



EURASIA DRILLING COMPANY LIMITED

MANAGEMENT'S REPORT ON 2011 RESULTS

For the twelve months ended December 31, 2011

Select financial and operating information

| | 2011 | 2010 | Change | % |
|--|------------------|-----------|---------|--------|
| <i>in thousand US\$, unless otherwise stated</i> | | | | |
| Revenue | 2,752,417 | 1,812,156 | 940,261 | 51.9% |
| EBITDA | 597,202 | 435,847 | 161,355 | 37.0% |
| EBITDA margin | 21.7% | 24.1% | (2.4)pp | - |
| Net income | 277,237 | 207,353 | 69,884 | 33.7% |
| Operating cash flow | 425,729 | 322,553 | 103,176 | 32.0% |
| Capital Expenditures | 399,954 | 283,777 | 116,177 | 40.9% |
| Dividend per share (US\$) | \$ 0.47 | \$0.31 | 0.16 | 51.6% |
| Diluted EPS (US\$) | \$ 1.89 | \$1.44 | 0.45 | 31.3% |
| Average exchange rate for the period (RUB/US\$) | 29.4 | 30.4 | (1.0) | (3.3%) |
| Meters drilled onshore (th. meters) | 4,777 | 4,103 | 674 | 16.4% |

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

The following report represents management's discussion and analysis of financial condition and results of operations for the twelve month period ended December 31, 2011 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 audited 2011 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, currently the largest oil producer in the world. Our customers include a number of the major Russian integrated oil and gas companies such as LUKOIL, Rosneft, Gazpromneft and TNK-BP that together accounted for over 60% of Russia's total crude oil production in 2011. Among other of our customers are KazMunaiGaz affiliates, Samara-Nafta, Naryanmarneftegaz (a joint venture between LUKOIL and ConocoPhillips) and Rusvietpetro. Offshore our client base includes LUKOIL, Dragon Oil, CMOC (a joint venture between Shell, KazMunayTeniz and the Oman Pearls Company Ltd) and others. Petronas Carigali became a new client to us starting in early 2011, post the purchase of the *SATURN* (formerly Trident 20) jack-up drilling rig from Transocean.

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 588 rigs, the largest in Russia, includes 258 land drilling and sidetracking rigs and 330 workover rigs, and we employ over twenty two thousand personnel (as of 31 December 2011). 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 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 center 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. In November 2010 we contracted Lamprell to build a new hi-spec jack-up rig, the completion of which is expected late in 2012. Early in 2011 we expanded our current offshore rig fleet to two jack-up rigs by acquiring the *SATURN* (formerly *Trident 20*) from Transocean. As such, in 2011 we have the capacity to serve approximately two-thirds the jack-up market in the Russian,

Kazakh and Turkmen waters of the Caspian Sea. 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 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. 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 meters 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 meters drilled), exceeding the previous record high achieved in 2008. Following the global recession oil prices stabilised in 2010 and grew further in 2011, giving oil and gas companies confidence to increase their CAPEX budgets. Russia's oil production and drilling volumes have continued to grow in 2011 reaching a new post-Soviet high; average oil production grew to 10.3 mln bpd, an increase of 1.2%, and drilling volumes expanded to 18.7 million meters, an increase of 9% as compared to 2010 according to CDU TEK.

Russia's oil production is mostly comprised of output from mature fields which in 2011 produced over 80% of total oil output in Russia. Since 2008 the output from these fields was declining and 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, 2011 was not an exception. Greenfield's contribution to the growth was important with the exception of certain fields in Timan-Pechora. The output from mature fields largely stabilized on the back of massively increased drilling volumes in 2010 and 2011 and the movement to more horizontal drilling and more under-balanced drilling.

Operations' review

During 2011 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. Along with our growing core business we completed two high-quality acquisitions, described more fully below, that were consolidated into our strong 2011 results.

Onshore business

Our 2011 onshore operating results include:

- Drilling output of 4.777 million meters, 16% above the output achieved in the corresponding period of 2010 (4.103 million meters);
- Horizontal meters drilled during 2011 more than doubled compared to 2010 and amounted to 879 thousand meters;
- Exploration drilling volumes were up 17% during 2011 compared to 2010;
- Reliance on our largest customer decreased in 2011 with its share comprising 55% of our total drilling volumes compared to 57% in the corresponding period of 2010;

Our Russian onshore drilling volumes increased 16% compared to volumes achieved in 2010, attributable to both organic and inorganic growth. Our cooperation with our main customer, LUKOIL, continues to be strong as we fulfill our commitments based on a long-term Framework Agreement that we signed at the end of 2009 for a period of three years. In 2011 LUKOIL increased its drilling volumes by 13% over the corresponding period of 2010. LUKOIL's share in our total drilling volumes decreased to 55% compared to

57% during 2010. One of our main strategic goals is to diversify our customer base while building long-term relationships with our clients. As such, the share of Rosneft in our total drilling volumes increased to 21% in 2011 from 11% during 2010. The increase is attributable to two reasons. Firstly, we were able to win more tenders with Rosneft including integrated project management type contracts. Secondly, Rosneft is a major client of SGC (ex-Schlumberger drilling assets) and accounts for about 70% of its drilling volumes.

TNK-BP accounted for 3% in our total drilling volumes during the 2011, as the number of drilling rigs employed increased to four in total. 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 a high standard of performance. The share of Gazpromneft in our drilling volumes decreased to 15% during 2011 compared to 29% in 2010. Our client portfolio includes the four largest E&P companies in Russia which, together, accounted for about 55% of the total drilling volumes in Russia in 2010 based on CDU TEK data. We also continue to work for Pechoraneft, Samaranafta and Rusvietpetro.

During 2011 our market share in the Russian onshore drilling market increased to 25% or one percentage point above our market share in 2010. The increase resulted primarily through consolidation of the Schlumberger drilling assets into our operations starting from late April 2011, while our core drilling volumes grew at a slightly slower pace than the market. The drilling pattern in 2011 has been characterised by less seasonality than that witnessed in 2010. The winter was fairly mild and development project start-ups at the beginning of the year were fairly rapid. EDC's exploration activity was also higher during 2011, increasing by 17% compared to 2010, with the majority of exploration wells drilled during the first quarter. Exploration drilling is normally concentrated during periods of ice-road availability, and consequently exploration drilling tends to tie up rigs by isolating them in remote areas. Overall in Russia exploration drilling volumes increased by 5% compared to 2010, as reported by CDU TEK.

EDC's horizontal drilling volumes more than doubled in 2011, reaching 18% of total meters drilled. This growth was driven by our major customer, LUKOIL. 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 rig fleet as of December 31, 2011 totaled 258 onshore drilling and sidetracking rigs compared to 211 as of 31 December 2010. The increase in our rig count is primarily due to the 19 drilling and 23 sidetracking rigs added from assets acquired from Schlumberger. In 2011 we retired 12 drilling rigs and added 17 rigs to our land fleet including one drilling rig added to SGC, and 14 newly manufactured drilling rigs plus 2 refurbished rigs to our legacy operations. 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.

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 efficiencies 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. To meet this requirement the Company has developed a five year rig fleet upgrade and modernisation plan according to which 14 rigs were ordered in 2010 and delivered during 2011 and early 2012. The drilling rigs that we are ordering are produced by Russian and Chinese manufacturers at prices significantly lower than in 2008 and with shorter lead times.

Our onshore workover and sidetracking operations continue to be an important part of our business. Our workover fleet as of December 31, 2011 totaled to 330 workover rigs as compared to 265 rigs as of December 31, 2010. The growth is mostly attributable to the acquisition of workover assets from Schlumberger as well as purchase of new workover units for our existing operations as we retire the old ones. The growth in workover jobs performed was quite moderate, while the growth in our sidetracking

operations was distinguishing. The number of sidetracking jobs performed in 2011 increased by nearly four times compared to 2011 and amounted to 153 jobs.

Transaction with Schlumberger

In the end of April 2011, we completed a transaction with Schlumberger, the world's leading oilfield services company, to exchange assets and to enter into a Strategic Alliance in the CIS. Schlumberger agreed to sell all its drilling (19 drilling rigs), sidetrack (23 sidetracking rigs) and workover rigs (34 workover rigs) currently operating mainly in West Siberia to EDC. The acquired companies from Schlumberger are OOO Sibirskaya Geophysicheskaya Company (SGC) that provides drilling and sidetracking services and ZAO Samatlorsky KRS (SKRS) which provides workover services. As part of the sale, the rigs' crews (12 drilling crews, 20 sidetracking crews and 25 workover crews) transferred to EDC. Schlumberger purchased the Company's drilling services businesses, which include the directional drilling, measurement while drilling, cementing and drilling fluids services to support 80 rigs. The field crews to support delivery of these services were transferred to Schlumberger. In addition, Schlumberger and EDC entered into a strategic alliance upon completion of the transaction whereby Schlumberger became the preferred supplier of drilling services to Eurasia Drilling Company for a 5-year period.

We see this transaction as a foundation of a long-term relationship between two industry leaders. Importantly, we will have guaranteed access to the latest technologies from Schlumberger to offer more complex onshore and offshore drilling solutions. The businesses that we are acquiring from Schlumberger are well managed and have established sound reputations as efficient and reliable service providers. Rosneft and TNK-BP are the largest customers for drilling and workovers, respectively. The rigs the Company has added through this transaction are in excellent condition and are compatible with our rig fleet, which is one of the most modern in Russia.

Offshore business

Our offshore operations remained strong in 2011. Our 2011 offshore operating results include:

- The offshore jack-up rig *SATURN* (formerly *TRIDENT 20*) was acquired from Transocean in February 2011 for our operations in the Caspian Sea - under EDC ownership the rig drilled two new exploration wells with 4 geological sidetracks, and performed 4 workovers;
- Our *ASTRA* jack-up rig was fully employed in Kazakh and Russian waters of the Caspian Sea, drilling three wells and performing an extended well test on one of them;
- Continued operations on LUKOIL's Yu. Korchagin field platform in the Caspian Sea, drilling three horizontal development wells, performing one workover and drilling three top-holes for extended-reach wells
- Construction of our new Super 116E jack-up drilling rig by Lamprell, to be used in our Caspian Sea operations, continues on schedule;

Our offshore operations remained strong in 2011. Our jack-up rig, *ASTRA*, after a period of paid stand-by at the start of the year, was employed first in Kazakh waters, and then starting from May was employed in Russian waters of the Caspian Sea. Three wells were drilled including an extended well test on one in the period.

The construction of our new jack-up drilling rig by Lamprell commenced at the end of 2010. In February 2011 the "strike steel" ceremony took place, and construction continues as per schedule. The new jack-up rig is a LeTourneau designed Super 116E self-elevating Mobile Offshore Drilling Platform, designed to operate in water depths of up to 350 feet and will have a rated drilling depth of 30,000 feet. The hull and related components are being pre-fabricated by Lamprell in its Sharjah facility, while the remaining component fabrication, final assembly and commissioning will be performed at a shipyard in the Caspian Sea. Transportation of the components to the Caspian is scheduled to begin in April 2012 via the Volga-Don canal system. Construction and commissioning are expected to be completed in the first half of 2103. The

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

We continued our operations on LUKOIL's Yuri Korchagin field platform, drilling three horizontal development wells, performing one workover and drilling three top-holes for extended-reach wells. Beginning in July, 2011 the LSP-1 platform underwent a scheduled two month upgrade to prepare for more extended reach drilling during the balance of the year.

Acquisition of SATURN (formerly TRIDENT 20) jack-up drilling rig from Transocean

In February 2011 we completed the acquisition of the SATURN jack-up drilling rig from Transocean for a total consideration of US\$ 260 million, excluding working capital adjustments. The SATURN is a Keppel FELS CS Mod V cantilever jack-up capable of operating in water depths to 350 feet and capable of drilling to 26,000 feet. The rig is presently operating in the Turkmen waters of the Caspian Sea on a long-term contract with Petronas Carigali (Turkmenistan) Sdn Bhd, which runs through 2012. Under EDC ownership the rig drilled two new exploration wells with 4 geological sidetracks, and performed 4 workovers in 2011. The acquisition of the SATURN is a milestone on our path to become the market leader in the Caspian offshore drilling market.

Outlook

Global oil prices were strong in 2011 and ranged from US \$93/barrel for Urals 32° to a maximum of US \$123/barrel, supporting the industry development. The prices were more volatile in Q1-2012, but higher on average than in the first quarter of 2011.

In the Russian market, most commentators forecast the growth in drilling volumes to continue further in 2012 as most E&P companies are guiding to expansion in their capital budgets. For the first few months of 2012 the drilling volumes in Russia continued to grow, though at a slightly slower pace than in 2011. The winter months of 2012 were characterized as quite warm compared to the usual temperatures recorded in Western Siberia during this time of year, which created delays in some of our equipment relocations. Overall, we expect 2012 to be characterized by greater seasonality than 2011.

More and more emphasis is being placed towards strategies to enhance upstream efficiency, including increases in new-well flow rates and improvements in the recovery factor on existing reserves. 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 similar pace as total drilling volumes and amount approximately to one million meters for EDC in 2012.

In 2011 we expanded our rig fleet by seventeen drillings rigs, which will be fully utilized in 2012. We will continue to make significant capital expenditures for the purpose of taking advantage of the growing demand for drilling services in our market. In 2012 we 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 15%, reaching the level of approximately 5.5 million meters 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 27% by the end of 2012.

The Company's relationship with its customers continues to be strong. Most of our customers are planning to increase their drilling volumes in 2012 compared to 2011. 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 remain at a level similar to 2011 (in 2011 LUKOIL accounted for 55% of total EDC drilling volumes). We expect to deploy more

drilling rigs with TNK-BP in the Orenburg area, while percentage-wise its share is also expected to stay flat compared to 2010, as this area is characterised by more complex and deeper drilling. 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 sidetracking 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 for a full 12 month program in 2012 in the Russian and Kazakh sectors of the Caspian Sea, and is currently deployed in Kazakh waters at an attractive day-rate for N Operating Company, developing the *N-Block*. The *SATURN* is expected to be fully utilised for new well drilling and well servicing in Turkmen waters in 2012, under the existing contract with Petronas Carigali, which expires in the end of 2012. We expect to renegotiate the contract with Petronas Carigali mid-2012 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 our Caspian fleet when the Super 116E jack-up being constructed by Lamprell enters service in 2013. We continue to evaluate opportunities for further expansion in this growing market.

Appreciation in the Russian ruble with respect to the US dollar is expected to improve our reported results for 2012 over 2011 as most commentators are confident the ruble will stay relatively strong.

We anticipate 2012 to be our busiest year yet as our customers are expanding their spending on our services. We will use 2012 to focus on execution to strengthen further our leadership position in the market. We continue to evaluate other opportunities both within and outside Russia and the CIS. Meanwhile, our historical businesses continue to perform well and grow with their markets. We expect 2012 to be another robust year.

Financial Review

During 2011 we achieved solid financial results across all lines and geographies of our business. We continue to concentrate on execution backed by our ongoing investment in drilling rig fleet modernisation and upgrade. Our fiscal year 2011 results reflect our success in achieving growth both organically and through strategic acquisitions with both EBITDA and PAT increasing in dollar terms while our margins are slightly lower due to changes in the service mix.

Our 2011 financial results include:

- Revenue for 2011 was US \$2,752 million, which is US \$940 million or 51.9% above US \$1,812 million reported for FY 2010;
- 2011 EBITDA was US \$597 million which is US \$161 million or 37.0% above US \$ 436 million EBITDA reported in 2010;
- EBITDA margin decreased to 21.7% which is 2.4 percentage points below 24.1% EBITDA margin reported for the fiscal year 2010;
- 2011 Net Income was US \$277 million which is US \$70 million or 33.7% above US \$207 Net Income reported in 2010;
- Diluted earnings per share for the fiscal year ended December 31, 2011 was US \$1.89, 31,3% higher than that of US \$1.44 for 2010;
- 2011 average US dollar exchange rate was 29.4 rubles per US dollar as compared to 30.4 rubles per US dollar in 2010, a percentage change of 3.3%.

Reconciliation of Net Income to EBITDA

Earnings before Interest, Taxes, Depreciation and Amortization (EBITDA), a non-GAAP financial measure, is computed with reference to the Company's net income for fiscal years 2011 and 2010 as follows (in thousands of US dollars, audited):

| | 2011 | 2010 |
|---------------------------------------|----------------|----------------|
| Net Income | 277,237 | 207,353 |
| Income Tax Expense | 82,512 | 71,812 |
| Loss / (gain) on Disposal of PP&E | 1,362 | (6,344) |
| Currency Transaction Loss | 11,054 | 7,355 |
| Gain on business exchange transaction | (32,284) | (557) |
| Impairment loss | 1,296 | 7,096 |
| Interest Income | (11,485) | (7,993) |
| Interest Expense | 52,342 | 15,125 |
| Depreciation | 215,168 | 142,000 |
| EBITDA | 597,202 | 435,847 |

In dollar terms our EBITDA in 2011 increased by US\$ 161 million or 37% compared to fiscal year 2010. At the same time, EBITDA margin dropped to 21.7% from 24.1% achieved in 2010. Our EBITDA margin is negatively affected by the changes in the mix of services in our core business leading to a higher component of third party services which are largely pass through costs.

Revenues

The following table sets forth a summary of our operating results for 2011 and 2010 (for additional information, please see the accompanying audited 2011 Consolidated Financial Statements).

Consolidated statements of income for the fiscal years ended December 31, 2011 and December 31, 2010 (All figures in thousands of US dollars, unless otherwise noted, audited):

| | 2011 | 2010 |
|--|------------------|------------------|
| Revenues | | |
| Drilling and related services | 2,720,112 | 1,798,881 |
| Other sales and services | 32,305 | 13,275 |
| Total revenues | 2,752,417 | 1,812,156 |
| Cost of services | (1,898,246) | (1,195,891) |
| Selling, general and administrative expenses | (144,614) | (106,920) |
| Taxes other than income taxes | (118,850) | (72,547) |
| Depreciation | (215,168) | (142,000) |
| (Loss) / gain on disposal of property, plant and equipment | (1,362) | 6,344 |
| Impairment loss | (1,296) | (7,096) |
| Income from operating activities | 372,881 | 294,046 |
| Interest expense | (52,342) | (15,125) |
| Interest income | 11,485 | 7,993 |
| Currency transaction loss | (11,054) | (7,355) |
| Gain on business exchange transaction | 32,284 | 557 |
| Other income / (expenses) | 6,495 | (951) |
| Income before income taxes | 359,749 | 279,165 |
| Income tax expense | (82,512) | (71,812) |
| Net income | 277,237 | 207,353 |
| Basic earnings per share of common stock (US dollars) | 1.89 | 1.45 |
| Diluted earnings per share of common stock (US dollars) | 1.89 | 1.44 |

Our total dollar-expressed revenues increased by US \$940.3 million, or 51.9%, to US \$2,752.4 million for 2011 from US \$1,812.2 million in the fiscal year 2010. Increase in other sales and services is mainly caused by rental fees received for the new jack-up rig *SATURN* from the acquisition date in the beginning of February till the end of May. During this period we were in the process of reassigning the long-term contract with Petronas Carigali from Transocean's affiliate to the Company. In 2010 we had no similar income.

The financial results of operations in US dollars for the fiscal year 2011 were influenced by several factors including an increase in our number of meters drilled (including projects with a significant amount of reimbursable services & products that have negative impact on our EBITDA margin), changes in the mix of services (drilling deeper wells and higher levels of horizontal drilling), our asset swap with Schlumberger (disposal of service assets and addition of SGC's drilling business), integration of the new jack-up rig *SATURN* as well as ruble appreciation (2011 average US dollar exchange rate was 29.4 rubles per US dollar as compared to 30.4 rubles per US dollar in 2010, a percentage change of 3.3%).

Cost of services

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

| | 2011 | 2010 |
|--|------------------|------------------|
| Services of subcontractors | 914,551 | 488,950 |
| Wages and salaries | 425,143 | 324,924 |
| Materials | 307,796 | 218,916 |
| Fuel and energy | 131,051 | 79,530 |
| Transportation of employees to drilling fields | 28,085 | 23,358 |
| Leasing and rent | 25,376 | 10,891 |
| Other | 66,244 | 49,322 |
| Total cost of services | 1,898,246 | 1,195,891 |

Cost of services increased by US \$702.4 million, or 58.7%, to US \$1,898.2 million for the fiscal year 2011 from US \$1,195.9 million for 2010. Cost of services as a percentage of total revenue increased from 66.0% in 2010 to 69.0% for the fiscal year 2011. This increase is mostly due to significant changes in the mix of services. Drilling deeper wells and a higher level of horizontal drilling resulted in an increase in revenue related to reimbursable outside services & products sold to our clients with no related mark-up. In addition, we are experiencing some cost inflation in 2011, particularly related to social taxes, fuel, energy and transportation.

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 and offshore division, services contracted from third parties include subcontracting for technological services; transportation services; road and pad construction; well facility services; petrophysical services; drilling motor and telemetry; cementing services; and drilling bit services. Services of subcontractors continue to be the largest component of our cost of services. For the fiscal year 2011, services of subcontractors were US \$914.5 million, or 48.2% of total cost of services, as compared to US \$489.0 million, or 40.9% of total cost of services for 2010. The key driving forces of the increase in both total dollars expended and the change as a percentage of total cost of services are a) an increase in revenue related to reimbursable services which are sold to clients with little related mark-up (e.g. telemetry for horizontal wells, casing and pads construction), b) the asset swap with Schlumberger which resulted in a disposal of internal services assets and acquisition of drilling assets.

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 2011 were US \$307.8 million, or 16.2% of total cost of services as compared to US \$218.9 million, or 18.3% of total cost of services for 2010. The increase in total dollars spent on materials is affected by the growth in drilling volumes and by an increase in reimbursable casing pipe in our new projects.

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 pension funds or social taxes we pay to the Russian government. Wages and salaries for the fiscal year 2011 were US \$425.1 million, or 22.4% of total cost of services as compared to US \$324.9 million, or 27.2% of total cost of services for 2010. The significant decrease in the percentage of total cost of services was mostly caused by an increase in the share of subcontractors.

Fuel and energy costs consist primarily of oil, lubricants and electricity. Fuel and energy costs for 2011 were US \$131.1 million, or 6.9% of total cost of services as compared to US \$79.5 million, or 6.7% of total cost of services for 2010. The change as a percentage of total cost of services is not material while the change in

dollars spent on fuel and energy is significantly affected by the price inflation in 2011 for energy and fuel expenses.

Costs relating to the transportation of employees to field locations primarily include transportation services related to the mobilization and rotation of rig crews. Expenses relating to the transportation of employees to field locations for the fiscal year 2011 were US \$28.1 million, or 1.5% of total cost of services as compared to US \$23.4 million, or 2.0% of total cost of services for 2010. 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 2011 were US \$25.4 million, or 1.3% of total cost of services as compared to US \$10.9 million, or 0.9% of total cost of services for 2010. The percentage of total cost of services change is not considered material. The increase in total dollars expended is primarily a function of an increase in amount of drilling equipment we have under lease as well as integration of rented equipment in SGC (the newly acquired drilling company from Schlumberger).

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 \$66.2 million or 3.5% of our total cost of services for the fiscal year 2011, as compared to US \$49.3 million or 4.1% of our total cost of services for 2010. The increase in the total amount is primarily caused by an increase in insurance costs. The decrease in the percentage of total cost of services is considered immaterial and mostly caused by increase in the share of services of subcontractors.

Selling, general and administrative expenses

Selling, general and administrative expenses increased by US \$37.7 million to US \$144.6 million for the 2011, as compared to US \$106.9 million for the fiscal year 2010. The total dollar increase is mostly attributable to the business growth both organically and through acquisitions of SGC & SKRS in the onshore segment and *SATURN jack-up rig* in the offshore segment. As a percentage of total revenues, selling, general and administrative expenses decreased to 5.3% in 2011 from 5.9% in 2010 due to the fixed nature of such expenses.

Taxes other than income taxes

Taxes other than income tax include various local taxes, such as property tax, social tax, education tax, police tax, animal protection tax and small nation’s tax. Taxes other than income taxes increased by US \$46.4 million to US \$118.9 million for the fiscal year 2011 as compared to US \$72.5 million for 2010. This increase is mostly attributable to the change in the Russian tax law and continuous adjustments in the formula for social contributions. As a percentage of revenue, taxes other than income taxes increased to 4.3% of revenue in 2011 as compared to 4.0% in 2010.

Depreciation

Depreciation increased by US \$73.2 million to US \$215.2 million for the fiscal year 2011 as compared to US \$142.0 million for 2010. As a percentage of revenues, depreciation was 7.8% for both 2011 and 2010. The total dollar increase was mostly caused by our ongoing modernisation program and significant capital expenditures in PP&E and by the depreciation of the equipment and machinery acquired with the purchase of both onshore (Schlumberger’s drilling, workover and sidetracking assets) and offshore (*SATURN* jack up rig) drilling assets. In addition, during 2011 we revised our original estimates of the useful life of our drilling pipe from 2-4 years to 2-3 years which increased depreciation in the 2011 income statement by US \$16.1 million.

Disposal of property, plant and equipment

Gain/(loss) on the disposal of property, plant and equipment decreased by US \$7.7 million to a loss of US \$1.4 million for the fiscal year 2011 as compared to a gain of US \$6.3 million for 2010. This change is

explained by common disposal of PPE and by the fact that no significant assets were sold in 2011 compared to 2010 when gain was contributed by the sale of our transportation assets in the Perm branch.

Income from operating activities

Income from operating activities increased by US \$78.8 million to US \$372.9 million for 2011, as compared to US \$294.0 million for 2010. The increase in total dollars is primarily due to the higher number of meters drilled and integration of the new businesses. As a percentage of revenues, income from operating activities decreased to 13.5% in the fiscal year 2011 from 16.2% in 2010. This percentage decrease is primarily due to increase in services of subcontractors (particularly reimbursable services in horizontal drilling sold to clients with no mark-up) and price inflation for social taxes, energy, fuel and transportation expenses as described above.

Interest expense

Interest expense increased by US \$37.2 million to US \$52.3 million for fiscal year 2011 as compared to US \$15.1 million for 2010. This increase is caused by interest incurred on the newly raised debt in December 2010 (US \$254 million from Alfa-Bank), April 2011 (US \$220 million from Raiffeisenbank) and June 2011 (US \$176 million ruble bond issue). This debt was raised at attractive terms for developing our business both onshore and offshore through acquisitions of strategic assets and modernisation of our drilling fleet.

Income before income taxes

Income before income taxes increased by US \$80.5 million to US \$359.7 million for 2011, as compared to US \$279.2 million for 2010. The increase in income before income taxes is attributable to the net gain realized from selling directional drilling, cementing and drilling fluid assets to Schlumberger (US \$32.9 million gain) and to the factors described in more detail above.

Income tax expense

Income tax expense increased by US \$10.7 million to US \$82.5 million for the fiscal year 2011, as compared to US \$71.8 million for 2010. Our effective tax rate decreased to 22.9% in 2011 from 25.7% in 2010 primarily due to the fact that in the first half of 2010 a 5% foreign withholding tax was applied on intercompany dividends declared and paid in the amount of RUR 5.0 billion. Additionally, in 2011 no tax was due on the US 32.8 million gain realised on the sale of the above described assets to Schlumberger. Based on current tax laws, we expect our effective corporate income tax rate to be approximately 23.5% in the future.

Net income

As a result of the foregoing factors, net income increased by US \$69.8 million to US \$277.2 million for the fiscal year 2011, as compared to US \$207.4 million for 2010.

Overview of financial situation as of December 31, 2011 and liquidity

After lengthening the maturity profile of our debt our balance sheet and cash flows remain strong. Our year-end 2011 financial situation highlights include:

- Cash and cash equivalents as of December 31, 2011 was US \$510 million, a decrease of US \$119 million as compared to cash and cash equivalent balance of US \$629 million as of December 31, 2010;
- Our total debt as of December 31, 2011 increased to US \$753 million as compared to US \$404 million debt balance as of December 31, 2010;
- During fiscal year 2011 we paid dividends in the amount of US \$45 million resulting from our successful 2010 operations;
- Net debt position (cash reduced by all debt) was US\$ 244 million as of December 31, 2011 (year-end 2010 we were net cash of US \$225 million);
- Capital expenditures for the fiscal year ended December 31, 2011 were US \$400 million including changes in restricted cash as compared to US \$284 million incurred during 2010.

Accounts receivable

Accounts receivable increased by US \$112.7 million to US \$348.1 million as of December 31, 2011, from US \$235.4 million at the beginning of the year. The increase in total dollars is primarily due to an increase in revenue. Expressed as the number of days outstanding, our trade receivable balance increased from approximately 49.3 days at the beginning of the year to approximately 51.5 days at the end of the period (both ratios are expressed in ruble terms). Year-end accounts receivable incorporate receivables in SGC and SKRS revenue for which we started consolidating in May after the acquisition. If we annualize revenue of these two business units then number of days outstanding would remain on the same level of 49 days.

Materials for drilling and workover

The balance for materials for drilling and workover, a component of our inventory balance, increased by US \$62.8 million from US \$127.9 million at the beginning of the year to US \$190.7 million at the end of the year. Expressed as the number of days for the total inventory to turn over, the turnover rate at the end of the year was approximately 247.8 days, up by a month as compared to 214.0 at the beginning of 2011, when expressed in ruble terms. For the same reason as above, if we calculate number of days for inventory to turn over with annualized results of SGC and SKRS, we would get 225.9 days in the end of 2011 which is slightly above the figure at the beginning of the year. This increase in turnover days as well as the increase in the dollar balance as of December 31, 2011 is primarily attributable to the growth of drilling volumes and acquisition of new drilling assets.

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 twelve month period ended December 31, 2011 and 2010 (in thousands of US dollars, audited):

| | 2011 | 2010 |
|--|-------------|-------------|
| Net cash provided by operating activities | 425,729 | 322,553 |
| Net cash used in investing activities | (848,865) | (325,190) |
| Net cash provided/(used) in financing activities | 347,340 | 206,188 |

Operating activities

Net cash provided by operating activities amounted to US \$425.7 million for 2011, as compared to US \$322.6 million for 2010. This increase in cash flows provided by operating activities is principally due to higher drilling volumes in 2011 compared to 2010 as well as cash flow generated by the newly acquired businesses.

Investing activities

Net cash used in investing activities amounted to US \$848.9 million for the fiscal year 2011, as compared to US \$325.2 million for 2010. The increase is mostly attributable to strategic acquisitions taking place in 2011 including the purchase of the jack-up rig *SATURN* from Transocean and the assets swap with Schlumberger. In addition we continue to capitalize on the growth opportunities in our markets by significantly increasing our investments in new property, plant and equipment. In 2011 our capital expenditures were US \$400.0 million, as compared to US \$283.8 million in 2010, including US \$84 million spent in 2011 on construction of the new jack up drilling rig as compared to US \$42 million for 2010. Another key factor attributing to this

growth is increase in our technical upgrade program and payments for the new rigs ordered in late 2010 and during 2011.

Financing activities

Net cash provided by financing activities amounted to US \$347.3 million for 2011, as compared to net cash of US \$206.2 million provided by financing activities in 2010. During both periods, dividends were paid and principal repayments of long term debt were made. The increase in net cash provided by financing activities during 2011 is attributable to debt raised from Raiffeisenbank and ruble bonds issued during the year used for developing our business both onshore and offshore through acquisitions of strategic assets and modernisation of our drilling fleet.

Liquidity

The table below shows our cash and cash equivalents for the period ended December 31, 2011 and the year ended 2010 (in thousands of US dollars, audited):

| | 2011 | 2010 |
|---|----------------|----------------|
| Short-term deposit - Russian rubles | 194,771 | 154,730 |
| Cash held in banks - Russian rubles | 188,410 | 76,451 |
| Cash held in banks - mostly in US dollars | 81,770 | 357,911 |
| Short-term deposit - US dollars | 39,320 | 40,033 |
| Other | 5,510 | 341 |
| Total cash and cash equivalents | 509,781 | 629,466 |

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. As of December 31, 2011 and 2010 advances given for property, plant and equipment amounted to the following (in thousands of US dollars, unaudited):

| | 2011 | 2010 |
|--|-------------|-------------|
| Advances given for property, plant and equipment | 130,105 | 67,557 |

The amounts represent cash advances for property, plant and equipment not yet received. The increase in advances given for property, plant and equipment is attributable to a US \$42 million advance paid for the construction of the new jack up rig to Lamprell and advances paid for the construction of the new onshore drilling rigs.

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

| | 2011 | 2010 |
|--------------------------|-------------|-------------|
| Construction in progress | 95,404 | 40,146 |

Increase in construction in progress as of December 31, 2011 compared to year-end 2010 is due to the arrival of new drilling rigs which are not yet put in service.

Additionally, as of December 31, 2011, the Company had on deposit restricted cash in the amount of US \$42.0 million to secure one tranche payment to Lamprell for the new jack up rig.

Capital resources

As of December 31, 2011 and 2010 our short-term and long-term debt amounted to the following (in thousands of US dollars, audited) (please see our 2011 Consolidated Financial Statements and the accompanying notes for more detail):

| | 2011 | 2010 |
|---|-------------|-------------|
| Short-term debt and current portion of long-term debt | 175,217 | 117,550 |
| Long-term debt | 578,117 | 286,367 |

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 obligations 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 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 the dividend payment 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 support of business growth, 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. In 2010 a dividend of 31 cents per share or US \$45 million was declared and paid early in 2011.

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 section for further details.

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 of the Plan for their performance in 2010.

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 718,868 of these GDR's to our officers under the Plan for their performance in 2009.

In April 2010 the remaining treasury shares, net of the award under the Plan and those given to Directors in lieu of cash for their Board service, 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 paid on May 19, 2010.

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 program lasted for 180 days and expired on February 26, 2012. During the time of the share buy-back program 105,781 GDRs were purchased.

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.

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 Plan.

The calculation of earnings per share for the twelve months 2011 and 2010 was as follows:

| | 2011 | 2010 |
|---|-------------|-------------|
| Net income available for common stockholders | 277,237 | 207,353 |
| Weighted average number of outstanding shares | 146,768,307 | 143,270,265 |
| Basic earnings per share of common stock (US dollars) | 1.89 | 1.45 |
| Contingent shares of under the Plan | - | 522,060 |
| Weighted average number of outstanding shares, after dilution | 146,768,307 | 143,792,325 |
| Diluted earnings per share of common stock (US dollars) | 1.89 | 1.44 |

Earnings per share calculated on a diluted basis of 146,768,307 shares amounted to US \$1.89 in 2011, compared to US \$1.44 in 2010. The improvement in earnings per share was attributable mainly to the increase in net income by 34% in fiscal year 2011 compared to 2010. The weighted average number of shares outstanding increased in 2011 by 2%.

Basic earnings per share were US \$1.89 in 2011 compared to US \$1.45 in 2010.

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. As of December 31, 2010 the aggregate principal amount of such loans was US \$70.0 million which were due to mature on December 31, 2011 and bore interest at the rate of 8.6% per annum. In the end of 2011, US \$20.0 million of these loans was repaid with the remaining

US \$50.0 million being renewed and due to mature on or before December 31, 2014. These shareholder loans bear interest of 5.8%-8.6% per annum.

In 2011, as well as in 2010, US \$6 million dollars was recognised and paid on these loans which are denominated in US dollars. Management believes the terms of these loans are no more 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 2011 and 2010 the Firm billed EDC for costs and expenses of US \$2.4 million and US \$2.2 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.

Guarantees

In October 2010 the Company originated a bank guarantee with a value of \$5.1 million in favor of a subcontractor in consideration for an option to acquire an interest in an exploration project from a company controlled by related parties. The bank guarantee and the option expired in October 2011 without being exercised and at no cost to the Company.

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 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.

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 meters utilising the horizontal drilling technique, representing 18% of our total drilling volumes, while in the corresponding period of 2010 our horizontal drilling operations were 437 thousand meters, or about 11% of total drilling volumes. "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 rather 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 upgrade and modernisation, logistics flow and mix of services.

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 have 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.

Starting from 2010 and further in 2011 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 and seventeen percent more exploration wells compared to 2010. Exploration and 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 mobilisations to distant locations. Another factor that affects our crew productivity is seasonality described in more details 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, 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 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 grow 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 the demand for drilling services in Russia. Importantly, since the wells we drill are getting deeper we see the demand coming for heavier rigs; 320 tons or greater. 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. The rigs that we are ordering are produced by Russian and Chinese manufactures at prices significantly lower than in 2008 and with much shorter lead times.

At the end of 2011 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 meters 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 their 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 evidences are 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. 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. 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 volumes each year is guaranteed on the basis of the Framework Agreement with LUKOIL requiring us to drill a minimum of 6.7 million meters 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 Disclosure about Market Risk

Interest Rate Risk

Please see our audited 2011 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 for 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 for each of the 12-month periods ending December 31 relating to debt obligations as of December 31, 2011 (in millions, except interest rate percentages):

| | Scheduled Maturity Date | | | | | | Fair Value | |
|----------------------------|-------------------------|-------|-------|------|------|---------------------|------------|-------------------|
| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 and Thereafter | Total | December 31, 2011 |
| Total long term debt | 175.7 | 202.9 | 118.4 | 67.7 | 33.8 | 155.3 | 753.8 | 753.3 |
| Fixed rate | 160.1 | 187.1 | 118.4 | 67.7 | 33.8 | 155.3 | 722.4 | 721.9 |
| Average interest | 7.4% | 7.1% | 6.9% | 7.3% | 7.9% | 8.4% | | |
| Variable rate ¹ | 15.6 | 15.8 | | | | | 31.4 | 31.4 |
| Average interest | 5.8% | 5.8% | | | | | | |

¹ Based on the LIBOR rate at the end of 2011, which rate may fluctuate in later periods.

As is further described in Note 12 of our audited 2011 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 borrowings in a foreign currency. 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. As of December 31, 2010, we had US \$327.5 million of a total of US \$403.9 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 rates will result in a change in the recognized 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 and offshore 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. In addition, in 2011 certain of our intercompany debt was denominated in a currency other than the functional currency of the debtor company (in all cases the debtor companies are and were 100% owned members of our consolidated group).

Concentration of Credit Risk

We have a concentration of credit risk since one customer made up approximately 60.9% of our sales during the fiscal year 2011 (71.2% for 2010). In order to reduce the exposure to this credit risk we have been increasing our business with other, unrelated, clients and monitoring our account 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 2011. Our Allowance for doubtful accounts stood at US \$14.6 million at the end of 2011 (US \$17.3 million at the end of 2010), which amount was considered adequate. Our cash and cash equivalents are placed with major banks within Russia, Switzerland and the United Kingdom.