Discussion and Analysis
of Financial Condition and Results of Operations

The following Discussion and Analysis of Financial Condition and Results of Operations for the twelve month period ending December 31, 2008 is intended to help our shareholders understand the results of our operations and our financial condition. This information is provided as a supplement to, and should be read in conjunction with, our 2008 audited Consolidated Financial Statements and the accompanying notes, prepared in accordance with US GAAP and included elsewhere in this document. As used in this Discussion, "Company", "we," "us," "our" and "EDC" means Eurasia Drilling Company Limited and, where the context requires, includes our subsidiaries.

This discussion 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 largest provider of onshore drilling services in Russia, as measured by the number of meters drilled, providing onshore integrated well construction services and workover services. In addition, we provide offshore drilling services in the Caspian Sea. We offer our onshore integrated well construction and workover services to local and international oil and gas companies primarily in Russia and our offshore drilling services to Russian and international oil and gas companies in the Russian, Kazakh and Turkmen sectors of the Caspian Sea.

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 LUKOIL. In December 2006, we entered the offshore drilling business by acquiring the offshore drilling business of LUKOIL, which primarily comprised the "*ASTRA*," a floating jack-up drilling rig located in the Caspian Sea. According to data published by CDU TEK, a service that reports Russian oil field information, we estimate that our share of the onshore drilling market in Russia was 22.4% as of December 31, 2007. During 2008 our share of the onshore drilling market increased to 26.0% as measured by the number of meters drilled. EDC also operates one of only three jack-up drilling rigs capable of drilling in the Caspian Sea, and as such we have the capacity to serve approximately one-third of that market.

Our business is currently organized within two main segments, onshore and offshore drilling services. Our onshore drilling services include the construction of production, exploration and appraisal oil and gas wells and certain other types of wells, including vertical, deviated and horizontal wells, ranging from a depth of approximately 1,200 meters to more than 5,000 meters. In addition, through the onshore division we provide a wide range of workover services, including sidetracking. We provide our onshore drilling services in several major onshore oil and gas regions of the Russian Federation, including Western Siberia, Timan-Pechora, the Volga-Urals and to a lesser extent Eastern Siberia. Drilling activities in Eastern Siberia are expected to grow in the future as our clients expand their activities in that region. During 2008 we also provided onshore drilling services in Kazakhstan. Our offshore division constructs oil and gas exploration and production wells in waters with depths of up to 45 meters. We provide our offshore drilling services with our jack-up rig, the *ASTRA*. In addition to LUKOIL, our customers include a number of the major Russian and international oil and gas companies operating in Russia and the Caspian Sea, such as Rosneft, Gazpromneft, TNK-BP, Total, Shell, KazMunaiGaz affiliates, PetroResource, Samara-Nafta and Naryanmarneftegaz, a joint venture between LUKOIL and ConocoPhillips.

Overview

Our 2008 financial and operating results include:

- revenues increased by 40.9% to US $2,101.7 million for the period;
- net income grew by 31.1% to US $220.9 million for the period (despite increases in some cost categories);
- earnings before interest, taxes, depreciation and amortization (EBITDA) improved by 44.3% to US $452.7 million;
- earnings per share increased, for the equivalent period, from US $1.31 in 2007 to US $1.51 in 2008;
- net cash provided by operating activities increased to a record US $309.9 million for the year;
- market share (based on meters drilled) grew from 22.4% during 2007 to 26.0% of the market during 2008 (all organic growth);
- increased our meters drilled by 23.6% from 3,268,564 for 2007 to 4,041,032 for 2008;
- increased our total number of land drilling rigs to 201 from 195 at the beginning of the year;
- repurchased approximately 9.6 million shares of our outstanding common stock; and
- completed shipyard upgrading work on the *ASTRA* - certifying it for uninterrupted offshore work for another five year period.

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

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

During 2008 our business continued to benefit from favorable market conditions resulting primarily from high commodity prices for much of the year and a resulting increase in demand for our services. This increased demand was met by adding drilling crews, improving the productivity of our existing drilling crews and utilizing a greater number of drilling rigs.

We increased the number of land drilling crews to 115, as compared to 112 at the beginning of 2008, and the number of land drilling rigs to 201, as compared to 195 at the beginning of

2008. As a result of these increases and also an increase in overall drilling efficiency, we increased the number of meters drilled on land by 23.6% to 4,041,032 meters, as compared to 3,268,564 meters in 2007. In addition, EDC drilled its first million meters in 102 days during 2008, as compared to 125 days in 2007.

The productivity of our crews was improved through the continuous implementation and utilization during 2008 of more advanced drilling technologies and the application of new standards to our drilling operations. Advanced crew training and application of innovative technologies allowed us to both improve Rates of Penetration (ROP) and reduce Non-Productive Time (NPT). Examples of technological advancements included wider usage of Polycrystalline Diamond Compact (PDC) drill bits, introduction of new generation drilling motors, optimization of bottom-hole-assemblies (BHAs) and mud programs/properties, and real-time drilling navigation. The use of top-drives and four-step drilling mud cleaning systems on our high specification rigs further improved ROP and efficiency in the increasingly more challenging wells we are drilling.

Our revenue growth depends on our ability to charge clients market prices for our onshore and offshore drilling and other services. The majority of our revenues are currently derived from services provided to the LUKOIL Group. The LUKOIL Framework Agreement established a pricing adjustment formula applicable to the onshore drilling services we provide to LUKOIL. Such pricing formula effectively limits our ability to adjust the prices related to our onshore drilling services for LUKOIL to reflect fluctuations in the market prices occurring prior to the following annual price adjustment. However, we consider that the prices at which we provide services pursuant to the LUKOIL Framework Agreement are acceptable given the volume of services provided over the course of each year. In addition, we believe that the contracts we enter into with our other customers provide us with greater flexibility to adjust their contract prices to better conform to current market levels. During 2008, we continued to diversify our customer base, with non-LUKOIL business increasing from 23.6% during 2007 to 27.3% during 2008.

During 2008 we continued to face cost pressure as a result of increases in labor costs, costs of services contracted to subcontractors, such as, for example, petrophysical and well services, and prices for materials essential to our operations. Cost of services increased by US $422.2 million, or 40.9%, to US $1,453.7 million for 2008 (US $1,031.5 million for 2007). Cost of services as a percentage of total revenue increased slightly from 69.1% during 2007 to 69.2% in 2008. Thus, these labor and vendor cost increases, while meaningful, were in line with the overall increase in revenue during 2008.

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 year we repurchased approximately 9.6 million shares, representing approximately 6% of our shares outstanding before the commencement of the program. The repurchase program continued on into the first two months of 2009 such that by the end of February 2009 we had repurchased a cumulative total of approximately 11.3 million shares of our stock, representing approximately 8% of our shares outstanding before the commencement of the program. It is our intention to retain the bulk of these repurchased shares in treasury.

Reconciliation of Net Income to EBITDA

Earnings Before Income Taxes, Depreciation and Amortization (EBITDA) is computed with reference to the Company's net income for 2008 and 2007 as follows (in thousands of US dollars, audited):

	2008	**2007**
Net Income	**220,933**	**168,544**
Income Tax Expense	75,271	60,907
Loss on Disposal of PP&E	4,722	610
Currency Transaction Losses/(Gains)	33,017	(349)
Interest Income	(9,553)	(4,546)
Interest Expense	26,553	29,880
Depreciation	101,777	58,705
EBITDA	**452,720**	**313,751**

Outlook

During the first half of 2008 the price of oil reached world record levels in nominal terms. However, during the second half of the year oil prices retreated to levels more consistent with prices seen earlier in the decade. Whether this trend will continue is unknown, but it is useful to note that the NYMEX futures prices for crude oil indicate that the price is expected to increase through the middle of the next decade.

Our long-standing business strategy continues to be the active expansion of our operations through acquisitions, expansion in offshore drilling and selective expansion in closely related services, upgrades and modifications to our drilling fleet and the deployment of our drilling assets in key geographic locations—all these initiatives are consistent with the demands of our clients. In 2008 we continued the execution of our active expansion strategy by the following developments and activities:

- expansion of our onshore drilling operations in Kazakhstan and Eastern Siberia, where the oilfield services market is expected to grow at 50% CAGR by 2011 according to Douglas-Westwood;
- strengthening of our position as an offshore drilling services provider in the Russian, Kazakh and Turkmen sectors of the Caspian Sea;
- expansion of our offering of a wider range of higher margin drilling and workover services, including sidetracking, horizontal drilling and off-cluster infill drilling;
- implementation of a fleet-wide modernization program to replace older mud pumps and mud cleaning systems, and to install top drives on the high capacity rigs; and
- evaluation of several potential strategic acquisition targets to expand our fleet within the Russian and Caspian markets. (Nothing has been finalized with respect to these potential targets and such potential targets may never be acquired.)

During 2008 our total capital expenditures were US $327.0 million, including letters of credit posted to secure new rigs to be delivered in 2009, which was comparable to US $319.7 million in 2007. The full effect of these capital expenditures will be realized over the next few fiscal years.

For 2009 we expect our drilling volumes to decrease over 2008. At least one of our major clients has publicly announced a reduction in its capital program for 2009 including the capital allocated to drilling new wells. In response to this expected reduction in drilling volumes we have substantially reduced our capital expenditure budget for 2009, instituted a plan to reduce our payroll costs through both staff reductions and acceptance by our employees of voluntary un-paid furloughs, refocused our efforts on inventory cost control, obtained cost reductions from our suppliers and vendors and reorganized our regional general and administrative functions to better control their costs. We also decided, temporarily, to limit the scope of our previously announced agreement with LeTourneau Technologies to assemble drilling rigs in Kaliningrad to a single drilling rig for 2009 delivery.

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

Many commentators believe Russian drilling volumes will increase in 2010 and later years as Russian production declines as a result of expected reductions in drilling volumes in 2009. In addition, the recent depreciation of the ruble with respect to the US dollar has made our services less expensive for our clients when measured in dollars. We are typically a ruble cost to our clients, most of who sell their oil and gas products by reference to the world dollar price and budget their capital expenditures primarily in US dollars. It is reasonable to expect that our clients will be more inclined to utilize more of our services since they now cost less in US dollar terms. In light of these trends, we intend to preserve our ability to expand our business in the future as the expected client demand for our services grows in 2010 and later years.

During 2008 we invested in a number of recruitment, retention and personnel development initiatives in connection with the expansion of the number of our crews and our efforts to mitigate personnel attrition. While we will reduce the number of our crews and resulting head-count during 2009, we intend to do so in a way that maximizes our ability to re-deploy crews if our business expands in 2010 and later years. This is being done by encouraging employees to take unpaid, voluntary furloughs and limiting lay-offs to those regions where we expect more prolonged downturns in drilling demand.

We anticipate a continuation of challenging market conditions for the rest of 2009. As a result, we expect our results from operations in 2009 to decline compared to 2008.

Results of Operations

During 2008 we had solid financial performance with strong and balanced contribution across all geographies and business lines. The strong performance during 2008 reflected the extensive modernization and upgrade of our equipment, investment in training and development of our crews, continued improvement of our cost control initiatives and a disciplined approach to developing new business from existing customers.

Revenues

The following table sets forth a summary of our operating results for 2008 and for 2007 (for additional information, please see the accompanying 2008 audited Consolidated Financial Statements).

Consolidated statements of income for the periods ended December 31, 2008 and 2007 (All figures in thousands of US dollars, unless otherwise noted, audited):

	2008	2007
Revenues		
Drilling and related services	2,071,683	1,468,047
Other sales and services	30,096	24,142
Total revenues	**2,101,779**	**1,492,189**
Cost of services	(1,453,718)	(1,031,480)
Selling, general and administrative expenses	(122,011)	(90,021)
Taxes other than income taxes	(72,571)	(56,574)
Depreciation	(101,777)	(58,705)
Loss on disposal of property, plant and equipment	(4,722)	(610)
Income from operating activities	**346,980**	**254,799**
Interest expense	(26,553)	(29,880)
Interest income	9,553	4,546
Currency transaction (loss)/gain	(33,017)	349
Other expenses	(759)	(363)
Income before income taxes	**296,204**	**229,451**
Income tax expense	(75,271)	(60,907)
Net income	**220,933**	**168,544**
Basic earnings per share of common stock (US dollars)	1.51	1.31

Total revenues increased by US $609.6 million, or 40.9%, to US $2,101.8 million for 2008 from US $1,492.2 million in 2007. The increase in revenue in 2008 was primarily influenced by an increase in the volume of drilling services provided by us. We increased the number of meters drilled by 23.6% to 4.041 million meters for 2008, as compared to 3.269 million meters for 2007.

Cost of Services

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

	2008	2007
Materials	463,679	323,872
Services of subcontractors	482,366	336,615
Wages and salaries	294,042	233,323
Fuel and energy	93,305	57,888
Transportation of employees to drilling fields	43,307	27,714
Leasing and rent	17,350	11,331
Other	59,669	40,737
Total cost of services	**1,453,718**	**1,031,480**

Cost of services increased by US $422.2 million, or 40.9%, to US $1,453.7 million for 2008 from US $1,031.5 million for 2007. As described more fully below, our cost of services for 2008 was primarily affected by an increase in the volume of drilling services provided by us, as cost of services as a percentage of total revenue remained stable at 69.1% in 2007 and 69.2% for 2008. We believe the stable operating margin despite cost inflation in many areas was primarily attributable to a concerted effort by management to improve the cost efficiency associated with our overall drilling process.

We generally subcontract with third parties to provide us with certain services in our onshore division where we do not perform these services ourselves. In our onshore division, services contracted from third parties include subcontracting for technological services; transportation services; preparatory services; well facility services; petrophysical services; well services; drilling motor and drilling navigation services; cementing services; and drilling bit services. Services of subcontractors were the largest component of our cost of services for 2008 and 2007. Services of subcontractors for 2008 were US $482.4 million, or 33.2% of total cost of services, as compared to US $336.6 million, or 32.6% of total cost of services, for 2007. The increase is primarily a function of the greater volume of services we provided to our clients. The change as a percentage of total cost of services is not considered material.

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 2008 were US $463.7 million, or 31.9% of total cost of services as compared to US $323.9 million, or 31.4% of total cost of services for 2007. The increase is primarily a function of the greater volume of services we provided. The change as a percentage of total cost of services is not material.

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 are required to pay to the Russian government in support of pension, social insurance and medical funds. The rate of contribution depends upon the amount of the salaries, wages and benefits accrued for our employees in the Russian Federation. Such expenses do not include contributions which we make to a private pension fund. Wages and salaries for 2008 were US $294.0 million, or 20.2% of total cost of services as compared to US $233.3 million, or 22.6% of total cost of services for 2007. The increase is primarily a function of the greater volume of services we provided which required more trained personnel, and also, a general increase in rates paid our employees to keep abreast of local inflation in order to reduce turnover and attract the best people in a market where there is high demand for skilled workers. The decrease as a percentage of total cost of services is a function of an increase in per-meter drilling efficiency of our personnel during 2008.

Fuel and energy costs consist primarily of oil, lubricants and electricity. Fuel and energy costs for 2008 were US $93.3 million, or 6.4% of total cost of services for 2008 as compared to US $57.9 million, or 5.6% of total cost of services for 2007. The increase in fuel and energy costs in 2008 was, in large part, due to an increase in fuel prices during this period as well as the greater volume of services we provided. Management believes the increase in fuel costs experienced by the Company was experienced by other companies operating in the Russian oil field service sector during 2008.

Costs relating to the transportation of employees to drilling fields primarily include transportation services related to the mobilization and rotation of rig crews. Expenses relating to the transportation of employees to drilling fields for 2008 were US $43.3 million, or 3.0%

of total cost of services as compared to US $27.7 million, or 2.7% of total cost of services for 2007. The increase is primarily a function of the greater volume of services we provided, which required fielding more crews. The change as a percentage of total cost of services is primarily attributable to fuel cost inflation and our wider geographic coverage in 2008.

Leasing and rent costs consist primarily of the cost of renting drilling equipment. Leasing and rent costs for 2008 were US $17.4 million, or 1.2% of total cost of services as compared to US $11.3 million, or 1.1% of total cost of services for 2007. The increase is primarily a function of the greater volume of services we provided. The change as a percentage of total cost of services is not material.

The remaining portion of our cost of services, which we categorize 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 $59.7 million or 4.1% of our total cost of services for 2008, as compared to US $40.7 million or 3.9% of our total cost of services for 2007. The increase is primarily a function of the greater volume of services we provided to our clients. The increase in the percentage of total cost of service for 2008 is not considered material.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by US $32.0 million to US $122.0 million for 2008, as compared to US $90.0 million for 2007. The increase is primarily a function of the greater volume of services we provided. As a percentage of total revenues, selling, general and administrative expenses were 5.8% and 6.0% for 2008 and 2007 respectively. This difference as a percentage of total revenues is not considered to be material.

Taxes Other Than Income Taxes

Taxes other than income taxes increased by US $16.0 million to US $72.6 million for 2008 as compared to US $56.6 million for 2007. The increase in taxes other than income taxes was primarily attributable to an increase in our asset base, business growth and an increase in the amount of social taxes payable by us resulting from an increase in the number of employees in 2008. Taxes other than income tax attributable to business growth included various local taxes, such as property tax, education tax, police tax, animal protection tax and small nation’s tax. As a percentage of revenue, taxes other than income taxes decreased to 3.4% during 2008 from 3.8% for 2007. This decrease is attributable to greater drilling crew efficiency obtained in 2008 over 2007 with resulting lower payroll expenses and lower social taxes, which more than offset increases in property taxes.

Depreciation

Depreciation increased by US $43.1 million to US $101.8 million as compared to US $58.7 million for 2007. As a percentage of revenues, the depreciation increased to 4.8% from 3.9% for 2007. Both of these increases in depreciation were primarily the result of an increase in capital expenditures; particularly the acquisition of additional drilling equipment during the last six months of calendar 2007 and during all of 2008.

Disposal of Property, Plant and Equipment

Loss on the disposal of property, plant and equipment increased by US $4.1 million to US $4.7 million for 2008. This difference was primarily due to the disposal of worthless drilling pipe, reclassified to fixed assets in 2008.

Income from Operating Activities

Income from operating activities increased by US $92.2 million to US $347.0 million for 2008, as compared to US $254.8 million for 2007. The increase in income from operating activities was primarily attributable to the increase in total volume of services we provided. As a percentage of revenues, income from operating activities decreased from 17.1% for 2007 to 16.5% for 2008. This decrease is primarily due to an increase in depreciation expense and an increase in fuel and energy costs as described above.

Interest Expense

Interest expense decreased by US $3.3 million to US $26.6 million for 2008, as compared to US $29.9 million for 2007. This decrease was primarily due to a net repayment of debt and lease obligations during 2008.

Income before Income Taxes

Income before income taxes increased by US $66.7 million to US $296.2 million for 2008, as compared to US $229.5 million for 2007. The increase in income before income taxes was primarily attributable to the overall growth of income from operating activities.

Income Tax Expense

Income tax expense increased by US $14.4 million to US $75.3 million for 2008, as compared to US $60.9 million for 2007. The increase in income tax expense was primarily attributable to the increase in our income. Our effective tax rate decreased slightly from 26.5% in 2007 to 25.4% in 2008 due to fewer non-deductable expenses in 2008 on a percentage basis. Based on current tax laws, we expect our effective corporate income tax rate to be approximately 22% in 2009.

Net Income

As a result of the foregoing factors, net income increased by US $52.5 million to US $221.0 million for 2008, as compared to US $168.5 million for 2007.

Accounts Receivable

Trade accounts receivable decreased by US $0.8 million to US $230.1 million as of December 31, 2008, from US $230.9 million at the beginning of the year. Expressed as the number of days outstanding, our receivable balance decreased from approximately 56.5 days at the beginning of the year to approximately 40.0 days at the end of the year. The decrease is due to the positive effect of our collection efforts during the period, especially at the end of 2008, and reflects the good relationships we have with our clients.

Materials for drilling and workover

The balance for materials for drilling and workover, a component of our inventory balance, increased by US $30.4 million from US $113.8 at the beginning of 2008 to US $144.2 at the end of 2008. This increase was primarily due to an increase in the volume of services provided by us. Expressed as the number of days for the total inventory to turnover, the turnover rate at the end of 2008 was approximately 114 days, which was down slightly from128 days at the beginning of 2008.

As is further described in Note 2 of our 2008 audited Consolidated Financial Statements, we changed the accounting treatment for our drill pipe. This change was made to better reflect the fact that the useful life of our drill pipe exceeds one year. The 2007 Financial Statements were restated to reflect this change in accounting treatment.

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 its existing credit facilities, as well as by utilizing a portion of the proceeds from the offering of its shares which occurred in November 2007.

Cash Flows

The table below shows our net cash flows from operating, investing and financing activities for the twelve month periods ended December 31, 2008 and 2007 (in thousands of US dollars, audited):

	2008	**2007**
Net cash provided by operating activities	309,851	173,320
Net cash used in investing activities	(323,890)	(306,151)
Net cash provided (used) by financing activities	(22,645)	449,753

Operating activities

Net cash provided by operating activities amounted to US $309.9 million for the 2008, as compared to US $173.3 million for 2007. This increase in cash flows provided by operating activities principally reflects a higher net income for 2008, after adjusting for greater non-cash charges in 2008; in particular for depreciation expenses and currency translation losses.

Investing activities

Net cash used in investing activities amounted to US $323.9 million for the 2008, as compared to US $306.2 million for the 2007. In both years the principal investment activity was investment in new property, plant and equipment.

Financing activities

Net cash used in financing activities amounted to US $22.6 million for 2008, as compared to net cash provided of US $449.8 million for 2007. These differences are the result of a net retirement of debt during 2008 as opposed to a net increase in debt during 2007 and the receipt during 2007 of the proceeds of our IPO.

Liquidity

The table below shows our cash and cash equivalents as of December 31, 2008 and 2007 (in thousands of US dollars, audited):

	2008	**2007**
Short-term deposit – US dollars	180,328	216,857
Short-term deposit – Russia rubles	50,696	61,254
Cash held in banks – US dollars	32,424	14,098
Cash held in banks – Russian rubles	15,982	50,880
Total cash and cash equivalents	279,430	343,089

Our cash flow in the short term can be negatively affected by the level of expenditures we are required to make in the fourth and first quarter of each year to mobilize 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 modernize the technical characteristics of our existing drilling rigs and equipment. As of December 31, 2008 and 2007 advances given for property, plant and equipment amounted to the following (in thousands of US dollars, audited):

	2008	2007
Advances given for property, plant and equipment	22,637	64,506

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

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

	2008	2007
Construction in progress	70,433	136,491

Advances for property, plant and equipment and Construction in progress decreased in 2008 as compared to 2007. These decreases reflect a reduction in our capital expenditures, due to declining oil prices in the second half of 2008 and the subsequent decrease in demand from our customers for new capacity.

In addition, at December 31, 2008, the Company had on deposit restricted cash of approximately US $72 million to secure letters of credit opened for the purpose of purchasing new drilling rigs to be delivered in 2009.

Capital Resources

As of December 31, 2008 and 2007 our short-term and long-term debt amounted to the following (in thousands of US dollars, audited) (please see our audited Consolidated Financial Statements and the accompanying notes for more detail):

	2008	2007
Short-term debt and current portion of long-term debt	91,721	118,911
Long-term debt	171,138	165,494

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.

Other

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.

Related Party Transactions

<u>PetroAlliance</u>

EDC purchased well construction and related services and equipment from PetroAlliance Services Company Limited ("PAS"), of which a significant stockholder of EDC was the Chairman of the Board of Directors, in the amount of approximately US $29.8 million in

2008 and US $42.2 million in 2007. Amounts payable to PAS were US $2.8 million and US $4.2 million as of December 31, 2008 and December 31, 2007, respectively. Management believes the amounts paid for these services during 2008 and 2007 were negotiated at arms-length and that such amounts paid were unaffected by the relationship described above.

Shareholder Loans

In the period from November 2006 through March 2007, the Company entered into loan agreements with its shareholders to partially fund the investment program of our onshore drilling services division and the purchase of our offshore drilling services business. The aggregate principal amount of such loans was US $70.0 million. The loans mature on December 31, 2011 and incur interest at the rate of 8.6% per annum. Interest expense of US $6.0 million and US $5.8 million was recognized and paid on these loans during 2008 and 2007, respectively. The slightly higher interest expense during 2008 is due to the timing of the funding of one of the loans during the first six months of 2007. The loans are denominated in US dollars. Management believes the terms of these loans are no less onerous than those which would have been negotiated in an arms-length negotiation.

Capital Lease Obligations

Capital lease obligations for property, plant and equipment under capital lease as of December 31, 2008 and 2007 from an associated company, OAO LK Leasing – a company in which a substantial stockholder of EDC has a controlling interest, were US $3.1 million and US $13.8 million, respectively. Management believes the terms of these leases are no less onerous than those which would have been negotiated in an arms-length negotiation.

Legal Services

The Company’s General Counsel, Douglas Stinemetz, is a partner with The Stinemetz Law Firm. During 2007 and 2008 the firm billed EDC for costs and expenses of US $0.3 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 less onerous than those which would have been negotiated in an arms-length negotiation for a similar level of service and expertise.

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.

The calculation of earnings per share for these periods was as follows:

	2008	**2007**
Net income available for common stockholders (‘000 US dollars)	220,923	168,544
Weighted-average number of outstanding shares	146,126,927	128,341,261
Basic earnings per share of common stock (US dollars)	1.51	1.31

There is no potential dilution in earnings available to common stockholders and as such diluted earnings per share are not disclosed.

Dividend Policy and Year-end 2008 Dividend Declaration

The level of our income and our ability to pay dividends depend primarily upon the receipt of dividends and distributions from our subsidiaries. The payment of dividends by our subsidiaries is contingent upon the sufficiency of their earnings, cash flows and distributable reserves and the ability of our subsidiaries to make, in accordance with relevant legislation, company law, exchange controls and contractual restrictions, dividend payments and other types of distributions to us.

In August 2007, we adopted a dividend policy according to which we expect to declare and pay dividends each year based on the Company's earnings and the cash needs of the business. Consistent with this policy, on December 16, 2008, we declared a dividend of US $0.25 per share, which was paid on January 30, 2009, to shareholders of record as of January 15, 2009.

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 characterized by significant fluctuations that are determined by the global balance of supply and demand. However, Russian natural gas prices are regulated by the Russian government. While Russian natural gas prices have increased in recent years, and are expected to continue to rise to a level closer to parity with export netbacks, they are still significantly below world levels. A substantial or an extended decline in crude oil and natural gas prices could result in lower capital expenditures by our customers, and consequently, a reduction in the number of wells to be drilled by oil and gas companies. Such a pattern of sequential downward and upward changes of our customers' capital expenditures has caused the results of our drilling operations to vary significantly from year to year during the life of the Company. The results of our workover operations tend to be less sensitive to the fluctuations in crude oil and natural gas prices, as our clients require such services both during periods of high and low oil prices.

Productivity

Our results of operations are affected by the productivity of our crews, as measured by the number of meters drilled per active drilling crew. For the year ended December 31, 2008, each of our active drilling crews drilled on average approximately 36,340 meters. Over the medium-term to long-term we expect this measure of our efficiency to improve due to the recent implementation and utilization of more advanced drilling technologies and the application of new standards to our drilling operations. Advanced crew training and application of innovative technologies allowed us to both improve Rates of Penetration (ROP) and reduce Non-Productive Time (NPT). Examples of technological advancements included wider usage of Polycrystalline Diamond Compact (PDC) drill bits, introduction of new generation drilling motors, optimization 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. During 2009 we may see a decrease in the meters drilled per crew as our operations are expected to contract as our customer demand is reduced from 2008 levels. However, as demand recovers in subsequent years we expect to see increases in productivity over the already high levels achieved in 2008.

Operating Capacity

Our revenue growth can be negatively affected by the number of drilling rigs and drilling crews available to us. During 2008 our ability to increase our onshore business depended on our ability to procure sufficient numbers of new drilling rigs and modernize our existing drilling rigs. As such, during 2008 we purchased 6 drilling rigs and in the second half of 2008 committed to purchase 9 new drilling rigs, (including one to be fabricated at our Kaliningrad facility) of which we expect seven to be delivered, or fabricated as the case may be, during the first half and two in the second half of 2009. During the first half of 2008, the global demand for new drilling rigs and rig modernization services substantially exceeded their supply. However, during the second half of 2008 the demand for new drilling rigs and modernization services was substantially reduced as the demand for drilling services in most areas of the world, including in Russia, was reduced. Our drilling fleet as of December 31, 2008 consisted of 201 land drilling rigs and one offshore jack-up drilling rig in the Caspian Sea, as described above. During 2009 we will likely stack some of our land drilling rigs. These drilling rigs will be available for use by us in later years when demand for our services is expected to increase.

Seasonality

Our revenue from onshore and offshore drilling services can be negatively affected by severe winter weather conditions in certain regions of Russia that make oil and gas operations difficult to non-operational during that season. For example, during January and February 2006, Russia experienced severely cold temperatures of approximately -45 degrees Celsius in certain regions where we operate and the lost drilling time during such period amounted to approximately 90 days, which was equivalent to the loss of use of three drilling crews for one calendar month, and which contributed to delays in the mobilization of our equipment and service commencement dates. Our revenue from onshore drilling services may also be negatively affected by winter 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 mobilized 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 utilized 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 mobilize 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.

Market Trends

Since EDC acquired the onshore drilling assets from LUKOIL in December 2004, drilling volumes in Russia have grown at a fairly steady pace. According to data published by CDU TEK, during the 2005 through 2007 period total meters drilled onshore Russia grew by a Compound Annual Growth Rate (CAGR) of 17.6%. Drilling volume growth slowed in 2008, however, to 5.7% above 2007 levels. CDU TEK crude oil production figures for Russia show a similar trend, with 2.3% CAGR in total Russian oil production over the 2005 through 2007 period, and a 0.6% production decline in 2008 v. 2007. Considering the maturity of

Russia's major oil producing fields, the drilling volume to oil production results of recent years as discussed above suggest that drilling volumes must continue to grow in order to stem future production declines.

In the first quarter of 2009, CDU TEK data indicates that overall Russian drilling volumes declined by 8.3% as compared to the first quarter of 2008, while oil production declined by 1.1% in Q1 2009 versus Q1 2008. As discussed above, seasonality affects drilling operations in Russia, with drilling volumes achieved in the 2nd and 3rd quarters of each year being substantially higher than 1st and 4th quarter levels in a typical year. During 2008, drilling volumes surged more than is typical in the middle portion of the year due to both seasonality effects and the run up in oil prices. In 2009, we do not expect a similarly atypical warm-weather or oil-price-driven surge in drilling levels, and we estimate that 2009 drilling volumes will decline as compared to 2008, despite the promising start to 2009.

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 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 higher margin drilling and workover services, including sidetracking and horizontal drilling.

For example, during calendar year 2006, we drilled 146,718 meters utilizing the horizontal drilling technique, while in 2007 our horizontal drilling operations increased to 304,134 meters. For the year ended December 31, 2008, horizontal drilling volume decreased slightly to 297,612 meters. In 2007 we drilled 95 horizontal wells, while in 2008 our horizontal drilling operations increased to 106 wells. The meter decrease was caused by lessening of average well depth. We expect the scope of our horizontal drilling to decline somewhat in 2009 as the overall demand for our services is expected to decline, but in subsequent years we think demand for horizontal drilling will expand over that provided by us in 2008.

Also by way of example, the number of side-tracks we performed in the past has fluctuated. For the year ended December 31, 2005, we drilled 37 side-tracks, while for the year ended December 31, 2006, we drilled 42 sidetracks. For the year ended December 31, 2007, we drilled 54 side-tracks, and for the year ended December 31, 2008 we drilled 67 side-tracks. Although we currently have incurred minimal capital expenditures with respect to sidetracking, we may significantly increase these expenditures in the future as we expect these services to give us a larger margin than our more traditional drilling services.

Price Optimization

Our revenue growth depends on our ability to charge clients market prices for our onshore and offshore drilling and other services. The LUKOIL Framework Agreement established a pricing adjustment formula applicable to the onshore drilling services we provide to LUKOIL. Such pricing formula effectively limits our ability to adjust the prices related to our onshore drilling services for LUKOIL in order to reflect fluctuations in the market prices occurring prior to the following annual price adjustment. However, we consider that the current prices at which we provide services pursuant to the LUKOIL Framework Agreement are 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 Consolidated Financial Statements for 2008, which are attached herein, 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, 2008 (in millions, except interest rate percentages):

	Scheduled Maturity Date							Fair Value
	2009	2010	2011	2012	2013	Thereafter	Total	12/31/08
Total long term debt	37.9	26.1	101.3	20.6	14.2	7.7	207.8	205.1
Fixed rate	37.9	16 .7	82,6	1.8	0.8	7.7	147.5	144.8
Average interest rate	9.1%	8.9%	8.7%	8.3%	8.1%	8.1%		
Variable rate[1]		9.4	18.8	18.8	13.4		60.3	60.3
Average interest rate	3.6%	3.6%	3.6%	3.6%	3.6%			

[1] Based on the LIBOR rate at the end of 2008, which rate may fluctuate in later periods.

As is further described in Note 11 of our December 31, 2008 audited Consolidated Financial Statements, attached elsewhere herein, 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, 2007, we had US $214.4 million of a total of US $284.4 million of our long and short-term debt denominated in the Russian ruble. As of December 31, 2008 we had US $192.9 million of a total of US $262.9 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 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, during 2007 and 2008 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.) Accounting rules require us to treat currency fluctuations with respect to these intercompany obligations as current period currency transaction gains and losses. Accordingly, during 2007 and 2008 we recognized a gain of US $1.5 million and a loss of US $48.6 million, respectively, on such intercompany obligations.

Concentration of Credit Risk

We have a concentration of credit risk since one customer made up approximately 74.0% of our sales during 2008 (79.7% for 2007). In order to reduce 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 2008. Our Allowance for doubtful accounts stood at US $6.8 million at the end of 2008 (US $4.6 million for 2007), which amount is considered adequate. Our cash and cash equivalents are placed with major banks within Russia, Switzerland and the United Kingdom.

Significant Accounting Policies

Our Consolidated Financial Statements are affected by the accounting policies used by management during their preparation. The detailed discussion of our significant accounting policies is provided in Note 2 of our December 31, 2008 audited Consolidated Financial Statements, included elsewhere, herein.