EURASIA DRILLING COMPANY LIMITED

Consolidated Financial Statements

(prepared in accordance with US GAAP)

As of December 31, 2012, 2011 and 2010
and for each of the years in the three year period
ended December 31, 2012

Contents

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Auditors' Report

To the Board of Directors

Eurasia Drilling Company Limited

We have audited the accompanying consolidated financial statements of Eurasia Drilling Company Limited and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012, 2011 and 2010, and the consolidated statements of comprehensive income, stockholders' equity and cash flows for 2012, 2011 and 2010, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the fair presentation of these consolidated financial statements based on our audits. We conducted our audits in accordance with Russian Federal Auditing Standards and auditing standards generally accepted in the United States of America. Those standards require that we comply with ethical requirements and plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to express an opinion on the fair presentation of these consolidated financial statements.

Audited entity: Eurasia Drilling Company Limited

Eurasia Drilling Company Limited, an Exempted Company incorporated in the Cayman Islands with Limited Liability with effect from the 25th day of November Two Thousand Two. Certificate of Incorporation CR-121302.

The registered office is situated at the offices of Paget-Brown Trust Company Ltd., Boundary Hall, Cricket Square, PO box 1111, Grand Cayman KY-1102, Cayman Islands.

Independent auditor: ZAO KPMG, a company incorporated under the Laws of the Russian Federation, a part of the KPMG Europe LLP group, and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Registered by the Moscow Registration Chamber on 25 May 1992, Registration No. 011.585.

Entered in the Unified State Register of Legal Entities on 13 August 2002 by the Moscow Inter-Regional Tax Inspectorate No.39 of the Ministry for Taxes and Duties of the Russian Federation, Registration No. 1027700125628, Certificate series 77 No. 005721432.

Member of the Non-commercial Partnership "Chamber of Auditors of Russia". The Principal Registration Number of the Entry in the State Register of Auditors and Audit Organisations: No.10301000804.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Eurasia Drilling Company Limited and its subsidiaries as of December 31, 2012, 2011 and 2010, and the results of their operations and their cash flows for 2012, 2011 and 2010 in accordance with U.S. generally accepted accounting principles.

ЗАКРЫТОЕ АКЦИОНЕРНОЕ ОБЩЕСТВО Г.Р. №011585
КПМГ
KPMG
МОСКВА

Usov A.I.

Director, power of attorney dated October 1, 2010 No. 52/10

ZAO KPMG

March 29, 2013

Moscow, Russian Federation

Eurasia Drilling Company Limited
Consolidated Balance Sheets
As of December 31, 2012, 2011 and 2010
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	2012	2011 (adjusted)	2010 (adjusted)
Assets				
Current assets				
Cash and cash equivalents	3	305,333	509,781	629,466
Accounts receivable, net	4	528,813	378,523	252,749
Inventories		213,058	190,727	127,918
Taxes receivable	12	27,201	33,146	34,960
Deferred income tax assets	12	11,175	3,710	11,472
Other current assets	8	13,792	42,719	20,241
Total current assets		**1,099,372**	**1,158,606**	**1,076,806**
Property, plant and equipment	5	1,768,119	1,286,125	765,184
Long-term accounts receivable	6	256	2,181	6,838
Deferred income tax assets	12	2,156	2,833	1,422
Goodwill	7, 17	107,998	105,399	32,727
Other non-current assets	8	57,154	48,672	70,830
Total assets		**3,035,055**	**2,603,816**	**1,953,807**
Liabilities and stockholders' equity				
Current liabilities				
Accounts payable and accrued liabilities		465,256	407,410	258,706
Advances received		2,288	3,766	20,295
Current portion of long-term debt	10	257,860	175,217	117,550
Taxes payable	12	90,276	69,030	54,257
Deferred income tax liabilities	12	6,499	5,340	478
Total current liabilities		**822,179**	**660,763**	**451,286**
Long-term debt	11	442,013	578,117	286,367
Accrued pension liability	13	15,598	11,216	6,889
Deferred income tax liabilities	12	92,639	49,376	24,744
Total liabilities		**1,372,429**	**1,299,472**	**769,286**
Stockholders' equity	16			
Common stock		1,469	1,469	1,469
Treasury stock, at cost		(1,652)	(2,244)	(13,148)
Additional paid-in capital		684,398	680,198	691,535
Retained earnings		1,072,369	793,111	578,716
Accumulated other comprehensive loss		(93,958)	(168,190)	(74,051)
Total stockholders' equity		**1,662,626**	**1,304,344**	**1,184,521**
Total liabilities and stockholders' equity		**3,035,055**	**2,603,816**	**1,953,807**

W. Richard Anderson
CFO of Eurasia Drilling Company Limited

LIMITED LIABILITY COMPANY EURASIA DRILLING COMPANY LIMITED CAYMAN ISLANDS

March 29, 2012

Eurasia Drilling Company Limited
Consolidated Statements of Comprehensive Income
For the years ended December 31, 21012, 2011 and 2010
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	2012	2011 (adjusted)	2010 (adjusted)
Revenues				
Drilling and related services		3,222,830	2,734,444	1,808,905
Other sales and services		14,503	32,305	13,275
Total revenues		**3,237,333**	**2,766,749**	**1,822,180**
Cost of services, excluding depreciation and taxes	15	(2,151,336)	(1,906,256)	(1,204,333)
General and administrative expenses, excluding depreciation and taxes		(161,270)	(144,614)	(106,920)
Taxes other than income taxes		(134,733)	(119,181)	(72,547)
Depreciation		(249,987)	(213,492)	(144,241)
Gain (loss) on disposal of property, plant and equipment		4,786	(1,362)	6,344
Impairment loss	17	-	(1,296)	(7,096)
Income from operating activities		**544,793**	**380,548**	**293,387**
Interest expense		(53,661)	(52,342)	(15,125)
Interest income		12,094	11,485	7,993
Currency transaction gain (loss)		631	(11,054)	(7,355)
Gain on business exchange transaction	17	-	32,284	557
Other (expenses) income		(8)	6,495	(951)
Income before income taxes		**503,849**	**367,416**	**278,506**
Income tax expense	12	(121,840)	(84,045)	(71,680)
Net income		**382,009**	**283,371**	**206,826**
Basic earnings per share of common stock (US dollars)	16	2.60	1.93	1.44
Diluted earnings per share of common stock (US dollars)	16	2.59	1.93	1.44
Other comprehensive income:				
Foreign currency translation gain (loss)		76,010	(92,089)	(7,498)
Pension benefits:				
Prior service cost		(931)	(561)	(1,535)
Actuarial (loss) gain		(847)	(1,489)	464
Other comprehensive income (loss)		**74,232**	**(94,139)**	**(8,569)**
Comprehensive income		**456,241**	**189,232**	**198,257**

Eurasia Drilling Company Limited
Consolidated Statements of Stockholders' Equity
For the years ended December 31, 2012, 2011 and 2010
(All amounts in thousands of US dollars, unless otherwise noted)

	Common stock	Treasury stock, at cost	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income/ (loss), net of tax	Total Stockholders' equity
Balances as of December 31, 2009 (adjusted)	**1,469**	**(58,332)**	**528,163**	**596,594**	**(65,482)**	**1,002,412**
Net income (adjusted)	-	-	-	206,826	-	**206,826**
Other comprehensive loss (adjusted)	-	-	-	-	(8,569)	**(8,569)**
Comprehensive income (adjusted)						**198,257**
Sale of common stock	-	54,956	162,548	-	-	**217,504**
Purchase of treasury stock	-	(13,148)	-	-	-	**(13,148)**
Incentive compensation plan	-	-	4,200	-	-	**4,200**
Exercise of incentive compensation plan	-	3,376	(3,376)	-	-	**-**
Dividends declared	-	-	-	(224,704)	-	**(224,704)**
Balances as of December 31, 2010 (adjusted)	**1,469**	**(13,148)**	**691,535**	**578,716**	**(74,051)**	**1,184,521**
Net income (adjusted)	-	-	-	283,371	-	**283,371**
Other comprehensive loss (adjusted)	-	-	-	-	(94,139)	**(94,139)**
Comprehensive income (adjusted)						**189,232**
Purchase of treasury stock	-	(5,114)	-	-	-	**(5,114)**
Disposal of treasury stock	-	481	-	-	-	**481**
Incentive compensation plan	-	-	4,200	-	-	**4,200**
Exercise of incentive compensation plan	-	15,537	(15,537)	-	-	**-**
Dividends declared	-	-	-	(68,976)	-	**(68,976)**
Balances as of December 31, 2011 (adjusted)	**1,469**	**(2,244)**	**680,198**	**793,111**	**(168,190)**	**1,304,344**
Net income	-	-	-	382,009		**382,009**
Other comprehensive income	-	-	-	-	74,232	**74,232**
Comprehensive income						**456,241**
Disposal of treasury stock	-	592	-	-	-	**592**
Incentive compensation plan	-	-	4,200	-	-	**4,200**
Dividends declared	-	-	-	(102,751)	-	**(102,751)**
Balances as of December 31, 2012	**1,469**	**(1,652)**	**684,398**	**1,072,369**	**(93,958)**	**1,662,626**

Eurasia Drilling Company Limited
Consolidated Statements of Cash Flows
For the years ended December 31, 2012, 2011 and 2010
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	2012	2011 (adjusted)	2010 (adjusted)
Cash flows from operating activities				
Net income		**382,009**	**283,371**	**206,826**
Adjustments for non-cash items:				-
Depreciation		249,987	213,492	144,241
Accrued interest expense		-	2,586	2,893
Deferred income tax		34,307	27,747	8,635
(Gain) loss on disposal of property, plant and equipment		(4,786)	1,362	(6,344)
(Gain) loss on disposal of subsidiary		-	(32,284)	557
Impairment loss	17	-	1,296	7,096
Decrease in allowance for doubtful accounts receivable		(2,833)	(1,806)	(947)
Foreign currency exchange rate difference (unrealized)		1,546	8,097	3,862
Incentive plan		4,200	4,200	4,200
All other items – net		3,186	368	(651)
Changes in operating assets and liabilities:			-	-
Accounts receivable		(126,878)	(113,378)	(51,104)
Inventories		(10,527)	(51,191)	(18,941)
Taxes receivable and payable		29,300	26,671	1,846
Other current assets and liabilities		32,588	(31,157)	(4,792)
Accounts payable and accrued liabilities		2,000	103,319	42,015
Advances received		(1,644)	(16,964)	(16,839)
Net cash provided by operating activities		**592,455**	**425,729**	**322,553**
Cash flows from investing activities				
Purchases of property, plant and equipment		(616,499)	(417,873)	(224,970)
Change in restricted cash	8	(3,400)	17,919	(58,807)
Proceeds from sale of property, plant and equipment		11,121	14,034	8,190
Disposal of subsidiary, net of cash disposed	17	-	95,374	767
Loans issued		(20,637)	-	(7,238)
Loan principal collections		17,136	1,021	-
Acquisition of subsidiaries, net of cash acquired	17	-	(559,340)	(43,132)
Investment in associate		(5,643)	-	-
Net cash used in investing activities		**(617,922)**	**(848,865)**	**(325,190)**
Cash flows from financing activities				
Proceed from issuance of short-term debt		-	90,000	-
Principal repayments of short-term debt		-	(90,000)	-
Proceeds from issuance of long-term debt		25,729	465,649	255,193
Principal repayments of long-term debt		(153,893)	(67,808)	(40,037)
Repayment of capital lease obligations		-	-	(538)
Dividends paid		(68,976)	(45,387)	(212,786)
Proceeds from sale of treasury stock		-	-	217,504
Purchase of treasury stock		-	(5,114)	(13,148)
Net cash (used in) provided by financing activities		**(197,140)**	**347,340**	**206,188**
Effect of exchange rate changes on cash		18,159	(43,889)	(7,809)
Net (decrease) increase in cash and cash equivalents		**(204,448)**	**(119,685)**	**195,742**
Cash and cash equivalents at beginning of period		509,781	629,466	433,724
Cash and cash equivalents at end of period	**3**	**305,333**	**509,781**	**629,466**
Supplemental disclosures of cash flow information				
Interest paid		50,706	46,286	11,910
Income tax paid		92,294	55,394	57,145

Note 1. Organization and environment

The primary activities of Eurasia Drilling Company Limited (the "Company") and its subsidiaries (together, the "Group") include providing exploratory and developmental drilling and oil and gas field services to companies operating within the Russian Federation, Kazakhstan, Iraq and the Caspian Sea region.

Eurasia Drilling Company Limited was registered on November 25, 2002 under the Law of the Cayman Islands. The Company was established for the purpose of acquiring OOO LUKOIL Burenie and its subsidiaries.

In November 2004 Eurasia Drilling Company Limited entered into a purchase agreement with OAO LUKOIL to acquire OOO LUKOIL Burenie and its subsidiaries. The acquisition was completed on December 30, 2004. Prior to the acquisition, the Company had no operating activity.

OOO LUKOIL Burenie, now OOO Burovaya Kompaniya Eurasia, was established in accordance with the decision of the Board of Directors of OAO LUKOIL on February 13, 1995 and registered by the resolution of the Head of Kogalym Administration № 216 on May 17, 1995. It was formed from the West Siberian drilling subdivisions of OAO LUKOIL.

As of December 31, 2012, 2011 and 2010 OOO Burovaya Kompaniya Eurasia had on-shore operating branches in Kogalym, Perm, Usinsk and Zhirnovsk (Volgograd Region) in the Russian Federation.

In 2007 the Group established a subsidiary in Kazakhstan, TOO BKE Kazakhstan Burenie, to provide on-shore drilling services.

In December 2006, the Group acquired a 100% interest in LUKOIL Shelf Limited and LUKOIL Overseas Orient which provide off-shore drilling services in the Caspian Sea to various oil and gas companies in the Russian Federation, Kazakhstan and Turkmenistan. In 2007 these companies were renamed EDC Shelf Limited and AstraOrient Limited, respectively. In 2007, the Company established a Russian subsidiary, OOO BKE Shelf, to operate its off-shore drilling services segment. All operations from EDC Shelf Limited were transferred to OOO BKE Shelf.

In December 2009, the Group acquired a 100% interest in OOO Kogalym Well Workover Division (OOO KWWD) and OOO Urai Well Workover Division (OOO UWWD) which provide well workover, well reconditioning and well servicing operations in West Siberia. In December 2011 these two companies were merged into one legal entity OOO KRS Eurasia.

In June 2010, the Group acquired a 100% interest in OOO Meridian which performs workover services in the Komi region (refer to Note 17).

In February 2011 the Group acquired a 100% interest in Caspian Sea Ventures International Limited (CSVI). The acquired company is the owner of a jack-up drilling rig operating in the Turkmen waters of the Caspian Sea (refer to Note 17).

In April 2011 the Group acquired a 100% interest in OOO Sibirskaya Geophisicheskaya Company (OOO SGC) and 100% in ZAO Samatlorsky KRS (ZAO SKRS). The acquired companies perform drilling and workover services in West Siberia (refer to Note 17).

In July 2012 the Group acquired rigs in Iraq and established a new company EDC Romfor to perform drilling and workover services in Kurdistan region.

The majority of the Group's revenues are currently derived from services provided to OAO LUKOIL and its affiliated entities (the "LUKOIL Group") and as such, the Group is economically dependent upon its contractual agreements with the LUKOIL Group (refer to note 21).

Note 1. Organization and environment (continued)

Business and economic environment

The accompanying financial statements reflect management's assessment of the impact of the business environment in the countries in which the Group operates on the operations and financial position of the Group. The future business environment may differ from management's assessment.

Basis of preparation

The consolidated financial statements have been prepared by the Group in accordance with accounting principles generally accepted in the United States of America ("US GAAP").

Note 2. Summary of significant accounting policies

The following significant accounting policies have been applied in the preparation of the consolidated financial statements.

Principles of consolidation

These consolidated financial statements include the financial position and results of the Company and controlled subsidiaries of which the Company directly or indirectly owns more than 50% of the voting interest, unless minority interest shareholders have substantive participating rights. Other significant investments in companies of which the Company directly or indirectly owns between 20% and 50% of the voting interest and over which it exercises significant influence but not control, are accounted for using the equity method of accounting. Investments in other companies are recorded at cost. Equity investments and investments in other companies are included in "Other non-current assets" in the consolidated balance sheet.

Use of estimates

The preparation of the consolidated financial statements requires management of the Group to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of property, plant and equipment, goodwill impairment assessment, accounts receivable, inventories, deferred income taxes, long-term debt, accrued pension liability and stock-based compensation liability. Actual results could differ from those estimates.

Acquisitions

Assets acquired and liabilities assumed in business combinations are recorded on the Company's consolidated balance sheet as of the respective acquisition dates based upon their fair values at such dates. The results of operations of the businesses acquired by the Company begin to be included in the Company's consolidated statement of income upon the respective acquisition dates.

Note 2. Summary of significant accounting policies (continued)

Functional and reporting currency

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

Translation from the functional currency to the US dollar was conducted as follows:

- All assets and liabilities were translated from the functional to the reporting currency at the exchange rate effective at the reporting date;
- Equity items were translated from the functional to the reporting currency at the historical exchange rate;
- Items in the statement of comprehensive income and cash flows were translated from the functional currency to the reporting currency at rates, which approximate rates at the date of transaction.

Translation differences resulting from the use of these exchange rates are included as a separate component of accumulated other comprehensive income/loss.

The closing exchange rate as of December 31, 2012, 2011 and 2010 was 30.3727, 32.1961 and 30.4769 Russian rubles to one US dollar, respectively.

The Russian ruble and other currencies of republics of the former Soviet Union are not readily convertible outside of their countries. Accordingly, the translation of amounts recorded in these currencies into US dollars should not be construed as a representation that such currency amounts have been, could be or will in the future be converted into US dollars at the exchange rate shown or at any other exchange rate.

Cash and cash equivalents

Cash and cash equivalents include all highly liquid investments with an original maturity of three months or less.

Cash with restrictions on immediate use

Cash funds for which restrictions on immediate use exist are accounted for within other current or non-current assets. The group classifies restricted cash in other current assets if the cash is to be used within a year for payment of existing or maturing obligations. If the cash is to be held for a longer period of time, the restricted cash is shown in other non-current assets. Cash classification in the noncurrent section is also set aside for plant expansion, retirement of long-term debt or purchase of long-term investments.

Note 2. Summary of significant accounting policies (continued)

Accounts receivable

Accounts receivable are recorded at their transaction amounts less allowance for doubtful accounts. Allowance for doubtful accounts receivable is recorded to the extent that there is a likelihood that any of the amounts due will not be obtained. Non-current receivables are discounted to the present value of expected cash flows in future periods using the original discount rate.

Inventories

Inventories, consisting primarily of materials and tools used for drilling are stated at the lower of cost or market value. The cost of inventories is determined using an "average cost" method.

Property, plant and equipment

Property, plant, and equipment are stated at cost, net of depreciation. Depreciation is calculated on a straight-line method over the useful lives of the assets, estimated to be in the following ranges:

Buildings	15 - 20 years
Machinery and equipment	2 - 20 years
Vehicles	5 - 20 years

The cost of maintenance, repairs and replacement of minor items of property, plant and equipment is expensed as incurred. Major refurbishments and improvements of assets are capitalized.

Goodwill

Goodwill represents the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed. It is assigned to reporting units as of the acquisition date. Goodwill is not amortized, but is tested for impairment at least on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The impairment test requires estimating the fair value of a reporting unit and comparing it with its carrying amount, including goodwill assigned to the reporting unit. If the estimated fair value of the reporting unit is less than its net carrying amount, including goodwill, then the goodwill is written down to its implied fair value.

Impairment of long-lived assets

Long-lived assets and certain intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset group may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset group to the estimated undiscounted future net cash flows expected to be generated by that group. If the carrying amount of an asset group exceeds its estimated undiscounted future net cash flows, an impairment charge is recognized by writing down the carrying value to the estimated fair value of the asset group. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to dispose and are no longer depreciated.

Leased assets

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as capital leases. Leased property, plant and equipment meeting certain capital lease criteria are capitalized and the present value of the related lease payments is recorded as a liability. Amortization of capitalized lease assets is computed on the straight-line method over the estimated useful life.

Note 2. Summary of significant accounting policies (continued)

Leased assets (continued)

Payments for operating leases, under which the Group does not assume all the risks and rewards of ownership are expensed in the period they are incurred.

Income taxes

Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the carrying amounts of existing assets and liabilities for the purpose of the consolidated financial statements and their respective tax bases and operating loss and tax credit carry forwards. Deferred income tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in tax rates is recognized in earnings in the reporting period which includes the enactment date.

The ultimate realization of deferred income tax assets is dependent upon the generation of future taxable income in the reporting periods in which the originating expenditures become deductible. In assessing the realizability of deferred income tax assets, management considers whether it is more likely than not that the deferred income tax assets will be realized. In making this assessment, management considers the scheduled reversal of deferred income tax liabilities, projected future taxable income, and tax planning strategies.

An income tax position is recognized only if the uncertain position is more likely than not of being sustained upon examination, based on its technical merits. A recognized income tax position is measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties relating to unrecognized tax benefits in income tax expense in earnings.

Interest-bearing borrowings

Interest-bearing borrowings are recognized initially at cost. Subsequent to initial recognition, long-term borrowings are stated at amortized cost with any difference between cost and redemption value being recognized in earnings over the period of the borrowings.

If borrowings are repurchased or settled before maturity, any difference between the amount paid and the carrying amount is recognized in earnings in the period in which the repurchase or settlement occurs.

Pension benefits

The expected costs in respect of pension obligations of the Group are determined by an independent actuary. The net periodic costs are recognized as employees render the services necessary to earn the postretirement benefits.

Environmental expenditures

Group companies accrue for losses associated with environmental remediation obligations, when such losses are probable and reasonably estimable. Such accruals are adjusted as further information becomes available or circumstances change.

Note 2. Summary of significant accounting policies (continued)

Revenue recognition

Drilling and related services

Drilling and related services are generally sold based upon contracts with customers that do not include significant post-delivery obligations. Service revenue is recognized when the services are rendered and collectability is reasonably assured. Rates for services are typically priced on a per day, per meter, per man-hour, or similar basis. Claims and change orders that are in the process of being negotiated with customers for extra work or changes in the scope of work are included in revenue when collection is deemed probable to the extent that the work has been performed.

In 2012 the Group changed its revenue recognition policy from units-of-delivery method to the percentage-of-completion method. This change was caused by the intention of the Group to convert from US GAAP to IFRS at some future date. Both methods are acceptable under US GAAP but percentage-of-completion method is preferable due to providing more transparency and more regular recognition of income. The adjustments required to reflect this change in accounting policy are shown in Comparative amounts section of Note 2.

The units-of-delivery method recognizes as revenue the contract price of units of a basic production product delivered during a period and as the cost of earned revenue the costs allocable to the delivered units; costs allocable to undelivered units were reported in the balance sheet as inventory or work in progress.

The percentage-of-completion method recognizes income as work on a contract progresses. For unit-price contracts (based on meters drilled or day-rates) the percentage-of-completion equals 100% of work performed each month. Revenue is recognized based on meters drilled or day-rates. For fixed-price contracts the percentage-of-completion is defined based on surveys of work performed or completion of physical proportion. Contract costs are accumulated in the same manner as inventory costs and are charged to operations as the related revenue from contracts is recognized. Claims and change orders that are in the process of being negotiated with customers for extra work or changes in the scope of work are included in revenue when collection is deemed probable.

Revenue is recognized only when it is probable that the economic benefits associated with the transaction will flow to the Group.

Other sales and services

Revenues for other sales and services are recognized when the significant risks and rewards of ownership have passed to the buyer, when it is probable that economic benefits will flow to the Group and when these economic benefits can be reliably measured.

All sales are shown net of value added tax.

Treasury stock

Purchases by Group companies of the Company's outstanding stock are recorded at cost and classified as treasury stock within Stockholders' equity. Authorized and Issued stock includes treasury stock. Outstanding stock does not include treasury stock.

Note 2. Summary of significant accounting policies (continued)

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 period. A calculation is carried out to establish if there is potential dilution in earnings per share if convertible securities were to be converted into shares of common stock or contracts to issue shares of common stock were to be exercised. If there is such dilution, diluted earnings per share are presented.

Share-based payments

The Group accounts for liability classified share-based payment awards to employees at fair value on the date of grant and as of each reporting date. Expenses are recognized over the vesting period. Equity classified share-based payment awards to employees are valued at fair value on the date of grant and expensed over the vesting period.

Commitments and contingencies

Certain conditions may exist as of the balance sheet date, which may result in losses to the Group but the impact of which will only be resolved when one or more future events occur or fail to occur.

If the Group's assessment of contingencies indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability is accrued and charged to earnings. If a probable material loss is within a range and there is no amount within the range which is a better estimate than any other amount, the minimum amount in the range is accrued. If the assessment indicates that a potential material loss is not probable, but is reasonably possible, or is probable but cannot be estimated, than the nature of the contingent liability, together with an estimate of the range of possible loss, is disclosed in the notes to the consolidated financial statements. Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

Changes in accounting policy

In September 2011, the FASB issued Accounting Standards Update ("ASU") No. 2011-08, *"Testing Goodwill for Impairment,"* which allows an entity to use a qualitative approach to test goodwill for impairment. This ASU permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount and hence whether it is necessary to perform the two-step goodwill impairment test as required by the provisions of Topic 350 of the Codification. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed for the fiscal years beginning after December 15, 2011. The Group adopted the requirements of ASU No. 2011-08 starting from the first quarter of 2012. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

Note 2. Summary of significant accounting policies (continued)

Changes in accounting policy (continued)

In June 2011, the FASB issued ASU No. 2011-05, *"Presentation of comprehensive income,"* which amends Topic 220 of the Codification. This ASU increases the prominence of other comprehensive income in financial statements. Under this ASU, an entity has the option to present the components of net income and comprehensive income in either one or two statements. The ASU eliminates the option in US GAAP to present other comprehensive income in the statement of changes in equity. ASU No. 2011-05 is effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011 (except those reclassification adjustments deferred by ASU No. 2011-12) and should be applied retrospectively. The Group adopted the requirements of ASU No. 2011-05 starting from the first quarter of 2012. This adoption changed the presentation of net and comprehensive income and stockholders' equity, but did not have any impact on the Group's results of operations, financial position or cash flows.

In May 2011, the FASB issued ASU No. 2011-04, *"Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRSs,"* which amends Topic 820 of the Codification. This ASU provides guidance for fair value measurements and disclosure requirements and clarifies the Board's intent about the application of existing fair value measurement requirements. The new standard does not extend the use of fair value but, rather, provides guidance about how fair value should be applied where it already is required or permitted under US GAAP. ASU No. 2011-04 is effective for public entities during interim and annual periods beginning after December 15, 2011 and should be applied prospectively. The Group adopted the requirements of ASU No. 2011-04 starting from the first quarter of 2012. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In April 2011, the FASB issued ASU No. 2011-02, *"A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring,"* which amends Topic 310 of the Codification. This ASU provides additional guidance in considering whether a restructuring constitutes a troubled debt restructuring and helps creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties. ASU No. 2011-02 is effective starting from the first interim or annual period beginning on or after June 15, 2011. The Group adopted the requirements of ASU No. 2011-02 starting from the third quarter of 2011. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

Recent accounting pronouncements

In December 2011, the FASB issued ASU No. 2011-11, *"Disclosures about Offsetting Assets and Liabilities."* This ASU requires entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The scope includes derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. ASU No. 2011-11 is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods, and should be applied retrospectively. The Group does not expect adoption of ASU No. 2011-11 to have any material impact on its results of operations, financial position or cash flows.

In January 2013, the FASB issued ASU No. 2013-01 *"Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities,"* which clarifies that ordinary trade receivables and payables are not in the scope of ASU No. 2011-11. The Group is evaluating the effect of the adoption of ASU No. 2011-11 and does not expect any material impact on its results of operations, financial position or cash flows.

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

Note 2. Summary of significant accounting policies (continued)

Comparative amounts

In 2012 the Group changed its revenue recognition policy from units-of-delivery method to the percentage-of-completion method. This change was caused by the intention of the Group to convert from US GAAP to IFRS at some future date (see above in the Revenue recognition section of Note 2).

The following prior period amounts have been adjusted to conform to the current period presentation.

Consolidated balance sheet

The following are the consolidated balance sheet captions as of December 31, 2011 as previously reported and adjusted:

	2011 as previously reported	**Adjustment**	**2011 as adjusted**
Accounts receivable, net	348,082	30,441	378,523
Inventories	214,434	(23,707)	190,727
Deferred income tax assets (current)	5,057	(1,347)	3,710
Retained earnings	787,250	5,861	793,111
Accumulated other comprehensive loss	(167,717)	(473)	(168,190)

The following are the consolidated balance sheet captions as of December 31, 2010 as previously reported and adjusted:

	2010 as previously reported	**Adjustment**	**2010 as adjusted**
Accounts receivable, net	235,360	17,389	252,749
Inventories	145,633	(17,715)	127,918
Deferred income tax assets (current)	11,407	65	11,472
Retained earnings	578,989	(273)	578,716
Accumulated other comprehensive loss	(74,063)	12	(74,051)

The retained earnings as of December 31, 2009 were adjusted from USD 596,340 thousand to USD 596,594 thousand.

Consolidated statement of comprehensive income

The following are captions of the statement of comprehensive income for the year ended December 31, 2011 as previously reported and adjusted:

	2011 as previously reported	**Adjustment**	**2011 as adjusted**
Revenue from drilling and related services	2,720,112	14,332	2,734,444
Cost of services	(1,898,246)	(8,010)	(1,906,256)
Taxes other than income taxes	(118,850)	(331)	(119,181)
Depreciation	(215,168)	1,676	(213,492)
Income tax expense	(82,512)	(1,533)	(84,045)
Net income	277,237	6,134	283,371
Basic (and diluted) earnings per share of common stock (US dollars)	1.89	0.04	1.93
Foreign currency translation loss	(91,604)	(485)	(92,089)
Comprehensive income	183,583	5,649	189,232

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

Note 2. Summary of significant accounting policies (continued)

Comparative amounts (continued)

Consolidated statement of comprehensive income (continued)

The following are captions of the statement of comprehensive income for the year ended December 31, 2010 as previously reported and adjusted:

	2010 as previously reported	Adjustment	2010 as adjusted
Revenue from drilling and related services	1,798,881	10,024	1,808,905
Cost of services	(1,195,891)	(8,442)	(1,204,333)
Depreciation	(142,000)	(2,241)	(144,241)
Income tax expense	(71,812)	132	(71,680)
Net income	207,353	(527)	206,826
Basic earnings per share of common stock (US dollars)	1.45	(0.01)	1.44
Foreign currency translation loss	(7,510)	12	(7,498)
Comprehensive income	198,772	(515)	198,257

Consolidated statement of cash flows

The following are captions of the statement of cash flows for the year ended December 31, 2011 as previously reported and adjusted:

	2011 as previously reported	Adjustment	2011 as adjusted
Net income	277,237	6,134	283,371
Depreciation	215,168	(1,676)	213,492
Deferred income tax	26,214	1,533	27,747
Accounts receivable, net	(98,111)	(15,268)	(113,379)
Inventories	(60,468)	9,277	(51,191)

The following are captions of the statement of cash flows for the year ended December 31, 2010 as previously reported and adjusted:

	2010 as previously reported	Adjustment	2010 as adjusted
Net income	207,353	(527)	206,826
Depreciation	142,000	2,241	144,241
Deferred income tax	8,767	(132)	8,635
Accounts receivable, net	(41,080)	(10,024)	(51,104)
Inventories	(27,383)	8,442	(18,941)

Certain other prior period amounts have been reclassified to conform with current period presentation.

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

Note 3. Cash and cash equivalents

Cash and cash equivalents include the following:

	As of December 31, 2012	As of December 31, 2011	As of December 31,2010
Short-term deposit - Russian rubles	128,295	194,771	154,730
Cash held in banks - Russian rubles	154,992	188,410	76,451
Cash held in banks - US dollars	19,118	81,770	357,911
Short-term deposit - US dollars	2,805	39,320	40,033
Other	123	5,510	341
Total cash and cash equivalents	**305,333**	**509,781**	**629,466**

Note 4. Accounts receivable, net

Accounts receivable include the following:

	As of December 31, 2012	As of December 31, 2011 (adjusted)	As of December 31,2010 (adjusted)
Trade accounts receivable	522,930	385,062	261,288
Advances given	18,460	8,062	8,737
	541,390	393,124	270,025
Allowance for doubtful accounts	(12,577)	(14,601)	(17,276)
Total accounts receivable, net	**528,813**	**378,523**	**252,749**

Note 5. Property, plant and equipment

Property, plant and equipment include the following:

	As of December 31, 2012	As of December 31, 2011	As of December 31,2010
Machinery and equipment	2,121,620	1,524,661	964,134
Buildings	39,674	28,654	38,112
Vehicles	42,185	23,231	34,712
	2,203,479	1,576,546	1,036,958
Less: accumulated depreciation	(762,569)	(515,930)	(379,477)
Construction in progress	51,568	92,142	40,146
Advances given for property, plant and equipment	275,641	133,367	67,557
Total property, plant and equipment	**1,768,119**	**1,286,125**	**765,184**

Note 6. Long-term accounts receivable

The Company's long-term accounts receivable were as follows:

	Stated interest rates	As of December 31, 2012	As of December 31, 2011	As of December 31,2010
Long-term accounts receivable denominated in USD	6%	-	-	791
Long-term accounts receivable denominated in Russian rubles	0.00%-8.25%	256	2,181	6,047
Total long-term accounts receivable		**256**	**2,181**	**6,838**

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

Note 6. Long-term accounts receivable (continued)

Long-term accounts receivable denominated in Russian rubles represent amounts receivable from trade sales during 2010 and 2011 in amount of USD 7.0 million and sales of property, plant and equipment as a part of the disposal of non-core assets program during 2011 in amount of USD 10.5 million.

Long-term accounts receivable denominated in US dollars represented amounts receivable from the sale of property, plant and equipment in November 2005 with a carrying value of USD 10 million to companies related to a former member of management of the Company. The Group recognized a gain of USD 5 million on this transaction. These receivables were secured by a pledge over the assets sold.

As these interest rates were below market rates at the date of origination these long-term accounts receivable have been recorded on the balance sheet by discounting the initial amount over the period it is to be repaid using market interest rates of 12.24%-15% estimated by management to be the rate applicable to the Group for borrowings of a similar nature.

Note 7. Goodwill

The movement in goodwill was as following:

Goodwill as of December 31, 2010	**32,727**
Goodwill acquired	110,458
Goodwill disposed	(30,628)
Cumulative translation adjustment	(7,158)
Goodwill as of December 31, 2011	**105,399**
Cumulative translation adjustment	2,599
Goodwill as of December 31, 2012	**107,998**

Note 8. Other current and non-current assets

The Group had restricted cash of USD 45.4 million, USD 42.0 million and USD 61.7 million included in other non-current assets as of December 31, 2012, December 31, 2011 and December 31, 2010, respectively. This amount collateralizes the Company's issuance of commercial letters of credit.

The Group had additional restricted cash of USD 4.0 million, USD 1.4 million ans USD 6.1 million included in other current assets as of December 31, 2012, December 31, 2011 and December 31, 2010, respectively. These amounts of USD 4.0 and USD 1.4 million as of December 31, 2012 and 2011, respectively, collateralize the Company's issuance of a guarantee for a customer. The amount of USD 6.1 million as of December 31, 2010 consists of a bid bond in the amount of USD 1.0 million and a guarantee issued for a subcontractor in the amount of USD 5.1 million (refer to Note 19).

The Group had bank deposits with original maturities that exceeded 3 months in amount of USD 34.6 million included in other current assets as of December 31, 2011.

Note 9. Obligations under capital leases

The Group leased drilling equipment and vehicles under agreements with an option to purchase the leased equipment at the end of the lease term. These assets were accounted for as capital leases.

Included in machinery and equipment and vehicles is nil, nil and USD 2.4 million of assets under capital lease as of December 31, 2012, 2011 and 2010, respectively.

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

Note 9. Obligations under capital leases (continued)

Property, plant and equipment includes assets under capital lease as follows:

	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
At cost	-	-	3,761
Less: accumulated depreciation	-	-	(1,349)
Net property, plant and equipment	**-**	**-**	**2,412**

Note 10. Current portion of long-term debt

Current portion of long-term debt includes the following:

	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
Current portion of long-term debt (note 11)	257,860	175,217	117,274
Short-term capital lease obligations	-	-	276
Total current portion of long-term debt	**257,860**	**175,217**	**117,550**

Note 11. Long-term debt

Long-term debt includes the following:

Lender	Final maturity date	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
Debt of the Company				
Loans from stockholders	2014	50,000	50,000	70,000
Debt of the Company's subsidiaries				
Raiffeisenbank	2016	220,000	220,000	-
8.4% Russian ruble bonds, maturing 2018	2018	164,622	155,298	-
Alfa Bank	2013	122,478	231,084	254,291
OOO Rushong-Hua	2015	52,321	-	-
OAO Sberbank of Russia	2014	43,899	62,119	-
OAO Sberbank of Russia	2015	26,339	-	-
OAO Sberbank of Russia	2013	20,214	31,441	50,275
Individual	2012	-	3,392	6,392
ZAO UniCredit Bank	2012	-	-	11,866
Loans from LUKOIL Group companies				
OOO LUKOIL-West Siberia	2011	-	-	7,078
OOO LUKOIL-Perm	2041	-	-	1,000
OAO Tebukneft	2010	-	-	282
OAO Uhtaneft	2015	-	-	78
Total long-term debt		**699,873**	**753,334**	**401,262**
Current portion of long-term debt (Note 10)		(257,860)	(175,217)	(117,274)
Long-term lease obligation		-	-	2,379
Total non-current long-term debt		**442,013**	**578,117**	**286,367**

Note 11. Long-term debt (continued)

Stockholders

Long-term loans from stockholders as of December 31, 2012 represent loans denominated in US dollars which bear interest at 5.8% and mature on or before December 31, 2014.

Debt of the Company's subsidiaries

Raiffeisenbank

Long-term debt with Raiffeisenbank with an outstanding balance of USD 220.0 million as of December 31, 2012 is denominated in USD and bears interest at 5.65% per annum. This debt is secured by the shares of a newly acquired company CSVI (refer to Note 17).

Russian ruble bonds

In June 2011, the Group issued 5 million non-convertible bonds with a face value of 1,000 Russian rubles each. The bonds were placed at face value with a maturity of 2,548 days. The bonds have a 182 days'coupon period and bear interest at 8.4% per annum.

Alfa-Bank

Long-term debt with Alfa-Bank with an outstanding balance of USD 122.5 million as of December 31, 2012 is denominated in Russian rubles and bears interest at 8.4% per annum.

OOO Rushong-Hua

Long-term debt with OOO Rushong-Hua with an outstanding balance of USD 52.3 million as of December 31, 2012 is denominated in Russian rubles at effective interest rate of 6.3% per annum.

OAO Sberbank of Russia

Long-term debt with OAO Sberbank of Russia with an outstanding balance of USD 43.9 million as of December 31, 2012 is denominated in Russian rubles and bears interest at 7.7% per annum.

Long-term debts with OAO Sberbank of Russia with an outstanding balance of USD 20.2 million as of December 31, 2012 are denominated in Russian rubles and bear interest at LIBOR plus 4.1% per annum.

Long-term debt with OAO Sberbank of Russia with an outstanding balance of USD 26.3 million as of December 31, 2012 is denominated in Russian rubles and bears interest at 10.15% per annum.

Individual

Long-term debt from an individual represents a loan denominated in US dollars which bore interest at a stated rate of 0% and matured on May 1, 2012. This relates to the acquisition of the new workover company OOO Meridian (refer to Note 17). This loan was recorded at fair value based on the effective interest rate estimated by the management at the acquisition date, which was 13% per annum.

This debt was secured by the shares of OOO Meridian.

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

Note 11. Long-term debt (continued)

ZAO UniCredit Bank

Long-term debt with ZAO UniCredit Bank was denominated in Russian rubles and bore interest at 8.95% per annum. This debt was repaid during 2011 before its maturity.

LUKOIL Group companies

Long-term debt, denominated in Russian rubles, represented various borrowings from LUKOIL Group Companies. This long-term debt was recorded at fair value based on effective interest rates estimated by management at the acquisition date, which on average was 12.66% per annum. This debt was repaid during 2011 before maturity.

As of December 31, 2012 and 2011 the Group had two unused lines with ZAO UniCredit Bank. The first one is a revolving line of credit denominated in Russian rubles which at the currency exchange rate as of December 31, 2012 equaled to USD 96.1 million. This line of credit is short-term in nature with the duration of 90 days and availability period until November 2014. The second one is a revolving overdraft line denominated in Russian rubles which at the currency exchange rate as of December 31, 2012 equals to USD 17.3 million and is available until September 2015. Both lines are solely intended for issuing or extending unsecured commercial letters of credit for the purpose of acquiring new drilling rigs (used as security for these lines). At year end both lines of credit were undrawn.

As of December 31, 2012, the Group also had a revolving multi-currency overdraft line with OAO Sberbank of Russia denominated in Russian rubles which at the currency exchange rate as of December 31, 2012 equaled to USD 98.8 million and is available until June 2017. It is solely intended for issuing or extending unsecured commercial letters of credit for the purpose of acquiring new drilling rigs. As of December 31, 2012, the line was undrawn.

As of December 31, 2012 the Group had secured a five-year loan facility of USD 227 million with an interest rate of three month LIBOR plus 3.65% per annum arranged by ZAO UniCredit Bank. The grace period for the principal is three years. The term of the facility is through December 27, 2017. The loan agreement also provides an irrevocable renewable bank guarantee of USD 45.4 million.

These unused lines of credit along with debts from *OAO Sberbank of Russia* are secured by property, plant and equipment with a carrying amount of USD 264.9 million as of December 31, 2012 (2011: USD 50.4 million; 2010; USD 53.2 million).

Maturities of long-term debts outstanding at December 31, 2012 are as follows:

2013	2014	2015	2016	2017	2018 and thereafter	Total
257,860	148,615	94,930	33,846	-	164,622	699,873

Note 12. Taxes

Income taxes

The Group is taxable in a number of jurisdictions within and outside of the Russian Federation and, as a result, is subject to a variety of taxes as established under the statutory provisions of each jurisdiction.

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

Note 12. Taxes (continued)

Income taxes (continued)

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

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

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

The majority of the Group's earnings in 2012, 2011and 2010 were taxed in the Russian Federation.

As of December 31, 2012, 2011 and 2010, and during 2012, 2011 and 2010 the Group did not have any unrecognized tax benefits and thus, no interest and penalties related to unrecognized tax benefits were accrued. The Group's policy is to record interest and penalties related to unrecognized tax benefits as components of income tax expense. In addition, the Group does not expect that the amount of unrecognized tax benefits will change significantly within the next twelve months.

The Company and its subsidiaries file standalone income tax returns in each country in which they operate. Income tax returns are open for inspection by the tax authorities in Russia for tax years 2010-2012, in Turkmenistan for 2010-2012, in Kazakhstan for 2009-2012 and Cyprus for 2011-2012.

	Year ended December 31, 2012	Year ended December 31, 2011 (adjusted)	Year ended December 31, 2010 (adjusted)
Current income tax expense	87,533	56,298	63,045
Deferred income tax expense	34,307	27,747	8,635
Total income tax expense	**121,840**	**84,045**	**71,680**

Deferred income taxes are included in the consolidated balance sheets as follows:

	As of December 31, 2012	As of December 31, 2011 (adjusted)	As of December 31,2010 (adjusted)
Deferred income tax assets – current	11,175	3,710	11,472
Deferred income tax assets – non-current	2,156	2,833	1,422
Deferred income tax liabilities - current	(6,499)	(5,340)	(478)
Deferred income tax liabilities – non-current	(92,639)	(49,376)	(24,744)
Net deferred income tax liability	**(85,807)**	**(48,173)**	**(12,328)**

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

Note 12. Taxes (continued)

Income taxes (continued)

The following table sets out the tax effects of each type of temporary differences which give rise to deferred income tax assets and liabilities:

	As of December 31, 2012	As of December 31, 2011 (adjusted)	As of December 31, 2010 (adjusted)
Inventories	15,884	8,720	7,581
Accrued pension liability	3,128	2,236	1,378
Property, plant and equipment	2,156	2,056	1,422
Accounts payable and accrued liabilities	2,064	1,810	5,852
Long-term accounts receivable	97	33	173
Long-term debt	-	-	290
Other current assets	-	203	570
Deferred income tax assets	**23,329**	**15,058**	**17,266**
Property, plant and equipment	(95,865)	(50,995)	(26,450)
Accounts receivable	(9,859)	(7,705)	(2,143)
Investments	(3,412)	(4,325)	-
Inventories	-	(206)	(12)
Long-term debt	-	-	(135)
Other current liabilities	-	-	(854)
Deferred income tax liabilities	**(109,136)**	**(63,231)**	**(29,594)**
Net deferred income tax liabilities	**(85,807)**	**(48,173)**	**(12,328)**

Based upon the level of historical taxable income and expectations for future taxable income over future periods, in which the deferred income tax assets are deductible, management believes it is more likely than not the Group will realize the benefits of these deductible temporary differences as of December 31, 2012, 2011 and 2010.

The Company has not recognized deferred income taxes on USD 1,182 million of undistributed earnings of its Russian subsidiaries, since such earnings are considered to be reinvested indefinitely. If the earnings were distributed in the form of dividends, the Company would be subject to foreign withholding taxes. The amount of unrecognized deferred income tax liability is USD 57 million.

Bases on the Company's intercompany dividend policy the Company recognized deferred income tax on 20% of the undistributed earnings of its Russian subsidiaries from its on-shore segment earned during the reporting period and on 30% of the undistributed earnings of its Russian subsidiaries from its off-shore segment earned during the reporting period. The remaining balances of retained earnings of these companies is considered to be reinvested indefinitely. Management of the Company has the intention and the ability not to distribute these retained earnings.

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

Note 12. Taxes (continued)

Income taxes (continued)

The following table is a reconciliation of the amount of income tax expense that would result from applying the Russian combined statutory income tax rate to income before income taxes to total income taxes:

	Year ended December 31, 2012	Year ended December 31, 2011 (adjusted)	Year ended December 31, 2010 (adjusted)
Income before income tax	503,849	367,416	278,506
Notional income tax at Russian statutory rate 20%	100,770	73,483	55,701
Increase in income tax due to:			
Non-deductible items, net	6,176	8,958	7,461
Regional rate differences	(2,179)	(967)	(1,255)
Withholding tax	4,258	4,325	8,103
Foreign rate differences	12,815	(1,754)	1,670
Total income tax expense	**121,840**	**84,045**	**71,680**

Taxes receivable include the following:

	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
Prepaid income tax	18,274	13,930	14,169
Prepaid value added tax	8,024	13,436	16,096
Value added tax recoverable	707	4,147	3,565
Other taxes	196	1,633	1,130
Total taxes receivable	**27,201**	**33,146**	**34,960**

Taxes payable include the following:

	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
Value added tax	53,112	45,442	33,138
Social taxes and contributions	15,720	5,843	7,859
Personal income tax	10,516	2,844	6,559
Property tax	5,012	6,988	3,139
Income tax payable	1,649	3,181	1,942
Other taxes	4,267	4,732	1,620
Total taxes payable	**90,276**	**69,030**	**54,257**

Note 13. Pension benefits

The Company sponsors a post employment and post retirement benefits program. The primary component of the post employment and post retirement benefits program is a defined benefit pension plan that covers the majority of the Company's employees. This plan is administered by a non-state pension fund, LUKOIL-GARANT, and provides pension benefits. The Company also provides several long-term employee benefits such as death-in-service benefits, lump sum at jubilee ages and lump-sum payments upon retirement of a defined benefit nature.

Jubilee benefits were calculated for the first time as at December 31, 2010 of USD 1.3 million and recognized immediately through earnings 2010.

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

Note 13. Pension benefits (continued)

Additionally the Company provides financial support, of a defined benefit nature, to its old age and disabled pensioners, who did not acquire any pension under the occupational pension program. The liabilities in respect to future pensioners were calculated for the first time as at December 31, 2011 of USD 1.8 million and recognized immediately through earnings 2011. Additionally in 2012 the liabilities in respect to payments in case of death of a pensioner were calculated for the first time as at December 31, 2012 of USD 0.5 million and recognized immediately through earnings 2012.

The Company's pension plan primarily consists of a defined benefit plan enabling employees to contribute a portion of their salary to the plan and at retirement to receive a lump sum amount from the Company equal to all past contributions made by the employee up to 3.5% of their annual salary.

Employees also have the right to receive upon retirement the benefits accumulated under the previous pension plan when OOO Burovaya Kompaniya Eurasia was a subsidiary of the LUKOIL Group. This plan was replaced in December 2003. These benefits have been fixed and included in the benefit obligation as of December 31, 2012, 2011 and 2010. The amount was determined primarily based on a formula including past pensionable service and relative salaries as of December 31, 2003.

Liabilities for former LUKOIL employees in respect of their pensions funded via LUKOIL-GARANT were included in the PBO and in assets as December 31, 2011 in the same amount equal to USD 3.8 million. This amount was excluded from liabilities and assets on January 1, 2011 by applying curtailment on liabilities and divestiture on assets due to the fact that these pension obligations were fully funded.

The Company uses December 31 as the measurement date for its post employment and post retirement benefits program. An independent actuary has assessed the benefit obligations as of December 31, 2012, 2011 and 2010.

LUKOIL-GARANT is a multiemployer pension plan in which OOO Burovaya Kompaniya Eurasia and OOO KRS Eurasia employees participate. The information that follows represents the obligations and assets attributable to OOO Burovaya Kompaniya Eurasia and OOO KRS Eurasia employees participating in this pension plan.

The following table provides information about the benefit obligations and plan assets as of December 31, 2012, 2011 and 2010. The benefit obligations below represent the projected benefit obligation of the pension plan.

	2012	2011	2010
Benefit obligations			
Benefit obligations as of January 1	15,171	14,883	11,558
Plan amendments	1,449	941	1,794
Service cost	1,324	1,107	797
Interest cost	1,277	954	1,037
Effect of exchange rate changes	997	(898)	(134)
Actuarial loss (gain)	969	1,667	(785)
Curtailment		(3,759)	-
Benefits paid	(1,878)	(1,554)	(652)
Benefits in case of death of a pensioner	495	-	-
Financial support to future pensioners	-	1,830	-
Jubilee benefits	-	-	1,268
Benefit obligations as of December 31	**19,804**	**15,171**	**14,883**

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

Note 13. Pension benefits (continued)

	2012	2011	2010
Plan assets			
Fair value of plan assets as of January 1	3,954	7,994	7,770
Employer contributions	1,580	1,290	515
Return on plan assets	312	65	347
Other changes in fair value of individual pension accounts	-	-	(230)
Effect of exchange rate changes	238	(81)	(60)
Divestitures	-	(3,759)	-
Benefits paid	(1,878)	(1,554)	(652)
Interest income on individual pension accounts	-	-	304
Fair value of plan assets as of December 31	**4,206**	**3,955**	**7,994**
Funded status	(15,598)	(11,216)	(6,889)
Amounts recognized in the consolidated balance sheet as of December 31			
Accrued pension liability	(15,598)	(11,216)	(6,889)

Weighted average assumptions used to determine benefit obligations as of December 31, 2012, 2011 and 2010:

	2012	2011	2010
Discount rate	7.10%	7.80%	7.80%
Rate of compensation increase	7.10%	7.30%	7.70%

Weighted average assumptions used to determine net periodic benefit costs for the year ended December 31, 2012, 2011 and 2010:

	2012	2011	2010
Discount rate	7.80%	7.80%	8.70%
Expected return on plan assets	8.63%	8.95%	10.07%
Rate of compensation increase	7.30%	7.70%	8.10%

Included in accumulated other comprehensive loss as of December 31, 2012, 2011 and 2010, are the following pre-tax amounts that have not yet been recognized in net periodic benefit cost:

	2012	2011	2010
Unamortized prior service cost	(1,988)	(777)	(80)
Unrecognized actuarial (loss) gain	(1,366)	(325)	1,622
Total benefit	**(3,354)**	**(1,102)**	**1,542**

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

Note 13. Pension benefits (continued)

Amounts recognized in other comprehensive loss before tax during the years ended December 31, 2012, 2011 and 2010:

	2012	2011	2010
Additional prior service cost from plan amendment	1,483	859	1,788
Re-classified prior service (cost) benefit amortization	(319)	(158)	131
Additional loss (gain) arising during the period	1,058	1,822	(593)
Re-classified gain amortization	-	39	13
Net amount recognized in other comprehensive loss for the period	**2,222**	**2,562**	**1,339**

The real expected rates of return on bonds and equities are based on what is observed in the international markets over extended periods of time. In the calculation of the expected return on assets no use is made of the historical returns LUKOIL-GARANT has achieved.

The plans are funded on a discretionary basis through a solidarity account, which is held in trust with LUKOIL-GARANT. LUKOIL-GARANT does not allocate separately identifiable assets to the Group or its other third party clients. All funds of plan assets and other individual pension accounts are managed as a pool of investments.

The asset allocation of the investment portfolio maintained by LUKOIL-GARANT for the Group and its clients was as follows:

Type of assets	As of December 31, 2012	As of December 31, 2011	As of December 31, 2010
Bank deposits	73%	44%	41%
Shares in investment funds	11%	13%	13%
Eurobonds	8%	4%	0%
Russian corporate bonds	4%	28%	37%
Equity securities of Russian issuers	0%	6%	5%
Shares of OAO LUKOIL	0%	2%	1%
Russian municipal bonds	-	-	2%
Other assets	4%	3%	1%
	100%	100%	100%

The investment strategy employed by LUKOIL-GARANT includes an overall goal to attain a maximum investment return, while guaranteeing the principal amount invested. The strategy is to invest with a medium-term perspective while maintaining a level of liquidity through proper allocation of investment assets. Investment policies include rules and limitations to avoid concentrations of investments.

The investment portfolio is primarily comprised of Level 1 investments: securities with fixed yield. The securities with fixed yield include mainly high yield corporate bonds. Maturities range from one to three years.

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

Note 13. Pension benefits (continued)

Components of net periodic benefit cost were as follows:

	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Service cost	1,324	1,107	797
Interest cost	1,277	954	1,037
Less expected return on plan assets	(335)	(394)	(719)
Amortisation of prior service cost (benefit)	312	173	(132)
Recognised actuarial gain	-	(42)	(13)
Benefits in case of death of a pensioner	495	-	-
Financial support to future pensioners	-	1,830	-
Jubilee benefits	-	-	1,268
Total net periodic benefit cost	**3,073**	**3,628**	**2,238**

Total employer contributions for 2013 are expected to be approximately USD 1.6 million.

Accumulated benefit obligations were USD 15.2 million, USD 12.1 million and USD 12.6 million as of December 31, 2012, 2011 and December 31, 2010, respectively.

The following benefit payments, which reflect expected future services, as appropriate, are expected to be paid:

	2013	2014	2015	2016	2017	5-year period 2013-2017	5-year period 2018-2022
Pension benefits	385	477	613	836	733	3,044	2,781
Lump sum payments upon retirement, death and disability	1,909	1,376	1,623	1,760	1,933	8,601	9,995
Total expected benefits to be paid	**2,294**	**1,853**	**2,236**	**2,596**	**2,666**	**11,645**	**12,776**

Note 14. Fair value of financial instruments

The fair values of cash and cash equivalents, current and long-term accounts receivable and long-term debt (Level 3) are approximately equal to their value as disclosed in the consolidated financial statements. The fair value of long-term receivables and of long-term debt was determined by discounting using estimated market interest rates for similar financing arrangements.

During the years ended December 31, 2012, 2011 and 2010, the Group did not have significant transactions or events that would result in nonfinancial assets and liabilities needing to be measured at fair value on a nonrecurring basis.

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

Note 15. Cost of services, excluding depreciation and taxes

Cost of services, excluding depreciation and taxes, includes the following:

	Year ended December 31, 2012	Year ended December 31, 2011 (adjusted)	Year ended December 31, 2010 (adjusted)
Services of subcontractors	936,797	917,187	492,243
Wages and salaries	488,407	425,210	326,299
Materials	414,288	309,252	221,375
Fuel and energy	152,785	131,776	80,273
Transportation of employees to drilling fields	40,003	30,689	23,364
Leasing and rent	20,781	26,336	10,884
Other	98,275	65,806	49,895
Total cost of services	**2,151,336**	**1,906,256**	**1,204,333**

Note 16. Stockholders' equity

Common and treasury stock

Number of shares	Year ended December 31, 2012	Year ended December 31, 2011	Year ended December 31, 2010
Authorized and issued common stock, par value 0.01 US dollar each	146,865,243	146,865,243	146,865,243
Treasury stock	(77,857)	(105,781)	(455,797)
Issued and outstanding common stock, par value 0.01 US dollar each	**146,787,386**	**146,759,462**	**146,409,446**

During 2010 certain directors of the Group elected to receive GDR's in lieu of cash. 19,854 shares of common stock held as treasury stock were issued to these directors as a compensation fee.

During 2010 the Group awarded 718,868 shares of common stock held as treasury stock to certain top-managers as a part of its incentive plan (refer to Note 22).

On April 15, 2010 the Company completed the placement of the balance of its GDRs repurchased by the Group as part of its buy-back program at a price of USD 19.00 per GDR. One GDR represents one ordinary share.

During 2010 the Group acquired an additional 455,797 shares of common stock for its compensation incentive program.

The movement of treasury stock during 2011 and 2012 was as following:

Number of shares held in treasury as of December 31, 2010	**455,797**
Number of shares purchased	188,200
Exercise of incentive compensation plan	(522,060)
Directors fees	(16,156)
Number of shares held in treasury as of December 31, 2011	**105,781**
Directors fees	(27,924)
Number of shares held in treasury as of December 31, 2012	**77,857**

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

Note 16. Stockholders' equity (continued)

Dividends and dividends limitations

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

Retained earnings of the Company's Russian subsidiaries were RUB 36.4 billion, RUB 25.4 billion and RUB 26.7 billion, respectively as of December 31, 2012, 2011 and 2010, pursuant to the statutory financial statements, which at the US dollar exchange rates as of December 31, 2012, 2011 and 2010 amount to USD 1,199 million, USD 789 million and USD 950 million, respectively.

At the Board of Directors meeting on December 12, 2012, dividends were declared for 2012, in the amount of USD 0.70 per share of common stock. Dividends payable by the Company of USD 103 million were included in "Accounts payable and accrued liabilities" in the consolidated balance sheet as of December 31, 2012.

At the Board of Directors meeting on December 12, 2011, dividends were declared for 2011, in the amount of USD 0.47 per share of common stock. Dividends payable by the Company of USD 69 million were included in "Accounts payable and accrued liabilities" in the consolidated balance sheet as of December 31, 2011. During the reporting period this dividend was fully paid.

At the Board of Directors meeting on December 14, 2010, dividends were declared for 2010, in the amount of USD 0.31 per share of common stock. Dividends payable by the Company of USD 45 million were included in "Accounts payable and accrued liabilities" in the consolidated balance sheet as of December 31, 2010. During the year ended December 31, 2011 this dividend was fully paid.

In April 2010 in connection with the placement of its shares held in treasury, the Company announced a one-time special interim dividend of USD 179 million. During the year ended December 31, 2010 this dividend was fully paid.

Earnings per share

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

	Year ended December 31, 2012	Year ended December 31, 2011 (adjusted)	Year ended December 31, 2010 (adjusted)
Net income available for common stockholders	382,009	283,371	206,826
Weighted average number of outstanding shares	146,782,754	146,768,307	143,270,265
Basic earnings per share of common stock (US dollars)	2.60	1.93	1.44
Contingent shares of stock incentive program (refer to Note 22)	875,260	-	522,060
Weighted average number of outstanding shares, after dilution	147,658,014	146,768,307	143,792,325
Diluted earnings per share of common stock (US dollars)	2.59	1.93	1.44

Note 17. Business combinations

On February 9, 2011 the Group acquired a 100% interest in Caspian Sea Ventures International Limited (CSVI) from Transocean Offshore International Ventures Limited for USD 262.9 million paid in cash. Caspian Sea Ventures Limited is the owner of a jack-up drilling rig operating in the Turkmen waters of the Caspian Sea. The purpose of the acquisition was to increase the Group's share in the Caspian offshore drilling market.

At the date of acquisition the Group allocated USD 62.1 million to goodwill, USD 194.2 million to property, plant and equipment, USD 5.6 million to cash, USD 11.3 million to current assets and USD 10.3 million to current liabilities. The value of property, plant and equipment was determined by an independent appraiser.

The main factors that made up the goodwill recognition are related to synergies the Group is expecting to achieve from combined operations and the profit margins that the acquired business is expected to generate. The goodwill is not considered to be deductible for tax purposes.

Since the date of acquisition the revenue and net income of the acquired company in amounts of USD 38.7 million and USD 30.6 million, respectively, are included in the Group's consolidated statement of income for the year ended December 31, 2011.

The acquired Company did not prepare financial statements in accordance with US GAAP and retrospective application requires assumptions about management's intent in a prior period that cannot be independently substantiated. Therefore, it is impractical to provide pro forma revenue and earnings information.

On April 28, 2011 the Group acquired a 100% interest in OOO Sibirskaya Geophisicheskaya Company (OOO SGC) and 100% in ZAO Samatlorsky KRS (ZAO SKRS) from Schlumberger Limited Group. The aggregate purchase price of the acquired entities was approximately USD 345.5 million, which included USD 242.9 million cash and USD 102.6 million representing the fair value of the Group companies transferred to Schlumberger Limited Group as part of the exchange transaction (effected in cash). The companies transferred were OOO New Technological Service (OOO NTS), OOO Tekhgeoservice (OOO TGS), OOO Megionskoye Tamponazhnoye Upravleniye (OOO MTU). The acquired companies perform drilling and workover services in West Siberia. The purpose of the acquisition was to increase the Group's share in the onshore drilling market and to diversify its client base.

At the date of acquisition the Group allocated USD 48.3 million to goodwill, USD 220.7 million to property, plant and equipment, USD 40.0 million to cash, USD 63.6 million to accounts receivable, USD 38.3 million to inventory, USD 52.7 million to current liabilities and USD 12.7 million to long-term deferred tax liability. The value of property, plant and equipment was determined by an independent appraiser.

The main factors that made up the goodwill recognition are related to synergies the Group is expecting to achieve from combined operations and the profit margins that the acquired business is expected to generate. The goodwill is not considered to be deductible for tax purposes.

The revenue and net income of the acquired companies in amounts of USD 287.0 million and USD 12.9 million, respectively, are included in the Group's consolidated statement of income for the year ended December 31, 2011.

The acquired businesses were reorganized prior to the dates of acquisitions and retrospective application requires assumptions about management's intent in a prior period that cannot be independently substantiated. Therefore, it is impractical to provide pro forma revenue and earnings information.

Note 17. Business combinations (continued)

The disposal of the Group's companies in consideration to this acquisition resulted in a gain in an amount of USD 32.9 million net of income tax.

In June 2010, the Group acquired a 100% interest in OOO Meridian for USD 12.2 million which was paid in three installments ending May 1, 2012. The fair value of the consideration comprised USD 11.0 million as of the date of acquisition, of which USD 6.4 million was paid before December 31, 2011. The remaining amount of USD 3.4 million was recorded as loan to individual (refer to Note 11).

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

The Group allocated USD 9.0 million to goodwill, USD 0.7 million to property, plant and equipment, USD 2.5 million to current assets, and USD 1.2 million to liabilities. The value of property, plant and equipment was determined by an independent appraiser. The main factors that made up the goodwill recognition were related to synergies the Group was expecting to achieve from combined operations. The goodwill is not considered to be deductible for tax purposes.

An impairment loss in amount of USD 7.1 million was recognized at December 31, 2010 due to the revision of future development plans. The amount of the loss was determined based on a present value valuation technique.

On August 9, 2010 the Group acquired a 100% interest in OOO "Megionskoye Tamponazhnoye Upravleniye" (OOO MTU) from OOO "Slavneft-Megionneftegaz" for RUB 275 million (or USD 9.0 million at the US dollar exchange rate as of December 31, 2010) paid in cash.

OOO MTU is a Russian provider of cementing services in West Siberia. The purpose of the acquisition was to broaden the spectrum of well construction services, improve the technical efficiency of the Group and to obtain a new customer in West Siberia.

The Group allocated USD 7.7 million to property, plant and equipment, USD 5.2 million to other assets, USD 3.4 million to liabilities and recognized USD 0.5 million gain on the bargain purchase. The value of property, plant and equipment was determined by an independent appraiser. The transaction resulted in a gain because the acquired entity was generating low profit margins prior to the acquisition and represented non-core assets of OOO "Slavneft-Megionneftegaz".

Note 18. Commitments and contingencies

Commitments

Insurance

The insurance industry in the Russian Federation and certain other areas where the Group has operations is in the course of development. Management believes that the Group has adequate property damage coverage for its main production assets. In respect of third party liability for property and environmental damage arising from accidents on Group property or relating to Group operations, the Group has insurance coverage that is generally higher than insurance limits set by the local legal requirements. Management believes that the Group has adequate insurance coverage of the risks, which could have a material effect on the Group's operations and financial position.

Note 18. Commitments and contingencies (continued)

Litigation

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

Environmental obligations

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

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

Taxation

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

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

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

Note 19. Related party transactions

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

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

Note 19. Related party transactions (continued)

The Company's General Counsel, Douglas Stinemetz, is a partner with The Stinemetz Law Firm. During year ended December 31, 2012, 2011 and 2010 the firm billed the Company for costs and expenses of USD 2.0 million, USD 2.4 million and USD 2.2 million, respectively. Mr. Stinemetz is not otherwise paid for his services as the Company's General Counsel.

Long-term loans from stockholders were USD 50 million as of December 31, 2012 and December 31, 2011 and USD 70 million as of December 31, 2010 (refer to Note 11). Interest expense of USD 2.9 million was recognized and paid on these loans during the years ended December 31, 2012 and 2011 and USD 6 million during the year ended December 31, 2010.

During 2012 the Group decreased its share in OOO Kliver from 51% to 25% but increased its investment in OOO Kliver by USD 5.6 million. During 2012 the Group issued a short-term loans of USD 20.6 million to an associate company OOO Kliver. The loans are denominated in Russian rubles, bear interest at 10% and mature on July 1, 2013. The outstanding balance was USD 3.6 million as of December 31, 2012. Interest income of USD 0.2 million was recognized during 2012.

In October 2010 the Company originated a bank guarantee with a value of USD 5.1 million (refer to Note 8) in favor of a subcontractor in consideration for an option to acquire an interest in an exploration project from a company controlled by related parties. The bank guarantee and the option expired in October 2011 without being exercised and at no cost to the Company.

Note 20. Segment information

Presented below is information about the Group's operating and geographical segments for the periods ended December 31, 2012, 2011 and 2010, in accordance with ASC 280, *"Disclosures about Segments of an Enterprise and Related Information"*.

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

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

The transactions between the segments are immaterial. Segment information is summarized as follows:

For the year ended December 31, 2012

	On-shore drilling services (CIS other than the Caspian Sea)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues	3,071,486	165,847	3,237,333
Net income	323,073	58,936	382,009
Total assets	2,441,391	593,664	3,035,055
Goodwill	47,275	60,723	107,998

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

Note 20. Segment information (continued)

For the year ended December 31, 2011

	On-shore drilling services (CIS)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues (adjusted)	2,581,730	185,019	2,766,749
Net income (adjusted)	233,810	49,561	283,371
Total assets (adjusted)	2,102,159	501,657	2,603,816
Goodwill	43,272	62,127	105,399

For the year ended December 31, 2010

	On-shore drilling services (CIS)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues (adjusted)	1,709,456	112,724	1,822,180
Net income (adjusted)	181,307	25,519	206,826
Total assets (adjusted)	1,801,484	152,323	1,953,807
Goodwill	32,727	-	32,727

Note 21. Concentration of credit risk and sales

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

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

	2012	2011	2010
Revenues for the year ended December 31 (adjusted)	2,054,724	1,692,200	1,280,826
Accounts receivable as of December 31 (adjusted)	260,781	194,005	124,182

Note 22. Incentive Compensation Plan

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

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

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

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

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

Note 22. Incentive Compensation Plan (continued)

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

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

The expected volatility factor was estimated based on the average historical volatility of comparable companies' shares for the previous 5 year period, ranging from 40% to 86%. The average and median of these were 56% and 48%, respectively. A portion of the award vests upon completion of each plan year and no restrictions apply thereafter. Therefore, no post vesting discount has been applied.

The grant date fair value of the plan was estimated at USD 21 million by an independent consulting firm. The Company has accrued the total amount as of December 31, 2012.

The participants may only receive GDRs, each representing one ordinary share of the Company. Therefore, the plan is equity classified. The Group recognized USD 4.2 million of compensation expense during for the year ended December 31, 2012. As of December 31, 2012, USD 21 million was recognized on the Company's balance sheet as an increase in additional paid-in capital.

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

On February 1, 2011 the Company announced that in accordance with its incentive compensation plan participants of the Plan were awarded 522,060 GDRs for their performance in 2010. One GDR represents one ordinary share.

Based on the stock price as of December 31, 2011 no incentive plan award was due for 2011.

In accordance with the Company's incentive compensation plan participants of the Plan were awarded 875,260 GDRs for their performance in 2012. One GDR represents one ordinary share.

Note 23. Subsequent events

The Company has evaluated subsequent events from the balance sheet date through March 29, 2013, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.