



## EURASIA DRILLING COMPANY LIMITED

### MANAGEMENT'S REPORT ON 2010 RESULTS

For the twelve months ended December 31, 2010

#### Select financial and operating information

	2010	2009	Change	%
<i>in thousand US\$, unless otherwise stated</i>				
Revenue	<b>1,812,156</b>	1,382,203	429,953	31.1%
EBITDA	<b>435,847</b>	319,813	116,034	36.3%
EBITDA margin	<b>24.1%</b>	23.1%	1pp	-
Net income	<b>207,353</b>	165,490	41,863	25.3%
Operating cash flow	<b>322,553</b>	409,507	-86,954	-21.2%
Capital Expenditures	<b>283,777</b>	106,815	176,962	165.7%
Net cash position	<b>225,549</b>	251,549	-26,000	-10.3%
Dividend per share (US\$)	<b>\$ 0.31</b>	\$0.25	0.06	24.0%
Diluted EPS (US\$)	<b>\$ 1.44</b>	\$1.22	0.22	18.0%
Average exchange rate for the period (RUB/US\$)	<b>30.4</b>	31.7	1.3	4.1%
Meters drilled Russia onshore (th. meters)	<b>4,103</b>	3,753	350	9.3%

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

### Introduction

The following report represents management's discussion and analysis of financial condition and results of operations for the twelve month period ended December 31, 2010 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 2010 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.

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

Our customers include a number of the major Russian and international oil and gas companies such as LUKOIL, Rosneft, Gazpromneft, TNK-BP, KazMunaiGaz affiliates, Samara-Nafta, Naryanmarneftegaz ( a joint venture between LUKOIL and ConocoPhillips), CMOC (a joint venture between Shell, KazMunayTeniz and the Oman Pearls Company Ltd), Dragon Oil and others. Petronas Carigali became a new client to us starting early 2011 post the purchase of *Trident XX* 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 in each of the major oil producing regions within our served market employing a total land rig fleet of 476 rigs including 211 land drilling rigs and 265 workover rigs and total personnel over seventeen thousand people. We continue to adopt new drilling technologies 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 onshore drilling and certain related assets of OAO LUKOIL. Since inception we have not substantially 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. We recently began 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. Further, in early 2011 we signed a Letter of Intent to purchase the in-house development and exploration drilling assets of Slavneft.

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 construction of which is expected late in 2012. Early in 2011 we expanded our current offshore rig fleet to two jack-up rigs by acquiring *Trident XX* from Transocean. As such, in 2011 we have the capacity to serve approximately two-thirds the jack-up market in 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.

In 2011 we will concentrate on project execution, and expect to deliver strong financial and operating results.

### Overview

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. Following the global recession the oil prices stabilised in 2010 in the range of US \$70 to US \$80/bbl giving oil and gas companies confidence to increase their CAPEX budgets. Russia's oil production and drilling volumes both reached post-Soviet peaks in 2010; oil production grew to 10.14 mln bpd (an increase of 2.2%) and drilling volumes expanded to 17.2 million meters (an increase of 18%), respectively, as compared to 2009 according to CDU TEK.

The major contributor to the Russian oil production growth was the increased output from certain Eastern Siberian fields. Growth in drilling volumes was mainly achieved through increased drilling in mature fields which account for about 80% of Russia's total oil production.

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

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

During 2010 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. This increased demand was met by adding drilling crews, adding new rigs to our fleet and improving utilisation of our rig fleet.

Our 2010 operating results include:

- Drilling output of 4.103 million meters, a record drilling volume during our operating history, 9% above the output achieved in the corresponding period of 2009 (3.753 million meters);
- At the beginning of October 2010 we signed a Letter of Intent with Schlumberger to sell and purchase each other's drilling and service assets and enter into a strategic alliance in the CIS;
- Contracted Lamprell Plc to build a new jack-up drilling rig to be used in our Caspian Sea operations;
- Further diversified our customer portfolio by commencing drilling operations for TNK-BP, a new client for EDC, in May 2010;
- Reduced our reliance on our largest customer in 2010 with its' share comprising 57% of our total drilling volumes compared to 63% in the corresponding period of 2009;
- Fully employed our jack-up rig, *ASTRA*, in Turkmen and Russian waters of the Caspian Sea; two production wells and three exploration wells were drilled and completed;
- Continued operations on LUKOIL's Yu. Korchagin field platform in the Caspian Sea, drilling four wells;
- Remained active with two drilling rigs in Kazakhstan; seven wells were drilled and completed;
- Completed fabrication of our first 450 ton drilling rig named "YERMAK" in March 2010.

#### Major Events post December 31, 2010

- In February 2011 we signed a Letter of Intent to purchase the development and exploration drilling assets of OAO NGK Slavneft for a total consideration of US\$ 150 million. We expect to close the transaction later in 2011. In addition, Slavneft and EDC have agreed to develop a Framework Agreement for the provision of drilling services by EDC to Slavneft following the acquisition. The Framework Agreement will cover a five year term commencing at the completion of the transaction and will include pricing terms, annual price adjustment provisions and commitments for drilling volumes. This new partnership with Slavneft is another important step in expanding our client base;
- In February 2011 we completed the acquisition of the *Trident XX* jack-up drilling rig from Transocean for a total consideration of US\$ 260 million. The *Trident XX* 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. The acquisition of the *Trident XX* is a milestone on our path to become the market leader in the Caspian offshore drilling market.

Our Russian onshore drilling volumes increased 9% compared to volumes achieved in 2009. The drilling volumes of our major customer declined by 1% during the 2010 as compared to the corresponding period of 2009. LUKOIL's share in our total volumes decreased to 57% in 2010 from 63% in 2009. It's our strategic goal to diversify our customer base while building long-term relationships with our clients. TNK-BP, a new client to us, contributed 2% of our 9% growth in meters in 2010. As of the end of 2010 we had four drilling rigs operating for TNK-BP. 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. We gained additional volumes with other clients during 2010 including Gazpromneft, which accounted for 29% of our total drilling volumes as compared to 24% during 2009. The list of our clients includes the four largest E&P companies in Russia which, together, accounted for about 56% of the total drilling volumes in Russia in 2010 based on CDU TEK data. In 2010 we also won important contracts with another four new clients, including Pechoranefit and Rusvietpetro.

Our market share for 2010 was approximately 24% which is slightly below the corresponding period of 2009. The reduction was primarily caused by an increase in drilling by the in-house drilling divisions of some Russian oil and gas majors, especially Surgutneftegas, whose drilling volumes increased 15% and reached 4,430 thousand meters in 2010 as per CDU TEK.

The drilling pattern in 2010 was characterised by greater seasonality than in 2009, but very similar to 2008. There was a slow start at the beginning of the year caused by severe winter conditions in West Siberia as well as higher exploration activity (which occurs during the ice-road season and ties up rigs by isolating them in remote areas). As per CDU TEK data, exploration drilling volumes in onshore Russia during 2010 were above the corresponding period of 2009 by 53%. Starting in March drilling accelerated reaching its peak in May 2010. In May 2010 we drilled 398 thousand meters - a record for our operating history.

During 2010 we expanded our drilling rig fleet to a total of 211 drilling rigs as compared to 207 at the end of 2009. Late in 2010 we added two new rigs for our new client, TNK-BP. 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 data. The services market in Russia is evolving toward higher technological content and advanced techniques. In Russia, as in the rest of the world, unexploited oil and gas reserves increasingly occur in more challenging environments, both geographically and geologically. 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 expect a strong 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 18 rigs were ordered in 2010 with the delivery times during 2011. US \$61.7 million was allocated as of December 31, 2010 to pay for the first five rigs. 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.

In March 2010 we completed the fabrication of a 450 metric ton high-spec rig named “YERMAK”. This rig design is unique within Russia, featuring a “Quadra” moving system which enables it to walk and turn in any direction. Another unique feature is a separate, fixed mud block incorporating mud pumps, tanks and processing equipment coupled with a flexible interconnecting umbilical system that conducts drilling fluids, steam and electrical energy and control systems cabling. This is the first rig incorporating such features to be designed for operations in Russia’s specific environment, characterised by extremely cold winter conditions, warm summer temperatures and limited transport networks. The rig is designed for deep cluster drilling applications since approximately 95% of the production wells in Russia are drilled directionally from pad clusters, while wellbore lengths are trending toward longer reach and deeper reserve targets.

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

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

We have contracted Lamprell Plc to build a new jack up drilling rig to be used in our Caspian Sea operations. 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 250 feet (extendable to 350 feet as required) and will have a rated drilling depth of 30,000 feet. The hull and related components are to be 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. Construction is expected to be completed at the end of 2012. 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 continue our operations on LUKOIL’s Yuri Korchagin field platform and drilled four wells during the 2010 including one vertical and three directional wells.

### Transaction with Schlumberger

In October 2010 we signed a Letter of Intent with Schlumberger, the world’s leading oilfield services company, to exchange assets and to enter into a Strategic Alliance in the CIS. Schlumberger has agreed to sell all drilling (19 drilling rigs), sidetrack (23 sidetracking rigs) and workover rigs (34 workover rigs) currently operating mainly in West Siberia to EDC. As part of the sale, the rigs’ crews (12 drilling crews, 20 sidetracking crews and 25 workover crews) will transfer to EDC. Schlumberger has also agreed to purchase 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 will move to Schlumberger. In addition, Schlumberger and EDC have agreed to enter into a strategic alliance upon completion of the transaction whereby Schlumberger becomes 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 that we are adding are in the appropriate condition and supportive to the average age of our rig fleet, which post completion of the transaction will be one of the most modern in Russia.

## Strategy Execution

Commencing from our IPO in November 2007, our strategy in broad terms has remained consistent. Below we summarise steps taken during 2010 to deliver on our strategy.

Strategy	Tasks	Actions
<b>Increase market share</b>	<p>Continue to grow our market share in Russia both organically and through targeted acquisitions;</p> <p>Continue to invest in expanding our fleet, implementing state-of-the-art technology and enhancing service quality</p>	<p>Signed a Letter of Intent with Schlumberger to acquire their drilling, workover and sidetracking assets;</p> <p>Signed a Letter of Intent with Slavneft early in 2011 to acquire their drilling assets;</p> <p>Ordered 18 new rigs with the delivery times in 2011</p>
<b>Growth of customer base</b>	<p>Continue to differentiate ourselves from our competitors in our domestic markets;</p> <p>Evaluate our opportunities in new geographical areas where we can add value and operate efficiently</p>	<p>In 2010 commenced drilling for TNK-BP, a new client for EDC;</p> <p>Once completed, transaction with Schlumberger will increase the volumes of work we perform for Rosneft in drilling and TNK-BP in workovers;</p> <p>5 yr. Framework Agreement for drilling with Slavneft, a new client to us, will go into effect once transaction is completed</p>
<b>Expansion in offshore drilling</b>	<p>Engage with expanding customer base to forge long-term relationships;</p> <p>Commission new offshore drilling assets to tie-in with anticipated new contracts;</p> <p>Develop offshore extended reach drilling capability</p>	<p>In 2010 we continued drilling operations for Lukoil on the Yuri Korchagin field platform in the Caspian Sea;</p> <p>Contracted Lamprell to build a new jack-up rig for our operations in the Caspian Sea; expected completion late 2012;</p> <p>Early in 2011 acquired <i>Trident XX</i> jack up rig from Transocean that is on long-term contract with Petronas Carigali (Turkmenistan) Sdn Bhd</p>
<b>Expand &amp; improve workover capacity</b>	<p>Conclude the integration of newly acquired businesses in West Siberia and Timan Pechora within existing workover structure;</p> <p>Target selected acquisitions of additional workover capacity</p>	<p>Integration &amp; improvement of workover businesses acquired in 2009 and 2010 continues according to the plan;</p> <p>Once completed, transaction with Schlumberger will add 57 workover and sidetrack rigs to our existing fleet of 265 well service &amp; workover rigs</p>
<b>Broaden technology platform</b>	<p>Expand and improve core drilling service offerings in advance of divestiture;</p> <p>Leverage strategic partnership with global technology leader Schlumberger to win additional work</p>	<p>By entering Strategic Alliance, EDC will have access to the latest technologies from Schlumberger to offer more complex onshore and offshore drilling solutions</p>

## Outlook

Global oil prices were resilient throughout 2010, averaging over US \$80/barrel for Urals 32° crude in the second half of the year. Oil prices have continued to gather strength this year, averaging over US \$100/barrel in the first quarter of 2011. NYMEX futures prices for crude oil currently show that prices are expected to remain above \$100/barrel (WTI) for the rest of the decade.

In the Russian market, most commentators forecast the rapid growth of new well starts in 2010 versus the previous year to continue into 2011 and beyond. Indeed, during the first few months of 2011, growth in drilling volumes in Russia has outpaced the 2010 growth rate year-on-year, according to CDU TEK. Relatively milder weather conditions in West Siberia coupled with robust commodity prices have contributed to the increasing growth rate early in the year, while the longer term outlook for sustained drilling demand growth in Russia remains underpinned by declining brownfield production.

Strategies to enhance upstream efficiency, including increases in new-well flow rates and improvements to the recovery factor on existing reserves, are progressively being pursued by our customers. A strong indicator of this trend is the increase in the number of horizontal production wells being planned, which we expect to rise substantially within our client base beginning in 2011. As an example, our largest customer, LUKOIL, has stated its intention to treble the number of new horizontal wells drilled in coming years. Meanwhile, we perceive a tightening in the supply of suitable drilling rigs, particularly in the higher specification and heavier rig classes. Pricing for drilling services has not yet been significantly impacted by supply constraints, but we believe pricing power may begin to favour contractors as indicated by certain of our clients' expressed interest in establishing multi-year contracts.

For 2011 we expect our onshore drilling volumes to exceed 2010 volumes by over 15%, reaching the level of approximately 4.8 million meters drilled. This estimate includes both improvements in legacy output and prorated contributions from acquisitions. Actual closing dates of the Schlumberger and Slavneft acquisitions, which we anticipate to be early Q-2 and late Q-3 2011, respectively, will affect total volumes achieved this year. EDC's market share in drilling volume terms is expected to increase from 24% achieved in 2010, to the level of 30-32% by Q-4 2011 on an annualised basis.

The Company's revenue growth is anticipated to outstrip volume growth in 2011 as our customers increasingly drill more horizontal wells, extend lateral reach and expand complexity. As noted earlier, the average depth of wells drilled by EDC has been increasing markedly in recent years. We expect this increasing depth trend to continue, and to drive the market toward higher specification and heavier drilling rigs as well as more complex supporting technologies.

The Company's client mix is projected to diversify further in 2011, with gains in drilling volumes for both TNK-BP and Rosneft and the addition of Slavneft as a customer later in the year. LUKOIL volumes are also expected to increase slightly in 2011 v. 2010, but due to gains with other clients, LUKOIL drilling is projected to account for less than 50% of EDC's total drilling volume (in 2010 LUKOIL accounted for 57% of total EDC drilling volume).

The well intervention market in Russia is projected to expand in 2011 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 2011 as we fully integrate the workover assets acquired from LUKOIL in early 2010, and through the subsequent addition of the workover and sidetrack fleets being acquired from Schlumberger. In addition to our comprehensive well servicing and workover workscope for LUKOIL West Siberia, the Company has been awarded a new workover contract for Rosneft in Vankor, East Siberia, which commences Q-2 2011. The additional workover assets being acquired from Schlumberger (34 rigs, 25 crews) are well utilised and primarily contracted to TNK-BP in their Samatlor field, representing a new area of activity for EDC. The new sidetrack capacity (23 rigs and 20 crews) being acquired by EDC from Schlumberger is also well utilised, with a broad contracted workscope for a variety of customers in 2011.

By the end of 2011, following consolidation of the Schlumberger and Slavneft assets into our operations, EDC will be not only the largest well construction contractor, but also the largest provider of workover, well servicing and sidetracking services in Russia.

EDC has established a significant offshore presence, beginning our first platform drilling services contract in 2009 and adding a second jack-up rig (the *Trident XX*) to our fleet in early 2011. The *ASTRA* jack-up drilling rig is committed for a full 12 month program in 2011 in the Russian and Kazakh sectors of the Caspian Sea, and is currently deployed in Kazakh waters at an attractive day-rate. The *Trident XX* is expected to be fully utilised for development drilling in Turkmen waters in 2011, under long term contract to Petronas Carigali. On-going operations on Lukoil's Yuri Korchagin field ice-resistant platform, where EDC is the General Contractor for drilling services, are expected to continue for most of the year prior to a drilling package upgrade in preparation for the Extended Reach Development (ERD) phase. The Company will further expand our Caspian fleet when the Super 116E jack-up being constructed by Lamprell enters service in 2013, and we continue to evaluate opportunities for further expansion in this growing market.

Recent appreciation in the Russian ruble with respect to the US dollar is expected to improve our reported results for 2011 over 2010 as most commentators are confident the ruble will stay relatively strong.

During the first half of 2011 we will be integrating two high-quality acquisitions into our operations which will provide, in both instances, accretive financial results in the short term while acting as strong platforms for future growth. Later in the year the Company expects to commence incorporation of the Slavneft drilling assets into our business, expanding both our client base and our geographic footprint. 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 2011 to be an outstanding year for all our stakeholders.

### Financial Review

During 2010 we achieved remarkable financial results across all lines and geographies of our business that exceeded our initial expectations. We continued to concentrate on execution backed by our ongoing investment in drilling rig fleet modernisation and upgrade. Our 2010 results reflect the revival in the overall drilling market activity as compared to 2009.

Our 2010 financial results include:

- Revenue for 2010 was US \$1,812 million, which is US \$430 million above US \$1,382 million reported for FY 2009;
- EBITDA margin improved to 24.1% for 2010, which is one percentage point above 23.1% EBITDA margin for 2009;
- 2010 Net Income was US \$207 million which is US \$42 million above Net Income reported in 2009 (US \$165 million);
- Diluted earnings per share for the fiscal year ended December 31, 2010 were US \$1.44 (2009 diluted earnings per share were US \$1.22);
- 2010 average US dollar exchange rate was 30.4 rubles per US dollar as compared to 31.7 rubles per US dollar in 2009, a percentage change of 4.1%.

**Reconciliation of Net Income to EBITDA**

Earnings before Interest, Taxes, Depreciation and Amortisation (EBITDA), a non-GAAP financial measure, is computed with reference to the Company's net income for 2010 and 2009 as follows (in thousands of US dollars, audited):

	2010	2009
<b>Net Income</b>	<b>207,353</b>	<b>165,490</b>
Income Tax Expense	71,812	43,857
Gain on Disposal of PP&E	(6,344)	(382)
Currency Transaction Loss	7,355	4,414
Net gain on acquisitions of businesses	(557)	(2,849)
Goodwill impairment loss	7,096	-
Interest Income	(7,993)	(10,631)
Interest Expense	15,125	13,524
Depreciation	142,000	106,390
<b>EBITDA</b>	<b>435,847</b>	<b>319,813</b>

**Revenues**

The following table sets forth a summary of our operating results for 2010 and 2009 (for additional information, please see the accompanying audited 2010 Consolidated Financial Statements).

Consolidated statements of income for the fiscal years ended December 31, 2010 and December 31, 2009 (All figures in thousands of US dollars, unless otherwise noted, audited):

	2010	2009
<b>Revenues</b>		
Drilling and related services	1,798,881	1,362,222
Other sales and services	13,275	19,981
<b>Total revenues</b>	<b>1,812,156</b>	<b>1,382,203</b>
Cost of services	(1,195,891)	(912,050)
Selling, general and administrative expenses	(106,920)	(94,861)
Taxes other than income taxes	(72,547)	(55,061)
Depreciation	(142,000)	(106,390)
Gain on disposal of property, plant and equipment	6,344	382
Goodwill impairment loss	(7,096)	-
<b>Income from operating activities</b>	<b>294,046</b>	<b>214,223</b>
Interest expense	(15,125)	(13,524)
Interest income	7,993	10,631
Currency transaction (loss)	(7,355)	(4,414)
Net gain on acquisitions of businesses	557	2,849
Other expenses	(951)	(418)
<b>Income before income taxes</b>	<b>279,165</b>	<b>209,347</b>
Income tax expense	(71,812)	(43,857)
<b>Net income</b>	<b>207,353</b>	<b>165,490</b>
<b>Basic earnings per share of common stock (US dollars)</b>	<b>1.45</b>	<b>1.22</b>
<b>Diluted earnings per share of common stock (US dollars)</b>	<b>1.44</b>	<b>1.22</b>

Our total dollar-expressed revenues increased by US \$430.0 million, or 31.1%, to US \$1,812.2 million for 2010 from US \$1,382.2 million in 2009.

The financial results of operations in US dollars for 2010 were influenced by several factors including an increase in our number of meters drilled, an integration of the new workover businesses and changes in the mix of services as well as ruble appreciation. Revenue from offshore operations also contributed to total revenue growth during the fiscal year ended December 31, 2010.

### *Cost of services*

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

	<b>2010</b>	<b>2009</b>
Services of subcontractors	488,950	320,379
Materials	218,916	218,718
Wages and salaries	324,924	222,603
Fuel and energy	79,530	63,581
Transportation of employees to drilling fields	23,358	28,143
Leasing and rent	10,891	10,857
Other	49,322	47,769
<b>Total cost of services</b>	<b>1,195,891</b>	<b>912,050</b>

Cost of services increased by US \$283.8 million, or 31.1%, to US \$1,195.9 million for 2010 from US \$912.1 million for 2009. Cost of services as a percentage of total revenue did not change from 2009 to 2010 staying at 66.0%. We believe that this stabilised margin, despite changes in the mix of services (drilling deeper wells and higher levels of horizontal drilling), was primarily attributable to sustained cost control efforts by management.

We generally subcontract with third parties to provide us with certain services in our onshore division in instances where we do not perform these services ourselves. In our onshore division, services contracted from third parties include subcontracting for technological services; transportation services; preparatory services; well facility services; petrophysical services; well services; drilling motor and drilling navigation services; cementing services; and drilling bit services. Services of subcontractors were the largest component of our cost of services during both 2010 and 2009. For the fiscal year 2010, services of subcontractors were US \$489.0 million, or 40.9% of total cost of services, as compared to US \$320.4 million, or 35.1% of total cost of services for 2009. The increase in total dollars expended was primarily a function of the growth in the volume of workover services provided by the group during 2010 due to the acquisition of workover business late in 2009, an increase in pass-through development services (along with corresponding revenue increase) and change in the mix of services (drilling deeper wells and higher levels of horizontal drilling). The change as a percentage of total cost of services is primarily caused by an increase in transportation costs in the Perm and Komi regions due to the sale of our own non-core transportation assets to a third parties and an increase in the number of turnkey well requests from our customers along with changes in the mix of services.

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 2010 were US \$218.9 million, or 18.3% of total cost of services as compared to US \$218.7 million, or 24.0% of total cost of services for 2009. The decrease in the percentage of total costs is mostly caused by a change to a different scheme of casing pipe financing instituted by some of our major customers late in the first quarter of 2009. Prior to the first quarter of 2009 casing pipe was included in the price of well construction and in cost of sales. In 2009 certain of our major customers chose to finance a portion of their casing pipe and provide it to us. In 2010, even more of

our major customers decided to operate under the new casing pipe financing scheme leading to the continued decrease of material costs as a percentage of total cost of services.

Employee wages and salaries include costs of our personnel directly engaged in providing onshore and offshore drilling and other services. Employee costs include amounts we pay in support of our private employee insurance and medical funds. Such expenses do not include contributions which we make to a private pension fund or social taxes we pay to the Russian government. Wages and salaries for the fiscal year 2010 were US \$324.9 million, or 27.2% of total cost of services as compared to US \$222.6 million, or 24.4% of total cost of services for 2009. The increase in both total dollars expenses and the percentage of total cost of services was caused by the integration of the new workover and telemetry businesses acquired late in 2009 for which wages and salaries constitute the largest component of cost of services. The total dollar increase was also to a lesser extent attributable to the increase in the dollar/ruble exchange rate.

Fuel and energy costs consist primarily of oil, lubricants and electricity. Fuel and energy costs for 2010 were US \$79.5 million, or 6.7% of total cost of services as compared to US \$63.6 million, or 7.0% of total cost of services for 2009. The change as a percentage of total cost of services is not material.

Costs relating to the transportation of employees to field locations primarily include transportation services related to the mobilisation and rotation of rig crews. Expenses relating to the transportation of employees to field locations for 2010 were US \$23.4 million, or 2.0% of total cost of services as compared to US \$28.1 million, or 3.1% of total cost of services for 2009. 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 2010 were US \$10.9 million, or 0.9% of total cost of services as compared to US \$10.9 million, or 1.1% of total cost of services for 2009. The percentage of total cost of services change is not considered material.

The remaining portion of our cost of services, which we categorise as “other”, includes current repair expenses for fixed assets; license fees; insurance expenses; safety and environmental expenses; and maintenance expenses. Other expenses amounted to US \$49.3 million or 4.1% of our total cost of services for 2010, as compared to US \$47.8 million or 5.2% of our total cost of services for 2009. The increase in the total amount is primarily caused by the change in the dollar/ruble exchange rate. The decrease in the percentage of total cost of services is considered immaterial.

#### ***Selling, general and administrative expenses***

Selling, general and administrative expenses increased by US \$12.0 million to US \$106.9 million for 2010, as compared to US \$94.9 million for 2009. The increase is caused by the integration of the acquired in the end of 2009 businesses. As a percentage of total revenues, selling, general and administrative expenses decreased to 5.9% in 2010 from 6.9% in 2009 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 \$17.4 million to US \$72.5 million for 2010 as compared to US \$55.1 million for 2009. The increase in taxes other than income taxes was primarily attributable to the integration of the new workover businesses and an increase in the dollar/ruble exchange rate. As a percentage of revenue, taxes other than income taxes were 4.0% for both 2010 and 2009.

#### ***Depreciation***

Depreciation increased by US \$35.6 million to US \$142.0 million for 2010 as compared to US \$106.4 million for 2009. As a percentage of revenues, the depreciation increased to 7.8% in 2010 from 7.7% in 2009. The total dollar increase was mostly caused by the significant capital expenditures in PP&E during the past 3 years, particularly the acquisition of additional drilling equipment and new drilling rigs that were placed into service in 2009 and 2010, by the depreciation on the equipment and machinery acquired with the purchase

of workover and telemetry businesses late in 2009 and by an increase in the dollar/ruble exchange rate. The increase as the percentage of total revenues is not material.

#### ***Disposal of property, plant and equipment***

Gain on the disposal of property, plant and equipment increased by US \$5.9 million to US \$6.3 million for 2010 as compared to US \$0.4 million for 2009. This increase was primarily due to a realised gain on the sale of non-core transportation assets in the Perm region during the first half of 2010.

#### ***Income from operating activities***

Income from operating activities increased by US \$79.8 million to US \$294.0 million for the fiscal year 2010, as compared to US \$214.2 million for 2009. The increase in total dollars is primarily due to sustained cost control efforts and higher number of meters drilled. As a percentage of revenues, income from operating activities increased to 16.2% in 2010 from 15.5% in 2009. This percentage increase is primarily due to percentage of total revenues decrease in selling, general and administrative expenses as described above.

#### ***Interest expense***

Interest expense increased by US \$1.6 million to US \$15.1 million for 2010 as compared to US \$13.5 million for 2009. This increase is mostly caused by interest expense on long-term liabilities for PP&E in the workover businesses acquired late in 2009.

#### ***Income before income taxes***

Income before income taxes increased by US \$69.9 million to US \$279.2 million for the fiscal year 2010, as compared to US \$209.3 million for 2009. The increase in income before income taxes was attributable to the factors described in more detail above.

#### ***Income tax expense***

Income tax expense increased by US \$27.9 million to US \$71.8 million for 2010, as compared to US \$43.9 million for 2009. In dollar terms, the increase in income tax expense was primarily attributable to the increase in our income. Our effective tax rate increased to 25.7% in 2010 from 20.9% in 2009 primarily due to a 5% foreign withholding tax on certain intercompany dividends declared and paid in the amount of RUR 5.0 billion during 2010 as well as increase in non-deductible expenses. 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 \$41.9 million to US \$207.4 million for the fiscal year 2010, as compared to US \$165.5 million for 2009.

#### **Overview of financial situation as of December 31, 2010 and liquidity**

Our balance sheet and cash flows remain strong. Our year-end 2010 financial situation highlights include:

- Cash and cash equivalents as of December 31, 2010 was US \$629 million, an increase of US \$195 million as compared to cash and cash equivalent balance of US \$434 million as of December 31, 2009;
- Our debt as of December 31, 2010 increased to US \$404 million as compared to US \$182 million debt balance as of December 31, 2009;
- During the fiscal year 2010 we paid dividends in the amount of US \$213 million including a US \$179 million special dividend on a treasury share sales transaction and a US \$34 million dividend resulting from our successful 2009 operations;
- Net cash position (cash reduced by all debt) was US\$ 225 million as of December 31, 2010 (December 31, 2009 net cash position was US \$252 million);
- Capital expenditures for the fiscal year ended December 31, 2010 were US \$284 million including changes in restricted cash as compared to US \$107 million incurred during 2009;

**Accounts receivable**

Accounts receivable increased by US \$44.3 million to US \$235.4 million as of December 31, 2010, from US \$191.1 million at the beginning of the year. The increase in total dollars is primarily due to increase in revenue. Expressed as the number of days outstanding, our trade receivable balance decreased from approximately 50.7 days at the beginning of the year to approximately 49.3 days at the end of the year (both ratios are expressed in ruble terms). This decrease is due to normal fluctuations in our collection cycle.

**Materials for drilling and workover**

The balance for materials for drilling and workover, a component of our inventory balance, increased by US \$17.9 million from US \$110.0 million at the beginning of the year to US \$127.9 million at the end of the period. Expressed as the number of days for the total inventory to turn over, the turnover rate at the end of the year was approximately 214.0 days, up from 175 days at the beginning of 2010, when expressed in ruble terms. The increase in turnover days as well as the increase in the balance as of December 31, 2010 is primarily attributable to the growth of lower turnover items required for more technologically advanced drilling and higher purchase volumes of spare parts required for maintenance of our rig fleet.

**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 periods ended December 31, 2010 and 2009 (in thousands of US dollars, audited):

	2010	2009
Net cash provided by operating activities	322,553	409,118
Net cash used in investing activities	(325,190)	(125,840)
Net cash provided/(used) in financing activities	206,188	(137,059)

**Operating activities**

Net cash provided by operating activities amounted to US \$322.6 million for 2010, as compared to US \$409.1 million for 2009. This decrease in cash flows provided by operating activities is principally due to a net negative change in the components of operating assets and liabilities for the fiscal year 2010 compared to 2009. The most significant factor contributing to this change is an increase in accounts receivable and inventory attributed to the overall increase in the volume of the drilling services during 2010 as compared to the contraction of the volume during 2009.

**Investing activities**

Net cash used in investing activities amounted to US \$325.2 million for 2010, as compared to US \$125.8 million for 2009. The increase is mostly attributable to our desire to capitalise on the growth opportunities in our markets by significantly increasing our investments in new property, plant and equipment for new projects as well as acquiring new businesses to diversify and expand our service lines.

In 2010 our capital expenditures were US \$283.8 million; mainly comprised of US \$145.6 million spent on rig fleet upgrade and maintenance, US\$ 61.7 allocated for the new rigs to be delivered in 2011 and US\$ 42 million prepayment for the new build Super 116E jack up rig.

**Financing activities**

Net cash provided by financing activities amounted to US \$206.2 million for 2010, as compared to net cash of US \$137.1 million used in financing activities during 2009. During both years, dividends were paid and

principal repayments of long term debt were made. The primary difference between the periods is the result of principal repayments of short term debt and purchase of treasury stock in 2009 as opposed to the sale of all the treasury stock in the first half of 2010 and payment of a special dividend in the approximate amount of the gain generated on the Company's repurchased GDRs. For further details on the transaction, refer to section *Overview of other matters*. Moreover, in December 2010 we received US \$254.3 million from a new credit line for financing strategic acquisitions in 2011.

### Liquidity

The table below shows our cash and cash equivalents for the period ended December 31, 2010 and the year ended 2009 (in thousands of US dollars, audited):

	2010	2009
Cash held in banks - mostly in US Dollars	357,911	60,000
Short-term deposit - Russian rubles	154,730	212,485
Cash held in banks - Russian rubles	76,451	44,110
Short-term deposit - US dollars	40,033	115,789
Other	341	1,340
<b>Total cash and cash equivalents</b>	<b>629,466</b>	<b>433,724</b>

Our cash flow in the short term can be negatively affected by the level of expenditures we are required to make in the fourth and first 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, 2010 and 2009 advances given for property, plant and equipment amounted to the following (in thousands of US dollars, audited):

	2010	2009
Advances given for property, plant and equipment	67,557	15,779

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 new jack up rig to Lamprell.

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):

	2010	2009
Construction in progress	40,146	73,997

The decrease in construction in progress in 2010 compared to 2009 is caused by a normal fluctuation in the new drilling rig delivery schedule.

Additionally, as of December 31, 2010, the Company had on deposit restricted cash of approximately US \$67.8 million to secure letters of credit opened for the purpose of purchasing new drilling rigs to be delivered in 2011 and to secure a bank guarantee issued for a subcontractor.

**Capital resources**

As of December 31, 2010 and 2009 our short-term and long-term debt amounted to the following (in thousands of US dollars, audited) (please see our 2010 Consolidated Financial Statements and the accompanying notes for more detail):

	2010	2009
Short-term debt and current portion of long-term debt	117,550	31,796
Long-term debt	286,367	150,379

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

**Overview of other matters****Dividend policy and year-end 2010 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, 2010 the dividend was declared by the Board of Directors on December 14, 2010 in the amount of 31 cents per share or US \$45 million which was included in "Accounts payable and accrued liabilities" and paid on January 18, 2011. In 2009 a dividend of 25 cents per share or US \$35 million was declared and paid early in 2010.

In addition, on April 15, 2010 the Company announced a one-time special interim dividend of US \$1.22 per share which reflected the approximate gain realised by the Group during its buy-back program. Refer to next 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 late May 2010.

### *Earnings per share*

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

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

	<b>2010</b>	<b>2009</b>
Net income available for common stockholders	207,353	165,490
Weighted average number of outstanding shares	143,270,265	135,121,647
Basic earnings per share of common stock (US dollars)	1.45	1.22
Contingent shares of under the Plan	522,060	718,868
Weighted average number of outstanding shares, after dilution	143,792,325	135,840,515
Diluted earnings per share of common stock (US dollars)	1.44	1.22

Earnings per share calculated on a diluted basis of 143,792,325 shares amounted to US \$1.44 in 2010, compared to US \$1.22 in 2009. The improvement in earnings per share was attributable mainly to the increase in net income by 25% in 2010 compared to 2009. The weighted average number of shares outstanding increased in 2010 by 6% resulting from placement of the treasury shares bought during 2008 and 2009 (refer to paragraph above) to the market on April 15, 2010.

Basic earnings per share were US \$1.45 in 2010 compared to US \$1.22 in 2009.

### *Related party transactions*

#### *Shareholder loans*

In the period from November 2006 through March 2007, the Company entered into loan agreements with its shareholders to partially fund the investment program of our onshore drilling services division and the purchase of our offshore drilling services business. The aggregate principal amount of such loans was US \$70.0 million. The loans mature on December 31, 2011 and incur interest at the rate of 8.6% per annum. In 2010, as well as in 2009, 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 2010 and 2009 the Firm billed EDC for costs and expenses of US \$2.2million and US \$1.3 million respectively. All services were billed at a discount to the Firm's normal billing rates while expenses were billed at their actual cost. In addition the amounts paid to The Stinemetz Law Firm include considerable third party expenses and charges for the services of other lawyers. Mr. Stinemetz is not otherwise paid for his services as the Company's general counsel. Management believes the amounts paid for these legal services

are no more onerous than those which would have been negotiated in an arms-length negotiation for a similar level of service and expertise.

### ***Off-balance sheet arrangements***

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

## **Certain Factors Affecting our 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 higher margin drilling and workover services, including sidetracking, horizontal and underbalanced drilling.

For example, during 2010, we drilled 437 thousand meters utilising the horizontal drilling technique, representing 11% of our total drilling volumes, while in the corresponding period of 2009 our horizontal drilling operations were 337 thousand meters, or about 9% 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, though the recovery rate could be further increased. Looking forward we see the increase in horizontal drilling as our customers already enjoyed higher flow rates from the wells drilled horizontally, which if drilled vertically were 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.

In 2010 we witnessed a number of factors that could moderate our preferred rate of productivity improvement. All these factors can be broadly described as changing mix of services that we provide to our customers. In 2010 we drilled 30% and 64% more horizontal and exploration wells, respectively, compared to 2009 and exploration and horizontal wells are inherently more time consuming to drill than comparable production wells. Average depth of the wells drilled by EDC in Western Siberia increased in aggregate about 7% over the period of 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. For example, during January and February 2010, Russia experienced severely cold temperatures of approximately -45° Celsius in certain regions where we operate and the lost drilling time during such period amounted to approximately 85 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 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.

### *Operating 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 18 rigs were ordered in 2010 with delivery times during 2011. 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 2010 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 4.5 million meters on an annual basis. The

transactions with Schlumberger and Slavneft will further expand our capacity and strengthen 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 2011, we signed a Letter of Intent to acquire 100% of Slavneft's drilling and exploration assets. 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.

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

During 2010, CDU TEK data indicated that overall Russian drilling volumes increased by 18% as compared to the corresponding period of 2009, while oil production increased by 2.2% during 2010 versus the corresponding period of 2009. This increase in production was primarily attributable to new Greenfield production that came on-stream in 2009, that compensated for a decrease in Brownfield oil production. As discussed above, seasonality affects drilling operations in Russia, with drilling volumes achieved in the 2nd and 3rd quarters of each year being substantially higher than 1st and 4th quarter levels in a typical year. During 2008, drilling volumes surged more than is typical in the middle portion of the year due to both seasonality effects and the run up in oil prices. During 2009 the seasonal pattern was more modest, but 2010 was characterised by similar seasonality trends as in 2008.

### **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 will get once we complete transactions with Schlumberger and Slavneft) 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 consolidated financial statements for 2010 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, 2010 (in millions, except interest rate percentages):

	Scheduled Maturity Date						Fair Value	
	2011	2012	2013	2014	2015	2016 and Thereafter	Total	December 31, 2010
Total long term debt	118.9	144.6	139.1	0.3	0.1	1.7	404.7	401.3
Fixed rate	102.2	127.8	122.3	0.3	0.1	1.7	354.4	351.0
Average interest	8.0%	8.2%	8.2%	0.0%	0.0%	0.0%		
Variable rate <sup>1</sup>	16.7	16.8	16.8				50.3	50.3
Average interest	4.4%	4.4%	4.4%					

<sup>1</sup> Based on the LIBOR rate at the end of 2010, which rate may fluctuate in later periods.

As is further described in Note 11 of our December 31, 2010 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, 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. As of December 31, 2009, we had US \$112.2 million of a total of US \$182.2 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 recognised revenues and expenses associated with such transactions. Furthermore, while the majority of our revenues are denominated in the Russian ruble, some of our costs, including some of those associated with purchases of foreign manufactured land rigs, are denominated in the US dollar and other currencies. Any significant foreign currency exchange rate fluctuations (both short- and long-term) could have a material adverse effect on our business, financial condition and results of operations. In addition, in 2010 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 71.2% of our sales during 2010 (68.6% for 2009). 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 2010. In 2009 we had a bad debt of approximately \$10 million for work performed in prior periods and determined to be uncollectible in 2009. Our Allowance for doubtful accounts stood at US \$17.3 million at the end of 2010 (US \$18.3 million for 2009), which amount was considered adequate. Our cash and cash equivalents are placed with major banks within Russia, Switzerland and the United Kingdom.