



EURASIA DRILLING COMPANY LIMITED

MANAGEMENT'S REPORT ON 2012 INTERIM PERIOD RESULTS

For the six months ending June 30, 2012

Select financial and operating information

	1H 2012	1H 2011	Change	%
<i>in thousand US\$, unless otherwise stated</i>				
Revenue	1,564,185	1,265,282	298,903	23.6%
EBITDA	373,314	267,021	106,293	39.8%
EBITDA margin	23.9%	21.1%	2.8pp	-
Net income	187,267	150,601	36,666	24.3%
Operating cash flow	231,703	125,010	106,693	85.3%
Capital Expenditures	281,783	214,736	67,047	31.2%
Basic/Diluted EPS (US\$)	\$1.28	\$1.03	0.25	24.3%
Average exchange rate for the period (RUB/US\$)	30.6	28.6	2.0	(7.0%)
Metres drilled onshore (th. metres)	2,871	2,325	546	23.5%

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

The following report represents management's discussion and analysis of EDC's financial condition and results of operations for the six month period ending June 30, 2012 ("2012 Interim period" or "1H12") 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 2012 Interim Consolidated Financial Statements and the accompanying notes, prepared in accordance with US GAAP. This discussion should not be considered all inclusive as it does not necessarily include all changes regarding general economic, political, governmental and environmental events. 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.

Nature of operations

Eurasia Drilling Company Limited is the leading onshore & offshore provider of oil & gas development and exploration well drilling services in the CIS. We offer onshore integrated well construction, sidetracking and workover services to local and international oil and gas companies primarily in Russia, and offshore drilling services to Russian and international oil and gas companies in the Russian, Kazakh and Turkmen sectors of the Caspian Sea.

Our land operations range mainly over the vast territories of the Russian Federation, one of the world's largest oil producers. Our customers include a number of major Russian integrated oil and gas companies such as LUKOIL, Rosneft, Gazpromneft and TNK-BP, which together accounted for over 60% of Russia's total crude oil production for the first half of 2012. Among other of our customers are KazMunayGas affiliates, Samara-Nafta, Naryanmarneftegaz (a joint venture between LUKOIL and ConocoPhillips), Rusvietpetro, Pechoranefit and Russneft. Offshore our client base includes LUKOIL, Petronas Carigali, Dragon Oil, CMOC (a joint venture between Shell, KazMunayTeniz and the Oman Pearls Company Ltd), N Operating Company (a joint venture between KazMunayGas, ConocoPhillips and Mubadala) and others.

Our operational objective is to deliver value added services to our clients while continuously improving the quality of our asset base. We have established a strong presence within our served markets. Our total land fleet of 601 rigs, the largest in Russia, includes 258 land drilling and sidetracking rigs and 343 workover rigs, and we employ approximately twenty two thousand personnel (as of 30 June 2012). We continue to adopt new drilling technologies and techniques in order to be in a position to satisfy our customers' demands for more technologically advanced and complex services.

We entered the onshore drilling and workover services business in December 2004 by acquiring substantially all of the onshore drilling assets, and certain related assets, of OAO LUKOIL. Until recently we had not relied on acquisitions to increase our share of the onshore drilling market. We were able to transform the Company from an in-house cost centre to an independent oilfield service provider with sound finances and materially improved operational efficiency. Late in 2010 we entered the next phase of our development by signing a Letter of Intent with Schlumberger to sell and purchase each other's drilling and service assets and to enter into a strategic alliance in the CIS. On 28 April, 2011 we completed the transaction and commenced consolidation of the acquired businesses.

In December 2006, we entered the offshore drilling business by acquiring the offshore drilling business of OAO LUKOIL, which primarily consisted of the *ASTRA*, a floating jack-up drilling rig located in the Caspian Sea. We continue to build momentum in the Caspian Sea. Early in 2011 we expanded our current offshore rig fleet to two jack-up rigs by acquiring the *SATURN* from Transocean. As such, in 2012 we have the capacity to serve approximately two-thirds of the jack-up market in the Russian, Kazakh, and Turkmen waters of the Caspian Sea. Currently, we have two additional jack-up rigs being constructed with delivery times scheduled

for early 2013 and late 2014. We continue to provide platform drilling services in the Northern Caspian Sea to LUKOIL for its Yuri Korchagin development, which we commenced near the end of 2009.

General overview

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 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 the countries of the Caspian Sea, and the prices of crude oil and natural gas in Russia. 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 oilfield services market in Russia is robust and it is arguably the most stable land market of any size in the world. Onshore drilling activity (as measured by wells or metres drilled) fell in 2009 as compared to 2008 by only around 6%, which was substantially less than the reductions in drilling activity experienced in the world's other large markets. In 2010 the Russian drilling market grew by 18% (as measured by metres drilled), exceeding the previous record high achieved in 2008. Following the global recession, oil prices stabilised in 2010 and grew further, giving oil and gas companies confidence to increase their CAPEX budgets. Russia's oil production and drilling volumes have continued to grow in 2012; in the first half of 2012 average oil and condensate output grew to 10.33 mln bpd, an increase of 1.1%, and drilling volumes expanded to 10.1 million metres, an increase of 9% as compared to the first half of 2011, according to CDU TEK.

Russia's oil production is mostly comprised of output from mature fields, which in the first half of 2012 produced over 80% of total oil output in Russia. Since 2008 the output from these fields has been declining; the overall growth in Russian production was achieved by the contribution from greenfields coming on stream in Eastern Siberia, Timan-Pechora, the Caspian, and Sakhalin. However, during the first half of 2012 the output growth from greenfields began slightly to decelerate which makes it more challenging to both offset the production decline from brownfields and increase Russia's total oil and condensate output. The output from the mature fields of Russia's four largest oil producers largely stabilised, resulting in a decline of 1% period-over-period, despite massively increased drilling volumes during the last several years, the movement to more horizontal drilling, as well as supportive changes in the taxation system.

Operations review

During the first half of 2012 our business continued to benefit from favorable market conditions resulting primarily from fairly stable commodity prices and a resulting increase in demand for our services. Our six months 2012 results were also impacted by consolidation from the beginning of the year, the results of operations of ex-Schlumberger drilling, sidetracking, and workover assets, which we acquired April 28, 2012, and the results of *SATURN*, the jack-up drilling rig acquired February 8, 2011 from Transocean.

Onshore business

Our first half 2012 onshore operating results include:

- Drilling output of 2.871 million metres, 23.5% above the output achieved in the corresponding period of 2011 (2.325 million metres);
- Horizontal metres drilled during the first half of 2012 increased by 12.8% compared to the corresponding period of 2011 and amounted to 412 thousand metres;
- Exploration drilling volumes decreased by 10.8% during the first half of 2012 compared to the corresponding period of 2011;
- Sidetracking activity more than quadrupled and amounted to 102 wells sidetracked during the first six months of 2012, as compared to 24 wells sidetracked during the corresponding period of 2011;
- Our market share increased to 29% based on metres drilled onshore in Russia during the first six months of 2012, up from 25% in the corresponding period of 2011;

- The share of our largest customer, LUKOIL, increased slightly to 56% of our total metres drilled during the first half of 2012, as compared to 54% during the corresponding period of 2011; however, LUKOIL drilling volumes increased by 29% for the same period;
- The share of Rosneft, our second largest customer, increased to 27% of our total metres drilled during the first six months of 2012 as compared to 20% during the corresponding period of 2011.

Our Russian onshore drilling volumes increased by 23.5% compared to the volumes achieved in 1H11. Growth in metres drilled in our legacy operations was similar to overall growth of the Russia's onshore drilling market period-over-period, while our industry-leading growth in total metres drilled was the result of consolidation of ex-Schlumberger drilling assets ("SGC") from the beginning of the year. As a result of such as outstanding performance our onshore Russian market share based on metres drilled increased to 29%, or four percentage point above our market share in 2011.

EDC's horizontal drilling volumes increased by 12.8% in the 2012 Interim period, compared to the corresponding period of 2011, and amounted to 412 thousand metres, which corresponds to 14.3% of our total metres drilled. This growth was driven by our major customers, LUKOIL and Rosneft. In horizontal drilling the component of high value third party services, such as directional drilling and telemetry services, is much more significant compared to conventional vertical or deviated well drilling.

Our cooperation with our main customer, LUKOIL, continues to be strong as we operate under a long-term Framework Agreement that we signed at the end of 2009 for a period of three years. 2012 is the last year of the existing Framework Agreement and both LUKOIL and EDC are on track to fulfill the terms. For the 2012 Interim period LUKOIL increased its drilling volumes by 29.4% over the corresponding period of 2011. Despite such a significant increase in LUKOIL's drilling activity, almost a third, its share in our total drilling volumes increased only by two percentage points compared to the first six months of 2011. Most of the growth comes from intensified drilling activity in Western Siberia.

It's our strategic priority to diversify our customer base in Russia while building long-term relationships with our clients. As such, the share of Rosneft increased to 27% during 1H 2012 in our total drilling volumes from 20% 1H 2011 as the metres drilled surged by 66.9% period-over-period. Most of the growth is attributable to the consolidation of SGC operations from the beginning of the year. Rosneft is SGC's largest client and accounted for 69% of its drilling volumes for the period. In addition, our legacy drilling operations, represented by BKE, were awarded more contracts to drill in the Vankor field in Eastern Siberia. Management believes that EDC has a strong proven track record with Rosneft and is eager to build the cooperation beyond the existing frontiers.

In 2010 we started to provide drilling services for TNK-BP. For the first half of 2012 its share in our total drilling volumes accounted for 1.5% compared to approximately 3% in the first half of 2011, as the volumes decreased by 35 thousand metres period-over-period. The decrease is the result lower activity in Western Siberia offset by increased activity in the Orenburg area, where drilling is much slower and more complex as compared to the drilling of an average well in Western Siberia. The share of TNK-BP in our total revenue reflects this complexity and despite the decrease in metres drilled period-over-period, revenues remained at a meaningful level. In addition, early in 2012 we concluded a three-year agreement with TNK-BP for drilling services in the Orenburg area. We are determined to meet or exceed all key performance indicators specified in the agreement.

One of the notable events of 2012 is the award of a drilling contract on the Novopostovskoe field in the Yamalo-Nenetsk Region, one of Gazpromneft's greenfield projects, where drilling commenced in May 2012. We've also placed one rig for Gazpromneft in the Orenburg area. Overall the share of Gazpromneft in our drilling volumes decreased to 8% during 1H12, compared to 19% in 1H11. EDS still provides a sizable 20% of Gazpromneft's total drilling volumes in Russia, based on CDU TEK data for the first half of 2012, and we are expanding collaboration in geographies of strategic importance to our customer.

Our client portfolio includes the four largest E&P companies in Russia, which, together, accounted for about 60% of the total drilling volumes in Russia in the first half of 2012, based on CDU TEK data. We also continue

to work for smaller oil and gas companies such as Pechoranefit, Samaranafta, Rusvietpetro, Russneft and others.

The availability of rigs is one of the keys to being a successful drilling company. Our rig fleet as of June 30, 2012 totaled 258 onshore drilling and sidetracking rigs, unchanged since December 31, 2011. Our rigs are located in all major oil and gas provinces of Russia and we continue to invest in modernisation of our rig fleet. Management believes that the effective age of our rig fleet is much less than Russia's average of 18-19 years, as per Douglas Westwood estimates. About a third of our rigs are less than 5 years old. Our rigs are capable of drilling a wide range of oil and gas wells, including vertical, deviated, horizontal, and extended-reach wellbores up to 6,400 metres (21,000 feet) in total length. More than half of our rigs are configured for pad drilling, the method that we believe will dominate future developments.

In Russia, as in the rest of the world, unexploited oil and gas reserves increasingly occur in more challenging environments, both geographically and geologically. The services market in Russia is evolving toward higher technological content and advanced techniques. As technology applications advance, so do the costs of bringing a barrel of hydrocarbons to market. To justify the higher costs, technologies must deliver greater efficiency and production potential to the oil and gas producers. To satisfy this requirement, and to ensure the stability and further growth of oil production in Russia, we forecast an increasing requirement for new modern rigs. We continue to deliver on our five year rig fleet upgrade and modernisation plan, developed in 2010, according to which 10-12 rigs will be delivered during 2012/early 2013 and put into operations. The drilling rigs that we are ordering are produced by Russian and Chinese manufacturers at prices significantly lower than the recent peak in 2008, with considerably shorter lead times.

Our onshore workover and sidetracking operations continue to be an important part of our business. Our workover fleet as of June 30, 2012 totaled to 343 workover rigs, as compared to 330 rigs as of June 30, 2011. The increase is due purchase of new workover rigs which are intended to replace older workover rigs due for retirement later this year. Growth in our total workover jobs performed in 1H12 has been quite moderate, while the growth in our sidetracking operations was noteworthy. The number of sidetracking jobs performed in the first half of 2012 increased by over four times, compared to the period of 2011, and amounted to 102 jobs.

Offshore business

Our 1H12 offshore operating results include:

- Our *ASTRA* jack-up rig was employed in Kazakh waters of the Caspian Sea, drilling on N Block;
- We drilled and completed four extended-reach horizontal development wells on Lukoil's Yuri Korchagin field platform in the Caspian Sea;
- Our *SATURN* jack-up rig continued operations for Petronas Carigali in Turkmen waters of the Caspian Sea; one well was drilled and three geological sidetracks were performed;
- Modules of our 3rd jack-up rig, the new-build *NEPTUNE*, were in the process of shipping to the Caspian Sea from Lamprell's shipyard in the UAE; and
- In April 2012 we contracted Lamprell to build our 4th jack-up drilling rig for our operations in the Caspian Sea.

Our offshore operations remained strong in the first half of 2012. Our crews remained active on LUKOIL's Yuri Korchagin field platform, drilling four challenging extended reach development (ERD) wells. ERD in Yuri Korchagin is expected to continue throughout 2012. To date the longest ERD well drilled by us offshore on this field is 5,868 metres.

Our *ASTRA* jack-up was deployed on the N Block in the Kazakh sector of the Caspian Sea, drilling an exploration well for N Operating Company, a joint venture between KazMunayGas, ConocoPhillips and Mubadala. Once it completed operations in N Block, the *ASTRA* moved to Russian waters of the Caspian Sea to work for LUKOIL for the remainder of the year and further into 2013.

Our *SATURN* jack-up continues operations for Petronas in Turkmenistan, and we are in process of negotiating a renewal of our long-term contract with Petronas for operations beginning in 2013.

Fabrication of *NEPTUNE*, our third Caspian jack-up rig, remains on schedule for deployment by mid-2013, and we began shipping rig modules via the Volga-Don canal system in April 2012. The LeTourneau designed Super 116E hull and related components are being pre-fabricated by Lamprell in its Sharjah facility, while the remaining component fabrication, final assembly, and commissioning are being performed at a shipyard in the Caspian Sea.

In April 2012 we ordered a 4th jack-up rig for our Caspian Sea operations from Lamprell; this rig will be another LeTourneau Super 116E, which we believe is the most versatile and efficient design in its class. This rig is planned for late 2014 delivery. Both Super 116E jack-ups we have on order are designed to operate in water depths of up to 350 feet, and will have rated drilling depths of 30,000 feet.

The demand for jack-up rigs in the Caspian Sea has reached a level where we are confident that both new high-spec rigs will be fully contracted for several years at favorable operating rates, once commissioned.

Outlook

We achieved strong first half 2012 results and we expect good progress across all our business segments during the remainder of the year.

In the Russian market, most commentators forecast the growth in drilling volumes to continue further in 2012 as most E&P companies have expanded their capital budgets. Russian crude oil production in July 2012 increased by 0.2% compared to June 2012 approaching record historic levels of January and March 2012. The drilling volumes in Russia in July 2012 increased by 4% month-over-month and by 10% period-over-period as per CDU TEK.

We continue to see more and more emphasis being placed on strategies to enhance upstream efficiency, including increases in new-well flow rates and improvements in the recovery factor on existing reserves using horizontal drilling techniques. The trend that rapidly took off in 2011 continues to prevail in 2012 as our customers are planning more horizontal production wells. We expect horizontal drilling volumes to grow at a somewhat slower pace than overall drilling volumes, totalling slightly less than one million metres for EDC in 2012.

We continue to make significant capital expenditures for the purpose of taking advantage of the growing demand for drilling services in our market. For the first six months of 2012 we have had and expect to have higher rig utilisation than in prior years. Pricing for drilling services in 2012 is more favourable than in 2011 as our customers started to observe some tightness in the rig supply, especially in heavier rig classes, which renewed certain clients' interest in establishing multi-year contracts to insure rig availability for their future drilling plans.

For 2012 we expect our onshore drilling volumes to exceed 2011 volumes by at least 16%, reaching the level of at least 5.6 million metres drilled, another record year for EDC. This estimate includes both improvements in our legacy business and the consolidation on a full year basis of the assets acquired from Schlumberger in late April 2011. Our average crew count is expected to increase by 14% compared to 2011 as we expand our activity in the fields we currently operate in as well as entering new ones. EDC's market share is expected to increase from 25% achieved in 2011, to about 28% by the end of 2012.

The Company's relationship with its customers continues to be strong. Most of our customers increased their drilling volumes during the first six months of 2012 compared to the corresponding period of 2011 and we expect this trend to continue during the second half of 2012. We expect Rosneft to account for over 25% of our total drilling volumes with the gains coming from both our legacy business and the drilling assets acquired from Schlumberger. The share of our major customer, LUKOIL, is projected to increase slightly from 2011 levels (in 2011 LUKOIL accounted for 55% of total EDC drilling volumes). We expect our drilling volumes with Gazpromneft to continue to decline in Western Siberia, which should be partially offset by volumes gained in the Yamal area.

In 2012 the well intervention market in Russia is projected to expand as high oil prices encourage efforts to prolong and enhance existing well production. Workover and sidetrack drilling activity are expected to be strong contributors to the Company's revenue in 2012. We continue to provide workover services to Rosneft in the Vankor field in East Siberia, which we commenced in the second quarter of 2011. The workover assets acquired from Schlumberger are well utilised and primarily contracted to TNK-BP in their Samatlor field, representing a new area of activity for EDC.

EDC has established a significant offshore presence, beginning our first platform drilling services contract in 2009 and adding a second jack-up rig (the *SATURN*) to our fleet in early 2011. The *ASTRA* jack-up drilling rig is committed until mid-2013 for drilling in the Russian of the Caspian Sea. The *SATURN* is expected to be fully utilised in Turkmen waters in 2012, under the existing contract with Petronas Carigali, which expires in the end of 2012. We expect to complete the negotiations on the contract renewal with Petronas Carigali for 2013 and subsequent years. On-going operations on Lukoil's Yuri Korchagin field ice-resistant platform, where EDC is the drilling contractor, are expected to continue throughout the year. The Company will further expand its Caspian fleet when the two new-build Super 116E jack-ups being constructed by Lamprell enter service in early 2013 and late 2014. We continue to evaluate opportunities for further expansion in this growing market.

If recent Russian ruble devaluation with respect to the US dollar continues through the remainder of the year, it might have a modestly unfavourable impact on our reported results for 2012 as we saw in 2009. We see the downside risk, though, being limited to translation losses as opposed to a contraction in our actual activity during 2012.

Despite some uncertainties in the global markets, oil price volatility and weaker ruble, we anticipate a strong second half of 2012 as we are right on track to deliver on our financial and operational targets. 2012 is yet our busiest year, as we increased our active drilling crews by 15% period-over-period. Meanwhile, we continue to evaluate opportunities outside Russia and the CIS. 2012 will be marked as the year when EDC established its footprint in the international market, as we acquired three active drilling rigs in Iraq in July 2012.

Financial Review

During the six month period ended June 30, 2012 we achieved remarkable financial results across all lines and geographies of our business, which met our initial expectations. We continue to concentrate on execution backed by our ongoing investment in drilling-rig fleet modernisation and upgrades. Our 2012 Interim Period results increased both in dollar terms and in margins, reflecting our success in achieving growth both organically and through strategic acquisitions.

Our Interim Period 2012 financial results include:

- Revenue for the six months ending June 30, 2012 was US \$1,564 million, which is US \$299 million, or 23.6%, above Revenue reported for 1H11;
- EBITDA for the six-month period ending June 30, 2012 was US \$373 million, which is US \$106 million, or 39.8%, above EBITDA reported in 1H11;
- EBITDA margin increased to 23.9% for 1H12, which is 2.8 percentage points above the 21.1% EBITDA margin reported for the corresponding period of 2011;
- 2012 Interim Period Net Income was US \$187 million, which is US \$37 million, or 24.3%, above Net Income reported for the corresponding period of 2011;
- Earnings per share (both basic and diluted) for the six-month period ending June 30, 2012 were US \$1.28 (1H11 earnings per share (both basic and diluted) were US \$1.03);
- The six-month 2012 average US dollar exchange rate is 30.6 rubles per US dollar, as compared to 28.6 rubles per US dollar in the respective period of 2011, a percentage reduction of 7.0%.

Reconciliation of Net Income to EBITDA

Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), a non-GAAP financial measure, is computed with reference to the Company's net income for the six-month period ending June 30, 2012 and the six-month period ending June 30, 2011 as follows (in thousands of US dollars, unaudited):

	2012	2011
Net Income	187,267	150,601
Income tax expense	58,894	36,842
Loss on disposal of PP&E	157	3,392
Currency transaction (gain)	(2,206)	(1,745)
Gain on business exchange transaction		(32,861)
Interest income	(6,543)	(3,753)
Interest expense	27,403	21,133
Depreciation	108,342	93,412
EBITDA	373,314	267,021

Our EBITDA in dollar terms increased by US\$ 106 million during the 2012 Interim Period as compared to the corresponding period of 2011. At the same time the EBITDA margin increased to 23.9% from 21.1% achieved during 1H11 due to sustained and effective cost control efforts by our management.

Revenues

The following table sets forth a summary of our operating results for the first six months of 2012 and for the first six months of 2011 (for additional information, please see the accompanying 2012 Interim Consolidated Financial Statements).

Consolidated statements of income for the six months ending June 30, 2012 and 2011 (All figures in thousands of US dollars, unless otherwise noted, unaudited):

	2012	2011
Revenues		
Drilling and related services	1,558,650	1,254,715
Other sales and services	5,535	10,567
Total revenues	1,564,185	1,265,282
Cost of services, excluding depreciation and taxes	(1,048,835)	(864,732)
General and administrative expenses, excluding depreciation and taxes	(70,475)	(63,142)
Taxes other than income taxes	(69,453)	(70,536)
Depreciation	(108,342)	(93,412)
Loss on disposal of property, plant, and equipment	(157)	(3,392)
Income from operating activities	266,923	170,068
Interest expense	(27,403)	(21,133)
Interest income	6,543	3,753
Currency transaction gain	2,206	1,745
Gain on business exchange transaction	-	32,861
Other (expenses) income	(2,108)	149
Income before income taxes	246,161	187,443
Income tax expense	(58,894)	(36,842)
Net income	187,267	150,601
Basic & diluted earnings per share of common stock (US dollars)	1.28	1.03

Our total dollar-expressed revenues increased by US \$298.9 million, or 23.6%, to US \$1,564.2 million for the 2012 Interim Period from US \$1,265.3 million in the comparable 2011 period.

The financial results of operations in US dollars for the 2012 Interim Period were influenced by several factors, including an increase in our number of metres drilled, changes in the mix of services (higher levels of horizontal drilling), consolidation from the beginning of the period assets acquired from Schlumberger in April 2011 as well as ruble depreciation (the six months 2012 average US dollar exchange rate was 30.6 rubles per US dollar as compared to 28.6 rubles per US dollar in the respective 2011 period, a percentage reduction of 7.0%).

Cost of services, excluding depreciation and taxes

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

	2012	2011
Services of subcontractors	466,202	389,936
Wages and salaries	235,708	202,360
Materials	196,423	155,098
Fuel and energy	78,418	62,500
Transportation of employees to drilling fields	22,416	14,864
Leasing and rent	11,702	7,739
Other	37,966	32,235
Total cost of services	1,048,835	864,732

Cost of services increased by US \$184.1 million, or 21.3%, to US \$1,048.8 million for the 2012 Interim Period from US \$864.7 million for the equivalent 2011 period. Cost of services as a percentage of total revenue decreased from 68.3% in the first six months of 2011 to 67.1% for 1H12. We believe the improvement of this ratio 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. Subcontractor services was the largest component of our cost of services for the first six months of both 2012 and 2011. For the 2012 Interim Period, services of subcontractors were US \$466.2 million, or 44.4% of total cost of services, as compared to US \$389.9 million, or 45.1% of total cost of services for the respective 2011 period. The key driving forces of the increase in total dollars expended are a) increases in revenue related to reimbursable services that are largely pass-through (e.g. telemetry and technology services for horizontal wells), b) the asset swap with Schlumberger.

Expenditures for materials have been primarily influenced by our customers' particular drilling programmes and projects. Materials for our onshore and offshore drilling divisions primarily include spare parts, tubular goods, mud chemicals, cement, and drilling tools. Materials costs for the 2012 Interim Period were US \$196.4 million, or 18.7% of total cost of services, as compared to US \$155.1 million, or 17.9% of total cost of services, for the comparable 2011 period. The increase in both total dollars spent on materials and the percentage of the total cost of services is primarily caused by the consolidation of SGC business on a full year basis (where a significant part of materials is in the reimbursable casing pipe for Rosneft in Nefteyugansk) and growth in materials usage in West Siberia (also significantly affected by the reimbursable casing pipe in Nefteyugansk).

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 we make to pension funds or social taxes we pay to the Russian government. Wages and salaries for the 2012 Interim Period were US \$235.7 million, or 22.5% of total cost of services, as compared to US \$202.4 million, or 23.4% of total cost of services, for the corresponding period of 2011. The increase in total dollars terms is primarily driven by the consolidation from the beginning of the period businesses acquired in April 2011 (SGC, SKRS) and the offshore jack-up rig the *SATURN*, while the effect from the annual salary indexation for our employees is offset by the ruble depreciation. The slight decrease in the percentage of total cost of services is considered minor and is partially caused by the sale of services businesses to Schlumberger as well as an increase in per-metre drilling efficiency of our personnel.

Fuel and energy costs consist primarily of oil, lubricants, and electricity. Fuel and energy costs for the six months ending June 30, 2012 were US \$78.4 million, or 7.5% of total cost of services, compared to US \$62.5 million, or 7.2% of total cost of services for the comparable 2011 period. A change as a percentage of total cost of services is not material, while the change in dollars spent on fuel and energy is affected by the consolidation of the acquired businesses and growth in the drilling volumes of our core business.

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 first half of 2012 were US \$22.4 million, or 2.1% of total cost of services, compared to US \$14.9 million, or 1.7% of total cost of services for the comparable 2011 period. The increase in both total dollars spent and the percentage of the total cost of services is primarily caused by the indexation of air tariffs and new clients with new locations.

Leasing and rent costs consist primarily of the cost of renting drilling equipment. Leasing and rent costs for the 2012 Interim Period were US \$11.7 million, or 1.1%, of total cost of services, compared to US \$7.7 million, or 0.9%, of total cost of services for the equivalent 2011 period. The percentage of total cost of services change is not considered material. The increase in total dollars expended is primarily a function of consolidating rented equipment in SGC and renting equipment to start up a workover project with Rosneft in a new location on Vankor field.

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 \$38.0 million, or 3.6%, of our total cost of services for the 2012 Interim Period, as compared to US \$32.2 million, or 3.7%, of our total cost of services for the comparable 2011 period. The increase in the total amount is primarily caused by the integration of new businesses. The decrease in the percentage of total cost of services is considered immaterial.

General and administrative expenses, excluding depreciation and taxes

General and administrative expenses increased by US \$7.4 million to US \$70.5 million for the 2012 Interim Period, as compared to US \$63.1 million for the 2011 period. As a percentage of total revenues, sales, general, and administrative expenses decreased to 4.5% in the 2012 Interim Period from 5.0% in the equivalent 2011 period, due to the fixed nature of such expenses. The increase in dollar terms is attributed to the newly acquired businesses.

Taxes other than income taxes

Taxes other than income taxes include various local taxes, such as social taxes, property taxes, road taxes, and other small regional taxes. Taxes other than income taxes decreased by US \$1.0 million to US \$69.5 million for the six months ending June 30, 2012, as compared to US \$70.5 million for the comparable 2011 period. Increases from newly acquired assets were offset by changes in Russian tax law (adjustments in the formula for social contributions) and the depreciation of the ruble, which led to lower contributions.

Depreciation

Depreciation increased by US \$14.9 million to US \$108.3 million for the 2012 Interim Period, as compared to US \$93.4 million for the 2011 period. As a percentage of revenues, the depreciation decreased to 6.9% from 7.4% in the 2011 Interim Period. The total dollar increase was mostly caused by our on-going modernisation programme, significant capital expenditures in PP&E, and the depreciation of equipment and machinery acquired with the purchase of new businesses.

Disposal of property, plant, and equipment

Gain/(loss) on the disposal of property, plant, and equipment increased by US \$3.2 million to a loss of US \$0.2 million for the 2012 Interim Period, as compared to a loss of US \$3.4 million for the comparable 2011 period. This change is explained by normal disposal of PPE and by the fact that no significant assets were sold in 1H12.

Income from operating activities

Income from operating activities increased by US \$96.8 million to US \$266.9 million for the 2012 Interim Period, as compared to US \$170.1 million for the corresponding period of 2011. The increase in total dollars is primarily due to the increase in drilling and, to a lesser extent, workover volumes, and sustained cost control efforts, as well as the integration of businesses acquired in 2011 from the beginning of the period. As a percentage of revenues, income from operating activities increased from 13.4% in 1H11 to 17.1% in 1H12. This is primarily due to the decrease, as a percentage of total revenues, of cost of services and social taxes, and to a lesser extent of depreciation and general and administrative expenses, as described above.

Interest expense

Interest expenses increased by US \$6.2 million to US \$27.4 million for the six months ending June 30, 2012, compared to US \$21.1 million for the comparable 2011 period. The increase in interest expense was primarily attributable to additional borrowings raised during 2011 to support our growth both onshore and offshore through acquisitions of strategic assets and modernisation of our drilling fleet. During 2011 we obtained a dollar-denominated credit facility from Raiffeisenbank in the amount of US \$220 million at 5.65% per annum and raised bonds in the amount of 5 bln Russian rubles at 8.4% per annum.

Income before income taxes

Income before income taxes increased by US \$58.8 million to US \$246.2 million for the 2012 Interim Period, compared to US \$187.4 million for the comparable 2011 period. The increase in income before income taxes is attributable to the factors described in more detail above.

Income tax expense

Income tax expenses increased by US \$22.1 million to US \$58.9 million for the 2012 Interim Period, compared to US \$36.8 million for the corresponding period of 2011. This increase was due primarily to a higher tax base. Our effective tax rate increased to 23.9% in the 2012 Interim period, from 19.7% in the 2011 Interim period. During the first half of 2011 we recognised a non-taxable net gain in the amount of US \$32.8 million from selling our directional drilling, cementing and drilling fluid assets to Schlumberger in April 2011. During the first half of 2012 no similar items were recognised and thus our effective tax rate returned to more normal levels. Based on current tax laws, we expect to keep our effective corporate income tax rate at similar levels in the future.

Net income

As a result of the foregoing factors net income increased by US \$36.7 million to US \$187.3 million for the 2012 Interim Period, compared to US \$150.6 million for the corresponding period of 2011.

Overview of financial situation and liquidity as of June 30, 2012

Our Interim Period 2012 financial situation highlights include:

- Cash and cash equivalents as of June 30, 2012 were US \$321 million, a decrease of US \$189 million compared to the cash and cash equivalents balance of US \$510 million as of December 31, 2011;
- Our total debt as of June 30, 2012 decreased to US \$670 million, compared to US \$753 million debt balance as of December 31, 2011;
- During the Interim Period of 2012 we paid dividends, in the amount of US \$69 million, resulting from our successful 2011 operations;
- Net debt position (cash reduced by all debt) was US \$349.7 million as of June 30, 2012 (year-end 2011 we were net debt of US \$244.6 million);
- Capital expenditures for the six months ending June 30, 2012 were US \$282 million, compared to US \$215 million (including changes in restricted cash) incurred during the corresponding period of 2011.

Accounts receivable

Accounts receivable increased by US \$91.9 million to US \$440.0 million as of June 30, 2012, from US \$348.1 million at the beginning of the year. Expressed as the number of days outstanding and calculated in the

functional currency, our receivable balance increased from approximately 51.5 days at the beginning of the year to approximately 55.8 days at the end of 2012 Interim Period. This increase in both dollar terms and in the number of days outstanding 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 total inventory balance, increased by US \$30.7 million, from US \$190.7 million at the beginning of the year to US \$221.4 million at the end of the period. The increase is mainly attributable to higher drilling volumes and increased amount of workover jobs. Expressed as the number of days for the total inventory to turn over and calculated in the functional currency, the turnover rate at the end of six months ending June 30, 2012 was approximately 220 days, which is below 248 days at the beginning of 2012.

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 period ending June 30, 2012 and 2011 (in thousands of US dollars):

	2012	2011
Net cash provided by operating activities	231,703	125,010
Net cash used in investing activities	(279,855)	(662,599)
Net cash provided/(used) in financing activities	(140,139)	421,034

Operating activities

Net cash provided by operating activities amounted to US \$231.7 million for the period ending June 30, 2012, as compared to US \$125.0 million for the six-month period ending June 30, 2011. This significant increase in cash flows provided by operating activities is principally due to a) higher drilling and workover volumes in the 2012 Interim Period than during the corresponding period of 2011, b) integration of acquired businesses from beginning of the period, and c) sustained cost control efforts by our management.

Investing activities

Net cash used in investing activities amounted to US \$279.9 million for the 2012 Interim Period, as compared to US \$662.6 million for the respective 2011 period. Investing activities during the first six months of 2012 are mainly represented by our onshore and offshore capital expenditures that amounted to US \$281.7 million as compared to US \$214.7 million during the corresponding period of 2011. The increase of US \$67 million is mainly represented by the payment to Lamprell in the amount of US \$45.4 million for the construction of our second new-build jack-up rig, *MERCURY*, with delivery scheduled for late 2014. During the first half of 2011 our investing activities were centred on the two acquisitions onshore and offshore, which was not the case during the first half of 2012.

Financing activities

Net cash used in financing activities amounted to US \$140.1 million for the 2012 Interim Period, compared to net cash of US \$421.0 million provided by financing activities during the corresponding period of 2011. During both periods, dividends were paid and certain debt was retired in accordance with its terms. During the first half of 2011 we raised US \$488.5 million through a ruble bond offering and new credit line facilities, while in the 2012 Interim Period no new credit facilities were opened. The funds raised during 2011 together with our strong cash flow from operations were sufficient to finance our last year's business acquisitions and current year capital expenditures programme.

Liquidity

The table below shows our cash and cash equivalents for the period ending June 30, 2012 (unaudited) and the period ending December 31, 2011 (in thousands of US dollars):

	2012	2011
Cash held in banks - Russian rubles	165,492	188,410
Short-term deposit - Russian rubles	88,668	194,771
Cash held in banks - mostly in US dollars	66,453	81,770
Short-term deposit - US dollars	8	39,320
Other	145	5,510
Total cash and cash equivalents	320,766	509,781

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 quarters 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 ending June 30, 2012 (unaudited) and for the year ended December 31, 2011 (audited) advances given for property, plant and equipment amounted to the following (in thousands of US dollars):

	2012	2011
Advances given for property, plant and equipment	186,626	130,105

The amounts represent cash advances for property, plant, and equipment not yet received. The increase in advances given for property, plant, and equipment is mainly attributable to a US \$45.4 million payment made to Lamprell for the construction of our second new-build jack-up rig, *MERCURY*, with late 2014 scheduled delivery.

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

	2012	2011
Construction in progress	90,794	95,404

As of June 30, 2012 construction in progress mainly consists of US \$42 million restricted cash balance to secure one tranche payment to Lamprell for the construction of our first new-build jack-up rig *NEPTUNE* with early 2013 delivery.

The decrease in construction in progress of June 30, 2012 compared to December 31, 2011 is caused by a normal fluctuation in the new drilling rig delivery schedule.

Capital resources

For the period ending June 30, 2012 (unaudited) and for the period ending December 31, 2011 our short-term and long-term debt amounted to the following (in thousands of US dollars) (please see our 2012 Interim Consolidated Financial Statements and the accompanying notes for more detail):

	2012	2011
Current portion of long-term debt	188,831	175,217
Long-term debt	481,592	578,117

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. Our net debt to EBITDA for 2011 was 0.4x. For the full year of 2012 we expect to keep this ratio at a similarly low level.

Our disciplined and conservative approach in managing our leverage was recognised by rating agencies which continued to maintain investment-grade rating with Fitch (BB) with stable outlook and Standard & Poor's (BB) with positive outlook.

Overview of other matters

Dividend policy and year-end 2011 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.

Our results of operations and cash generating capacity continue to be strong, which allows us both to invest in our growing business and to increase dividend payments to our shareholders. The decision of the Board of Directors on the amount of dividends to pay depends on many factors, including, but not limited to, the financial situation and results of the Company, its capital needs for the support of business growth, the overall macroeconomic and market environment, and tax and legislative issues.

For the year ended December 31, 2011 a dividend was declared by the Board of Directors on December 14, 2011 in the amount of 47 cents per share, or US \$69 million, which was included in "Accounts payable and accrued liabilities" and paid on January 18, 2012. For 2010 a dividend of 31 cents per share, or US \$45 million, was declared and paid early in 2011.

Treasury shares

In March 2008, the Company introduced an incentive plan for certain members of management for a five-year period beginning January 1, 2008. In accordance with its Incentive Compensation Plan (the Plan), 522,060 GDRs were awarded early in 2011 to participants in the Plan for their performance in 2010.

No GDR's were awarded to our officers under the Plan for fiscal 2011 as the company's stock price did not increase past the required amount.

In August 2011, we announced that we may buy back up to US \$60 million of our Global Depositary Receipts due to exogenous market conditions. The repurchase programme lasted for 180 days and expired on February 26, 2012. During the time of the share buy-back programme 105,781 GDRs were purchased. During the first six months period 27,924 shares were transferred to Directors in lieu of cash for their service in 2011. As of June 30, 2012 there are 77,857 shares in treasury.

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 reflects shares that may be issued contingent upon stock price performance under the terms of the Plan.

The calculation of earnings per share for the first six months of 2012 and 2011 was as follows:

	2012	2011
Net income available for common stockholders	187,267	150,601
Weighted average number of outstanding shares	146,778,071	146,728,649
Basic/diluted earnings per share of common stock (US dollars)	1.28	1.03

Basic earnings per share were US \$1.28 in the first six months of 2012, compared to US \$1.03 in 1H11. The improvement in earnings per share was attributable mainly to the increase in net income by 24% during 1H12 compared to the corresponding period of 2011. Diluted earnings per share were the same as basic earnings per share in the first six months of 2012.

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 programme of our onshore drilling services division and the purchase of our offshore drilling services business. As of December 31, 2011 the aggregate principal amount of such loans was US \$50 million. These loans are denominated in US dollars and bear interest at 5.8%-8.6% per annum, with the maturity date on or before December 31, 2014.

In the 2012 Interim Period, US \$1.4 million interest was recognised on these loans, of which US \$0.7 million was paid, compared to US \$3 million interest recognised and paid in 1H11 (the principal amount was US \$70 million). Management believes the terms of these loans are no more onerous than those that 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 2012 and the corresponding period of 2011 the Firm billed EDC for costs and expenses of US \$0.8 million and US \$1.6 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 that 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 Results of Operations

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 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 in 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.

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

For example, in 2011 we drilled 879 thousand metres utilising horizontal drilling techniques, representing 18% of our total drilling volumes, while in the corresponding period in 2010 our horizontal drilling operations were 437 thousand metres, or about 11% of total drilling volumes. In the first half of 2012 we continue to see this trend. Horizontal drilling volumes increased by 13% compared to the corresponding period in 2011. “Easy to access” reservoirs that were intensively developed during past decades are no longer capable of delivering appropriate flow rates using conventional drilling techniques. Looking forward we see an increase in horizontal drilling as our customers report higher flow rates from wells drilled horizontally. In many instances vertical wells are not economically feasible due to low flow rates. The horizontal drilling technique is especially beneficial when used to drill reservoirs with a greater horizontal dimension than vertical thickness. It is estimated that horizontal drilling could improve initial well flow rates by two to seven times in some reservoirs.

Productivity

Our results of operations are affected by the productivity of our crews, which in turn depends on a number of factors. Among those factors are crew training and incentives, operating procedures, fleet upgrades and modernisation, logistics flow, and mix of services.

Overall, we believe our core productivity per crew was better during the first half of 2012 when compared to the same period of 2011. 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 has allowed us to both improve Rates of Penetration (ROP) and reduce Non-Productive Time (NPT). Examples of technological advancements include wider usage of Polycrystalline Diamond Compact (PDC) drill bits, introduction of new generation drilling motors, optimisation of BHAs and mud programmes/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 challenging wells we are drilling.

During the last several years we witnessed a number of factors that could moderate the rate of productivity improvement when measured on a per meter basis. All these factors can be broadly described as changing the mix of services that we provide to our customers. In 2011 we drilled twice as many horizontal wells compared to 2010. We continue to drill more such wells in 2012. Horizontal wells are inherently more time consuming to drill than comparable production wells. The average depth of the wells drilled by EDC in Western Siberia increased in aggregate about 7% over the period of a little over two years. Deeper wells require disproportionately more time to drill and heavier drilling rigs. We’ve also expanded our client base and plan to continue this in the future, which, as a general rule, requires rig mobilisation to distant locations. Another factor that affects our crew productivity is seasonality described in more detail in the paragraph below.

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. 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, material 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 this 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 allows us to drill there year-round.

Operational Capacity

Our revenue growth can be negatively affected by the number of drilling rigs and drilling crews available to us. Our ability to increase our onshore business or maintain its current level depends on our ability to procure a sufficient number of new drilling rigs and modernise our existing ones. Following the stabilisation of the global economy, we witnessed the recovery of demand for drilling services in Russia. Importantly, since the wells we drill are getting deeper we see the demand coming for heavier rigs. We've developed a five-year plan according to which 17 rigs were ordered in 2010 and delivered in 2011 and early 2012 to our legacy business. Further in 2012 we ordered another 10-12 rigs with late 2012/early 2013 delivery. Most of these new rigs are heavy rigs, i.e. 320 ton hook load and greater. As of June 30, 2012 about a quarter of our rigs are in the heavy class.

At the end of the 2012 Interim Period we believed we had sufficient capacity with the addition of the new rigs added to our drilling fleet and our increased drilling efficiency to drill well over 6.1 million metres on an annual basis. The transaction with Schlumberger has further expanded our capacity and strengthened our presence in Russia.

Market trends

One noticeable recent market trend is a movement by the Russian oil and gas majors to divest themselves of their in-house service divisions. The process of divestment was initiated in 2004 when we acquired substantially all of the onshore drilling and certain related assets of LUKOIL. In 2009 TNK-BP continued the trend by selling its oilfield services assets to Weatherford. In 2010 both Gazpromneft and Slavneft publicly stated their intention to divest their in-house services divisions. Early in 2012 Gazpromneft divested its drilling assets, while Slavneft was still in the process of divestiture. It's quite possible that other oil and gas companies will follow this trend in the near future, which will change the structure of the oil field services market by shifting activity towards independent providers.

The Russian onshore drilling market is growing rapidly, while the drilling is getting more complex. The obvious evidence is the dramatic increase in horizontal drilling and deepening average well depths in Russia. During the past 10 years a "typical" well drilled in Russia increased by 40%, approaching three kilometres in measured depth. As reservoirs mature, more sophisticated drilling techniques are becoming more vital to support the country's long-term production profile.

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.

This pricing formula effectively limited our ability to adjust prices related to our onshore drilling services for LUKOIL in order to reflect fluctuations in the market prices occurring prior to the next annual price adjustment. In January 2010 we signed a new Framework Agreement with LUKOIL. More than 50% (excluding additional volumes we obtained after the transaction with Schlumberger) of our drilling volume each year is guaranteed on the basis of the Framework Agreement with LUKOIL, requiring us to drill a minimum of 6.7 million metres for the period from 2010 to 2012. The pricing formula is similar to the one in the previous Framework Agreement. We consider 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.

Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

Please see our reviewed 2012 Interim Consolidated Financial Statements for a description of our short-term and long-term debt and the associated interest rates and maturities.

Our exposure to market risk of changes in interest rates relates primarily to our long-term and short-term debt. The table below presents scheduled long-term debt maturities in U.S. dollars and related weighted-average interest rates relating to debt obligations as of June 30, 2012 for each of the 12-month periods ending June 30 (in millions, except interest rate percentages):

	Scheduled Maturity Date						Fair Value	
	2013	2014	2015	2016	2017	2018 and Thereafter	Total	June 30, 2012
Total long term debt	188.8	153.7	107.8	67.7	152.4		670.4	670.4
Fixed rate	170.6	144.7	107.8	67.7	152.4		643.2	643.2
Average interest	7.3%	7.0%	7.0%	7.6%	8.4%			
Variable rate ¹	18.2	9.0					27.2	27.2
Average interest	6.5%	6.5%						

¹ Based on the LIBOR rate at the end of 2012 Interim Period, which rate may fluctuate in later periods.

As is further described in Note 10 of our reviewed 2012 Interim Consolidated Financial Statements, certain debt was originally contracted at below-market interest rates. The schedule above assumes a market rate for such debt in the computation of its fair market value.

Currency Risk

We are exposed to foreign currency exchange rate risks. The currency giving rise to these risks is primarily the Russian ruble. We use the Russian ruble for the majority of our operations, while the US dollar is our reporting currency. Foreign exchange gains and losses result from converting monetary and certain non-monetary assets and liabilities denominated in the Russian ruble into US dollar amounts at each balance sheet date. This includes any borrowing in foreign currency. As of June 30, 2012 we had US \$400.4 million, of a total of US \$670.4 million, of our long- and short-term debt denominated in the Russian ruble. As of December 31, 2011, we had US \$479.9 million, of a total of US \$753.3 million, of our long- and short-term debt denominated in the Russian ruble. In addition, the results of our operations are impacted by transactions entered into in currencies other than the Russian ruble, and a fluctuation in the Russian ruble/US dollar exchange rate will result in a change in the recognised revenues and expenses associated with such transactions. Furthermore, while the majority of our revenues are denominated in the Russian ruble, some of our costs, including some of those associated with purchases of foreign manufactured land rigs, are denominated in the US dollar and other currencies. Any significant foreign currency exchange rate fluctuations (both short- and long-term) could have a material adverse effect on our business, financial condition, and results of operations.

Concentration of Credit Risk

We have a concentration of credit risk since one customer made up approximately 61.1% of our sales during the 2012 Interim Period (60.2% for the comparable 2011 period). In order to reduce exposure to this credit risk we have been increasing our business with other, unrelated, clients and monitoring our accounts receivable balances closely. We perform periodic credit checks on our customers and, as a result, did not have any material bad debt expense from our operations during 1H12. Our allowance for doubtful accounts stood at US \$14.2 million at the end of the six-month period ending June 30, 2012 (US \$14.6 million at the end of 2011), which amount was considered adequate. Our cash and cash equivalents are placed with major banks within Russia, Switzerland and the United Kingdom.