	37,432	31,796
Taxes payable		58,315	53,463
Deferred income tax liabilities		3,215	–
<b>Total current liabilities</b>		<b>305,600</b>	<b>350,997</b>
Long-term debt	10	126,470	150,379
Accrued pension liability		4,189	3,865
Deferred income tax liabilities		18,520	16,009
<b>Total liabilities</b>		<b>454,779</b>	<b>521,250</b>
<b>Stockholders' equity</b>	14		
Common stock		1,469	1,469
Treasury stock, at cost		–	(58,332)
Additional paid-in capital		689,520	528,163
Retained earnings		520,639	596,340
Accumulated other comprehensive loss		(94,939)	(65,482)
<b>Total stockholders' equity</b>		<b>1,116,689</b>	<b>1,002,158</b>
<b>Total liabilities and stockholders' equity</b>		<b>1,571,468</b>	<b>1,523,408</b>

### W. Richard Anderson

CFO of Eurasia Drilling Company Limited  
August 27, 2010

## Interim consolidated statements of income

(all amounts in thousands of US dollars, unless otherwise noted)

	Note	For the six months ended June 30, 2010 (unaudited)	For the six months ended June 30, 2009 (unaudited)
<b>Revenues</b>			
Drilling and related services		853,572	666,086
Other sales and services		8,441	7,102
<b>Total revenues</b>		<b>862,013</b>	<b>673,188</b>
Cost of services	13	(555,368)	(449,022)
Selling, general and administrative expenses		(54,659)	(43,944)
Taxes other than income taxes		(45,698)	(32,376)
Depreciation		(67,127)	(49,791)
Gain on disposal of property, plant and equipment		5,790	688
<b>Income from operating activities</b>		<b>144,951</b>	<b>98,743</b>
Interest expense		(7,629)	(7,530)
Interest income		6,531	3,655
Currency transaction (loss) gain		(1,870)	5,328
Other income (expenses)		55	(364)
<b>Income before income taxes</b>		<b>142,038</b>	<b>99,832</b>
Current income taxes		(29,234)	(23,083)
Deferred income taxes		(7,994)	1,643
<b>Total income tax expense</b>	3	<b>(37,228)</b>	<b>(21,440)</b>
<b>Net income</b>		<b>104,810</b>	<b>78,392</b>
Basic earnings per share of common stock (US dollars)	14	0.75	0.58
Diluted earnings per share of common stock (US dollars)	14	0.75	0.57

# Interim consolidated statements of cash flows

(all amounts in thousands of US dollars, unless otherwise noted)

	Note	For the six months ended June 30, 2010 (unaudited)	For the six months ended June 30, 2009 (unaudited)
<b>Cash flows from operating activities</b>			
<b>Net income</b>		<b>104,810</b>	78,392
Adjustments for non-cash items:			
Depreciation		67,127	49,791
Accrued interest expense		1,770	538
Deferred income taxes		7,994	(1,643)
Gain on disposal of property, plant and equipment		(5,790)	(688)
Gain on sale of share in subsidiary		(970)	–
Allowance for doubtful accounts receivable		4,123	7,305
Foreign currency exchange rate difference (unrealised)		(644)	(7,285)
Incentive plan		2,100	2,100
All other items – net		(373)	6
Changes in operating assets and liabilities:			
Accounts receivable		(45,577)	502
Inventories		(25,249)	36,393
Taxes receivable		10,187	7,064
Other current assets		(9,470)	2,302
Accounts payable and accrued liabilities		9,389	(20,246)
Advances received		(15,544)	6,635
Taxes payable		7,036	8,072
Other liabilities		(1,320)	(307)
<b>Net cash from operating activities</b>		<b>109,599</b>	168,931
<b>Cash flows from investing activities</b>			
Purchases of property, plant and equipment		(60,220)	(123,550)
Change in restricted cash		(59,092)	57,394
Proceeds from sale of property, plant and equipment		8,140	1,873
Sale of share in subsidiary, net of cash disposed		754	–
Acquisition of subsidiaries, net of cash acquired		(23,781)	–
<b>Net cash used in investing activities</b>		<b>(134,199)</b>	(64,283)
<b>Cash flows from financing activities</b>			
Principal repayments of short-term debt		–	(45,366)
Principal repayments of long-term debt		(23,201)	(15,166)
Repayment of capital lease obligations		(275)	(1,915)
Dividends paid		(212,786)	(34,327)
Proceeds from sale of treasury stock		217,589	–
Purchase of treasury stock		–	(6,636)
<b>Net cash used in financing activities</b>		<b>(18,673)</b>	(103,410)
Effect of exchange rate changes on cash		(7,281)	(2,163)
<b>Net decrease in cash and cash equivalents</b>		<b>(50,554)</b>	(925)
Cash and cash equivalents at beginning of period		433,724	279,430
<b>Cash and cash equivalents at end of period</b>	4	<b>383,170</b>	278,505
<b>Supplemental disclosures of cash flow information</b>			
Interest paid		4,429	7,851
Income tax paid		11,969	9,418

# Notes to the interim consolidated financial statements (unaudited)

(all amounts in thousands of US dollars, unless otherwise noted)

## Note 1. Basis of financial statement presentation

The accompanying interim consolidated financial statements and notes thereto of Eurasia Drilling Company Limited (the 'Company') and its subsidiaries (together, the 'Group') have not been audited by independent accountants, except for the balance sheet as of December 31, 2009. In the opinion of the Company's management, the interim consolidated financial statements include all adjustments and disclosures necessary to present fairly the Group's financial position, results of operations and cash flows for the interim periods reported herein. These adjustments were of a normal recurring nature.

These interim consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ('US GAAP'). These financial statements should be read in conjunction with the Group's December 31, 2009 annual consolidated financial statements. The interim consolidated financial statements have been prepared following the accounting policies applied and disclosed in the December 31, 2009 consolidated financial statements.

The results for the six-month period ended June 30, 2010 are not necessarily indicative of the results expected for the full year.

### Functional and reporting currency

The functional currency of the Company and its subsidiaries, except for OOO Burovaya Kompaniya Eurasia, OOO Kliver, OOO NTS, OOO TGS, OOO KWWD, OOO UWWD, OOO Meridian and TOO BKE Kazakhstan Burenie, is the US dollar. The functional currency of OOO Burovaya Kompaniya Eurasia, OOO Kliver, OOO NTS, OOO TGS, OOO KWWD, OOO UWWD and OOO Meridian is the Russian ruble and the functional currency of TOO BKE Kazakhstan Burenie is the Kazakh Tenge because these are the currencies of the primary economic environments in which they operate and in which cash is generated and expended. The Group's reporting currency is the US dollar.

The closing exchange rate as of June 30, 2010 and December 31, 2009 was 31.1954 and 30.2442 Russian rubles to one US dollar, respectively.

## Note 2. Recent accounting pronouncements

In February 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-09, '*Subsequent events*' which amends Accounting Standards Codification (ASC) No. 855 (former SFAS No. 165, '*Subsequent events*'), issued in May 2009. The Group adopted ASC No. 855 starting from the second quarter of 2009. These standards address accounting and disclosure requirements related to subsequent events and require management of an entity which is an SEC filer or is a conduit bond obligator for conduit securities that are traded in a public market to evaluate subsequent event through the date that the financial statements are issued. Entities that do not meet these criteria should evaluate subsequent events through the date the financial statements are available to be issued and are required to disclose the date through which subsequent events have been evaluated. The Group determined that it should evaluate subsequent events through the date the financial statements are available to be issued and applied the requirements of ASU No. 2010-09 starting from the financial statements for 2009.

In January 2010, the FASB issued ASU No. 2010-06, '*Improving Disclosures about Fair Value Measurements*,' which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information about purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. This ASU also clarifies existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. ASU No. 2010-06 is effective for interim and annual reporting periods beginning after December 15, 2009, except for the detailed Level 3 roll forward disclosures (which are effective for the annual reporting periods starting after December 15, 2010 and for interim periods within those annual reporting periods). The Group adopted the requirements of ASU No. 2010-06 (except for the detailed Level 3 roll forward disclosures) starting from the first quarter of 2010. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In January 2010, the FASB issued ASU No. 2010-02, '*Accounting and Reporting for Decreases in Ownership of a Subsidiary – A Scope Clarification*' to clarify the scope of ASC Subtopic No. 810-10, '*Consolidation – Overall*.' This ASU specifies that the guidance in ASC Subtopic No. 810-10 on accounting for decreases in ownership of a subsidiary applies to: (1) a subsidiary or group of assets that constitutes a business or nonprofit activity; (2) a subsidiary that is a business or a nonprofit activity that is transferred to an equity method investee or a joint venture; and (3) an exchange of a group of assets that constitute a business or nonprofit activity for a non-controlling interest in an entity. If a company's ownership interest in a subsidiary that is not a business or nonprofit activity decreases, then other accounting guidance generally would be applied based on the nature of the transaction. The new pronouncement also clarifies that the recent guidance on accounting for decreases in ownership of a subsidiary does not apply if the transaction is a sale of in-substance real estate or a conveyance of oil and gas properties. This ASU is effective for interim and annual periods ending after December 15, 2009 and the guidance should be applied on a retrospective basis to the first period in which the company adopted ASC No. 810. The Group adopted ASU No. 2010-02 for the 2009 annual financial statements. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.



# Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

## Note 2. Recent accounting pronouncements continued

In January 2010, the FASB issued ASU No. 2010-01, 'Accounting for Distributions to Shareholders with Components of Stock and Cash' which addresses how an entity should account for the stock portion of a dividend in certain arrangements when a shareholder makes an election to receive cash or stock, subject to limitations on the amount of the dividend to be issued in cash. The stock portion of the dividend should be accounted for as a stock issuance upon distribution, resulting in basic earnings per share being adjusted prospectively. Prior to distribution, the entity's obligation to issue shares would be reflected in diluted earnings-per-share based on the guidance in ASC No. 260, which addresses contracts that may be settled in shares. This ASU is effective for interim and annual periods ending after December 15, 2009. The Group adopted ASU No. 2010-01 for the 2009 annual financial statements. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In December 2009, the FASB issued ASU No. 2009-17, 'Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities,' which amends the guidance on variable interest entities in ASC No. 810. This ASU changes the approach to determining a variable interest entity's (VIE) primary beneficiary from a quantitative assessment to a qualitative assessment designed to identify a controlling financial interest, and increases the frequency of required reassessments to determine whether an entity is the primary beneficiary of a VIE. ASU No. 2009-17 also clarifies, but does not significantly change, the characteristics that identify a VIE. ASU No. 2009-17 is effective as of the beginning of a company's first fiscal year that begins after November 15, 2009, and for subsequent interim and annual reporting periods. The Group adopted the requirements of ASU No. 2009-17 starting from the first quarter of 2010. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In August 2009, the FASB issued ASU No. 2009-05, 'Measuring Liabilities at Fair Value,' which amends Subtopic No. 820-10, 'Fair Value Measurements and Disclosures – Overall' for the fair value measurements of liabilities. ASU No. 2009-05 provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following techniques: valuation based on the quoted price of the identical liability when traded as an asset; valuation based on quoted prices for similar liabilities or similar liabilities when traded as an asset, or another valuation technique that is consistent with the principles of Topic 820 (such as present value technique or price for the identical liability). This ASU also clarifies that an entity is not required to include a separate input relating to the existence of a restriction that prevents the transfer of the liability. ASU No. 2009-05 is effective for the first interim or annual reporting periods after its publication. The Group adopted the requirements of ASU No. 2009-05 starting from the financial statements for 2009. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In June 2009, the FASB issued ASC No. 105 (former SFAS No. 168, 'The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles'). The FASB Accounting Standards Codification ('Codification') is the exclusive authoritative reference for US GAAP recognised by the FASB and applied by nongovernmental entities, except for SEC rules and interpretive releases, which are also authoritative US GAAP for SEC registrants. The change established by ASC No. 105 divides nongovernmental US GAAP into authoritative Codification and guidance that is not authoritative. The contents of the Codification carry the same level of authority, eliminating the four-level US GAAP hierarchy previously set forth in SFAS No. 162. The Codification supersedes all non-SEC accounting and reporting standards. All other non-grandfathered, non-SEC accounting literature not included in the Codification became non-authoritative. This Statement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Group adopted ASC No. 105 for the 2009 annual financial statements. This adoption did not have any impact on the Group's results of operations, financial position or cash flows.

In March 2008, the FASB issued ASC No. 815 (former SFAS No. 161, 'Disclosures about Derivative Instruments and Hedging Activities'). This ASC improves financial reporting about derivative instruments and hedging activities by enhanced disclosures of their effects on an entity's financial position, financial performance and cash flows. The Group adopted the provisions of ASC No. 815 starting from the first quarter of 2009. This adoption did not have any impact on the Group's results of operations, financial position or cash flows.

In December 2007, the FASB issued ASC No. 810 (former SFAS No. 160, 'Non-controlling Interests in Consolidated Financial Statements – an amendment of ARB No. 51'). This ASC applies to all entities that prepare consolidated financial statements (except not-for-profit organisations) and affects those which have an outstanding non-controlling interest (or minority interest) in their subsidiaries or which have to deconsolidate a subsidiary. This ASC changes the classification of a non-controlling interest; establishing a single method of accounting for changes in the parent company's ownership interest that does not result in deconsolidation and requires a parent company to recognise a gain or loss when a subsidiary is deconsolidated. The Group prospectively adopted the provisions of ASC No. 810 in the first quarter of 2009, except for the presentation and disclosure requirements which were applied retrospectively. This adoption did not have any impact on the Group's results of operations, financial position or cash flows.

# Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

## Note 3. Income taxes

Operations in the Russian Federation are subject to a Federal income tax rate of 2.0% and a regional income tax rate that varies from 13.5% to 18.0% at the discretion of the individual regional administration.

The Groups' operations outside the Russian Federation are subject to the following rates of income tax:

Kazakhstan	30%-40%
Turkmenistan	20%
Cyprus	10%
Cayman Islands and British Virgin Islands	0%

The majority of the Group's earnings for the periods ended June 30, 2010 and 2009 were taxed in the Russian Federation.

The Group's effective income tax rates for the periods ended June 30, 2010 and 2009 differ from the statutory income tax rate primarily due to the incurrence of costs that are either not tax deductible or only deductible to a certain limit.

The increase of the effective income tax rate in the period ended June 30, 2010 is caused primarily by a 5% foreign withholding tax on intercompany dividends declared in the amount of RUR 5.0 billion which at the US dollar exchange rate as of June 30, 2010 amount to US \$160.3 million. During the reporting period RUR 3.0 billion was remitted, RUR 2.0 billion was remitted in July of 2010 for which deferred tax liability in the amount of US \$3.2 million was accrued as of June 30, 2010.

The Company will change its intercompany dividend policy starting July 1, 2010 and will recognise deferred income tax on 20% of the undistributed earnings of its Russian subsidiary OOO Burovaya Kompaniya Eurasia. The remaining earnings of its Russian subsidiaries are considered to be reinvested indefinitely.

The Group's accounting policy is to record penalties and interest related to unrecognised tax benefit as components of income tax expense.

## Note 4. Cash and cash equivalents

Cash and cash equivalents include the following:

	As of June 30, 2010	As of December 31, 2009
Short-term deposit – Russian rubles	155,531	212,485
Short-term deposit – US dollars	135,974	115,789
Cash held in banks – other currencies	54,481	60,000
Cash held in banks – Russian rubles	36,895	44,110
Other	289	1,340
<b>Total cash and cash equivalents</b>	<b>383,170</b>	<b>433,724</b>

## Note 5. Accounts receivable, net

Accounts receivable include the following:

	As of June 30, 2010	As of December 31, 2009
Trade accounts receivable	241,076	201,321
Advances given	6,583	8,100
	247,659	209,421
Allowance for doubtful accounts	(21,774)	(18,367)
<b>Total accounts receivable, net</b>	<b>225,885</b>	<b>191,054</b>

## Note 6. Inventories

Inventories include the following:

	As of June 30, 2010	As of December 31, 2009
Materials for drilling and workover	122,508	110,000
Work in progress	17,554	6,801
<b>Total inventories</b>	<b>140,062</b>	<b>116,801</b>

# Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

## Note 7. Property, plant and equipment

Property, plant and equipment include the following:

	As of June 30, 2010	As of December 31, 2009
Machinery and equipment	859,895	787,989
Buildings	31,589	32,017
Vehicles	21,836	25,586
	<b>913,320</b>	845,592
Less: accumulated depreciation	<b>(306,922)</b>	(251,180)
Construction in progress	41,230	73,997
Advances given for property, plant and equipment	8,703	15,779
<b>Total property, plant and equipment</b>	<b>656,331</b>	684,188

## Note 8. Restricted cash

The Group had restricted cash of US \$61.7 million and US \$2.6 million included in other non-current assets as of June 30, 2010 and December 31, 2009, respectively. This amount collateralises the Company's issuance of commercial letters of credit.

## Note 9. Short-term debt and current portion of long-term debt

Short-term debt and current portion of long-term debt includes the following:

	As of June 30, 2010	As of December 31, 2009
Current portion of long-term debt (note 10)	37,176	31,291
Short-term capital lease obligations	256	505
<b>Total short-term debt and current portion of long-term debt</b>	<b>37,432</b>	31,796

## Note 10. Long-term debt

Long-term debt includes the following:

Lender	Final maturity date	As of June 30, 2010	As of December 31, 2009
<i>Debt of the Company</i>			
Loans from stockholders	2011	70,000	70,000
<i>Debt of the Company's subsidiaries</i>			
OAO AKB Sbergatelnny Bank	2013	56,787	58,573
ZAO UniCredit Bank	2012	16,562	22,208
Loan from individuals	2012	6,392	-
<i>Loans from LUKOIL Group companies</i>			
OOO LUKOIL-West Siberia	2011	10,010	13,292
OOO LUKOIL-Perm	2041	987	1,086
OAO Tebukneft	2014	302	337
OAO Uhtaneft	2015	83	93
OAO Komineft	2010	59	190
OOO LUKOIL-Komi	2010	1	2
OAO LUKOIL	2018	-	12,788
OOO LUKOIL Nizhnevolzhskneft	2010	-	243
<b>Total long-term debt</b>		<b>161,183</b>	178,812
Current portion of long-term debt (note 9)		<b>(37,176)</b>	(31,291)
Long-term capital lease obligation		2,463	2,858
<b>Total non-current long-term debt</b>		<b>126,470</b>	150,379

## Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

### Note 10. Long-term debt continued

#### Stockholders

Long-term loans from stockholders represent loans denominated in US dollars which bear interest at 8.60% and mature on December 31, 2011. These loans were received for the purpose of financing the purchases of property, plant and equipment.

#### Debt of the Company's subsidiaries

##### ОАО АКБ Сберегательный Банк

Long-term debts with ОАО АКБ Сберегательный Банк with an outstanding balance of US \$56.8 million as of June 30, 2010 are denominated in Russian rubles. These debts were given for the issuance of commercial letters of credit with ОАО АКБ Сберегательный Банк. Under the terms of debt agreements, these debts bear interest at 3% per annum on unpaid amount of the letters of credit and at LIBOR plus 4.1% per annum on the remaining amount.

##### ЗАО UniCredit Банк

Long-term debt with ЗАО UniCredit Банк with an outstanding balance of US \$16.6 million is denominated in Russian rubles and bear interest at 8.95% per annum.

#### Individual

Long-term debt from an individual represents a loan denominated in US dollars which bears interest at 0% and mature on May 1, 2012. This debt was given in relation to the acquisition of the new workover company ООО Meridian (refer to Note 16). This loan has been recorded at fair value based on the effective interest rate estimated by the management to be applicable to the Company at the acquisition date which was 13% per annum.

This debt is secured by the shares of ООО Meridian.

#### LUKOIL Group companies

Long-term debt of subsidiaries, denominated in Russian rubles, represent various borrowings from LUKOIL Group Companies. This long-term debt has been recorded at fair value based on effective interest rates estimated by management to be applicable to the Company at the acquisition date, which on average was 12.66% per annum.

Long-term debt of subsidiaries is secured by property, plant and equipment with a carrying amount of US \$59.3 million.

Maturities of long-term debts outstanding at June 30, 2010 are as follows:

	July 1, 2010 to June 30, 2011	July 1, 2011 to December 31, 2011	2012	2013	2014	2015 and thereafter
	37,176	90,905	19,427	12,733	125	817

### Note 11. Pension benefits

Components of net periodic benefit cost were as follows:

	For the six months ended June 30, 2010	For the six months ended June 30, 2009
Interest cost	486	455
Service cost	402	233
Less expected return on plan assets	(358)	(336)
Amortisation of prior service benefit	(65)	–
Recognised actuarial gain	(6)	–
<b>Total net periodic benefit cost</b>	<b>459</b>	<b>352</b>

### Note 12. Fair value of financial instruments

The fair values of all financial instruments are approximately equal to their carrying values as disclosed in the interim consolidated financial statements. Fair values were determined based on discounted cash flows using estimated market interest rates for similar financial arrangements.

# Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

## Note 13. Cost of services

Cost of services includes the following:

	For the six months ended June 30, 2010	For the six months ended June 30, 2009
Services of subcontractors	208,961	158,697
Wages and salaries	159,310	110,985
Materials	102,482	112,137
Fuel and energy	42,221	32,940
Transportation of employees to drilling fields	11,764	11,553
Leasing and rent	4,247	4,729
Other	26,383	17,981
<b>Total cost of services</b>	<b>555,368</b>	<b>449,022</b>

## Note 14. Stockholders' equity

### Common stock

	As of June 30, 2010	As of December 31, 2009
Authorised and issued common stock, par value 0.01 US dollar each	146,865,243	146,865,243
Treasury stock	–	(12,421,825)
<b>Issued and outstanding common stock, par value 0.01 US dollar each</b>	<b>146,865,243</b>	<b>134,443,418</b>

### Dividends and dividends limitations

Profits available for distribution from the Company's Russian subsidiaries to the Company in respect of any reporting period are primarily determined by reference to the statutory financial statements of these subsidiaries prepared in accordance with the laws of the Russian Federation and denominated in Russian rubles. Under Russian Law, dividends are limited to the retained earnings as set out in the statutory financial statements of the Company's Russian subsidiaries. These laws and other legislative acts governing the rights of stockholders to receive dividends are subject to various interpretations.

Retained earnings of the Company's Russian subsidiaries were RUR 18.1 billion and RUR 19.8 billion, respectively as of June 30, 2010 and December 31, 2009, pursuant to the statutory financial statements, which at the US dollar exchange rates as of June 30, 2010 and December 31, 2009 amount to US \$581 million and US \$654 million, respectively.

At the Board of Directors meeting on December 15, 2009, dividends were declared for 2009, in the amount of US \$0.25 per common share. Dividends payable by the Company of US \$34 million were included in 'Accounts payable and accrued liabilities' in the consolidated balance sheet as of December 31, 2009. During the reporting period the dividends were fully paid.

On April 15, 2010 the Company completed a placing of the balance of its GDRs repurchased by the Group as part of its buy-back program at a price of US \$19.00 per GDR. In connection with the placing the Company announced a one-time special interim dividend of US \$179 million which reflects the gain realised by the Group during its buy-back program. During the reporting period the dividends were fully paid.

### Earnings per share

The calculation of earnings per share was as follows:

	For the six months ended June 30, 2010	For the six months ended June 30, 2009
Net income available for common stockholders	104,810	78,392
Weighted average number of outstanding shares	139,395,511	135,814,029
Basic earnings per share of common stock (US dollars)	0.75	0.58
Contingent shares of stock incentive program (Note 20)	588,585	983,494
Weighted average number of outstanding shares, after dilution	139,984,096	136,797,523
Diluted earnings per share of common stock (US dollars)	0.75	0.57

## Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

### Note 15. Comprehensive income

	For the six months ended June 30, 2010	For the six months ended June 30, 2009
Net income	104,810	78,392
Other comprehensive income:		
Foreign currency translation loss	(29,457)	(41,229)
<b>Comprehensive income</b>	<b>75,353</b>	<b>37,163</b>

### Note 16. Business combinations

In June 2010, Eurasia Drilling Company Group acquired a 100% interest in OOO Meridian for US \$12.2 million which will be paid in three instalments ending May 1, 2012.

OOO Meridian performs well workover in Komi region. The purpose of the acquisition was to gain access to a new geographical market for workover services allowing more efficient delivery of services.

This business combination did not have a material impact on the Group's consolidated operations for the six month periods ended June 30, 2010 and 2009. Therefore, no pro forma income statement information has been provided.

The Group allocated US \$9.0 million to goodwill, US \$0.7 million to property, plant and equipment, US \$2.5 million to current assets, and US \$1.2 million to liabilities. The value of property, plant and equipment was determined by an independent appraiser. The main factors that made up the goodwill recognition are related to synergies the Group is expecting to achieve from combined operations.

In December 2009, Eurasia Drilling Company Group acquired 100% interests in OOO Tekhgeoservice (OOO TGS) for RUR 1.06 billion (or US \$35.0 million at the US dollar exchange rate as of December 31, 2009) paid in cash.

OOO TGS is a Russian provider of wellsite directional drilling and telemetry services. The purpose of the acquisition was to broaden the spectrum of well construction services and improve the technical efficiency of the Group.

The Group allocated US \$30.8 million to goodwill, US \$4.6 million to property, plant and equipment, US \$3.9 million to current assets, US \$0.3 million to long-term deferred tax liabilities and US \$4.0 million to other liabilities. The value of property, plant and equipment was determined by an independent appraiser. The main factors that made up the goodwill recognition are related to synergies the Group is expecting to achieve from combined operations, the higher profit margins that the acquired business generates and access to telemetry technology.

In December 2009, Eurasia Drilling Company Group acquired 100% interests in OOO Kogalym Well Workover Division (OOO KWWWD) and OOO Urai Well Workover Division (OOO UWWWD) for RUR 645 million (or US \$21.3 million at the US dollar exchange rate as of December 31, 2009) paid in cash.

OOO KWWWD and OOO UWWWD perform well workover, well reconditioning and well servicing operations in West Siberia for OAO LUKOIL. The purpose of the acquisition was to increase the Group's market share in workover business.

The Group allocated US \$31.1 million to property, plant and equipment, US \$28.1 million to other assets, US \$13.3 million to short-term and long-term debt, US \$0.6 million to long-term deferred tax liability, US \$21.2 million to other liabilities and recognised US \$2.8 million gain on the bargain purchase. The value of property, plant and equipment was determined by an independent appraiser. The transaction resulted in a net gain because the acquired entities were generating low profit margins prior to the acquisition and represented non-core assets of OAO LUKOIL Group.

# Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

## Note 17. Commitments and contingencies

### Commitments

#### *Commitments for provision of drilling services*

In 2009 the Group signed a three-year agreement for drilling services with OAO LUKOIL. Under this agreement the Group will provide drilling services to the LUKOIL Group and precise terms of rendering of such services will be set by signing annual well construction contracts with the LUKOIL Group starting from January 1, 2010 through December 31, 2012. The estimated level of drilling to be performed by the Group during this three-year period was agreed at a minimum of 6.7 million metres. The prices for drilling services under these contracts will be reviewed on an annual basis based on market prices.

The Group estimates that drilling services of at least US \$296 million will be provided by the Group during the remaining six months of 2010.

### Contingencies

#### *Insurance*

The insurance industry in the Russian Federation, Kazakhstan and Turkmenistan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. Management believes that the Group has adequate property damage coverage for its main production assets. In respect of third party liability for property and environmental damage arising from accidents on Group property or relating to Group operations, the Group has insurance coverage that is generally higher than insurance limits set by the local legal requirements. Management believes that the Group has adequate insurance coverage of the risks, which could have a material effect on the Group's operations and financial position.

#### *Litigation*

The Group is involved in various claims and legal actions arising in the normal course of business. It is the opinion of management that the ultimate disposition of these matters will not have a material adverse effect on the Group's consolidated financial position, results of operations, or liquidity.

#### *Environmental obligations*

Group companies have operated in the Russian Federation, Kazakhstan and Turkmenistan for several years. Environmental regulations are currently under consideration in these countries. Group companies routinely assess and evaluate their obligations in response to new and changing legislation.

As liabilities in respect of the Group's environmental obligations are able to be determined, they are charged against income over the estimated remaining lives of the related assets or recognised immediately depending on their nature. The likelihood and amount of liabilities relating to environmental obligations under proposed or any future legislation cannot be reasonably estimated at present and could become material. Under existing legislation, however, management believes that there are no significant unrecorded liabilities or contingencies, which could have a materially adverse effect on the operating results or financial position of the Group.

#### *Taxation*

The taxation system in the Russian Federation, Kazakhstan and Turkmenistan is relatively new and is characterised by frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities, which have the authority to impose severe fines, penalties and interest charges. A tax year remains open for review by the tax authorities during the three subsequent calendar years; however, under certain circumstances a tax year may remain open longer. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of tax legislation.

The tax authorities in each region may have a different interpretation of similar taxation issues which may result in taxation issues successfully defended by the Group in one region being unsuccessful in another region. There is some direction provided from the central authority based in Moscow on particular taxation issues.

These circumstances may create tax risks that are substantially more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable tax legislations, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these interim consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

## Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

### Note 18. Related party transactions

In the rapidly developing business environment in the Russian Federation, companies and individuals have frequently used nominees and other forms of intermediary companies in transactions. The senior management of the Company considers that the Group has appropriate procedures in place to identify and properly disclose transactions with related parties in this environment and has disclosed all of the relationships identified which it deemed to be significant.

The Company's General Counsel, Douglas Stinemetz, is a partner with The Stinemetz Law Firm. During six months ended June 30, 2010 and 2009 the firm billed the Company for costs and expenses of US \$0.7 million and US \$0.5 million, respectively. Mr. Stinemetz is not otherwise paid for his services as the Company's General Counsel.

Long-term loans from stockholders were US \$70 million as of June 30, 2010 and December 31, 2009 (refer note 10). Interest expense of US \$3 million and US \$3 million was recognised and paid on these loans during the six months ended June 30, 2010 and 2009, respectively.

### Note 19. Segment information

Presented below is information about the Group's operating and geographical segments for the periods ended June 30, 2010 and 2009, in accordance with ASC 280, 'Disclosures about Segments of an Enterprise and Related Information'.

The Group has two operating and geographical segments: on-shore drilling conducted in the CIS and off-shore drilling conducted in the Caspian Sea. These segments are based upon the Group's organisational structure, the way in which these operations are managed, the availability of separate financial results, and materiality considerations. Management, on a regular basis, assesses the performance of these operating segments.

Geographical segments have been determined based on the area of operations and include two segments. They are CIS and the Caspian Sea.

Segment detailed information is summarised as follows:

#### For the six month period ended June 30, 2010

	On-shore drilling services (CIS)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues	<b>811,775</b>	<b>50,238</b>	<b>862,013</b>
Net income	<b>91,440</b>	<b>13,370</b>	<b>104,810</b>
<b>Total assets</b>	<b>1,480,788</b>	<b>90,680</b>	<b>1,571,468</b>

#### For the six month period ended June 30, 2009

	On-shore drilling services (CIS)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues	637,978	35,210	673,188
Net income	66,794	11,598	78,392
Total assets	1,254,724	74,557	1,329,281

### Note 20. Concentration of credit risk and sales

A significant proportion of the Group's operations are with LUKOIL Group companies and as such the Group has significant concentrations of credit risk with the LUKOIL Group.

Included in the Group's sales and accounts receivables are the following transactions and balances with LUKOIL Group companies.

	2010	2009
Sales for the six months ended June 30	<b>594,263</b>	458,795
Accounts receivable as of June 30, 2010 and December 31, 2009	<b>132,965</b>	106,500



# Notes to the interim consolidated financial statements (unaudited) continued

(all amounts in thousands of US dollars, unless otherwise noted)

## Note 21. Incentive compensation plan

In March 2008, the Company introduced an incentive plan to certain members of management ('participants') for a five year period from January 1, 2008. Compensation under this plan is based on a multiple of the participants' annual salary and adjusted for:

- a percentage determined by the increase in the quoted price of the Company's stock from a pre-determined Starting Price to the closing price of the stock in the particular year ('Factor'), and
- the year of compensation under the plan.

The Factor ranges from 0% (where the increase in the stock price is less than 5%) to 100% (where the increase in the stock price is greater than 20%) for any given year during the five year period.

The percentages applied to each of the years under the plan are equal to 12% for 2008, 15% for 2009, 18% for 2010, 25% for 2011 and 30% for 2012.

The Starting Price for the 2008 year was US \$27.09 and has been determined with reference to the quoted market price of the Company's shares on the London Stock Exchange ('LSE'). The Starting Price is determined at the beginning of each year based on an average quoted stock price for the last 20 trading days of the preceding year.

The rights to compensation under this plan vest yearly, immediately after the final trading day of the compensation year if the participants are still employed or otherwise in good standing with the Company.

The fair value of the plan was estimated using the Monte Carlo simulation method for the years 2008 to 2012, assuming risk-free interest rates of 0.37% and 1.55% that are based on the yield of one and five year US Treasury securities as of the valuation date, respectively, an expected term of five years and a volatility factor of 48%.

The expected volatility factor was estimated based on the average historical volatility of comparable companies' shares for the previous five year period, ranging from 40 to 86%. The average and median of these were 56% and 48%, respectively. A portion of the award vests upon completion of each plan year and no restrictions apply thereafter. Therefore, no post vesting discount has been applied.

The grant date fair value of the plan was estimated at US \$21 million by an independent consulting firm. The Company has approximately US \$10.5 million of unrecognised compensation expense as of June 30, 2010 that will be accrued up to 2012.

Effective January 1, 2009 the Company has modified the incentive plan and cancelled participants' right to elect to receive cash in lieu of GDRs upon the vesting of such performance award. This modification converts the plan from liability to equity classified. The Group recognised US \$2.1 million of compensation expense during six months ended June 30, 2010 and 2009.

On February 1, 2010 the Company announced that in accordance with its incentive compensation plan participants of the Plan were awarded 718,868 GDRs for their performance in 2009. One GDR represents one ordinary share.

The number of contingent shares of stock incentive program is estimated based on the stock price as of June 30, 2010 and is approximately 589 thousand shares.

## Note 22. Subsequent events

On August 9, 2010 the Group acquired a 100% interest in OOO MTU from OOO 'Slavneft-Megionneftegaz' for US \$8.8 million paid in cash. OOO MTU is a Russian provider of cementing services in West Siberia. The purpose of the acquisition was to broaden the spectrum of well construction services, improve the technical efficiency of the Group and to get a new customer in West Siberia.

The Company has evaluated subsequent events from the balance sheet date through August 27, 2010, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.

## Corporate information

### Directors

**Earl of Clanwilliam**  
(formerly Lord Patrick James Gillford)  
Chairman of the Board of Directors,  
Eurasia Drilling Company Ltd.  
Principal, Policy Partnership Ltd.

**Alexander Yu. Djaparidze**  
Chief Executive Officer,  
Eurasia Drilling Company Ltd.

**L. Todd Gremillion**  
Former Partner, Akin, Gump, Strauss,  
Hauer & Feld

**Martin E. Hansen**  
Former Chief Financial Officer,  
Eurasia Drilling Company Ltd.

**Rene Huck**  
Former Vice-President, Schlumberger

**Victor Kalyuzhny**  
Former Extraordinary and  
Plenipotentiary Ambassador  
of the Russian Federation in  
the Republic of Latvia

**Alexander Shokhin**  
Member, Board of Directors, LUKOIL  
Member, Board of Directors, TNK-BP

### Officers

**Alexander Yu. Djaparidze**  
Chief Executive Officer

**Murat Sampiev**  
Chief Operating Officer

**W. Richard Anderson**  
Chief Financial Officer

**Murray L. Vasilev**  
Senior Vice President  
Business Development

**S. Douglas Stinemetz**  
General Counsel and Secretary

### Subsidiary officers

**Alexander N. Bogachev**  
President, OOO Burovaya  
Kompaniya Eurasia

**Taleh M. Aleskerov**  
Senior VP Finance and CFO,  
OOO Burovaya Kompaniya Eurasia

**Medjid M. Zulpukarov**  
General Director, BKE Shelf Ltd.

**Vladimir Kurlyshev**  
General Director, OOO NTS

**Yury Sitlivy**  
President, EDC International Ltd.

### Registered address

**Eurasia Drilling Company Limited**  
Boundary Hall  
Cricket Square  
PO Box 1111  
Grand Cayman KY1-1102  
Cayman Islands

### Principal administrative offices

No. 53, Mykonos Court  
Aristide Charalambous 2  
1077 Nicosia  
Cyprus

### Financial advisers

Goldman Sachs International  
CJSC Investment Company  
'Troika Dialog'

### Transfer agent

JP Morgan Securities Ltd

### Legal advisers

Skadden, Arps, Slate,  
Meagher & Flom LLP & Affiliates

### Bankers

Barclays Bank PLC  
OAO Sberbank  
(Zapadno-Uralskiy branch)  
ZAO Unicredit Bank

### Auditors

ZAO KPMG

### Annual General Meeting

The Annual General Meeting  
of Members of Eurasia Drilling  
Company Limited will be held  
on Friday, September 16, 2010  
in Cannes, France.

### Investor relations contacts

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Vice President, Marketing and  
Investor Relations

**Evgenia Bitsenko**  
Manager, Investor Relations

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[www.eurasiadrilling.com](http://www.eurasiadrilling.com)



