



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

The following report represents management's discussion and analysis of EDC's financial condition and results of operations for the six-month period ending June 30, 2013 ("2013 Interim period" or "1H 2013") and is intended to help our shareholders and other users of our financial statements better understand our operations and attendant financial results and current financial condition. This information is provided as a supplement to, and should be read in conjunction with, our reviewed 2013 Interim Consolidated Financial Statements and the accompanying notes, prepared in accordance with US GAAP. This discussion should not be considered all inclusive as it does not necessarily include all changes regarding general economic, political, governmental and environmental events. As used in this report, "Company", "we," "us," "our," and "EDC" means Eurasia Drilling Company Limited and, where the context requires, includes our subsidiaries.

This report contains forward-looking statements that involve known and unknown risks, uncertainties, and other factors which may cause our actual results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements.

### Nature of operations

We are the largest provider of onshore drilling services in Russia, as measured by the number of meters drilled, according to REnergyCo. We also provide offshore drilling services in the Caspian Sea and are the largest provider of such services in the sectors where we operate, based on the number of jack-up drilling rigs, according to Wood Mackenzie. We offer our onshore integrated well construction services and workover services to local and international oil and gas companies primarily in Russia and our offshore drilling services to Russian and international oil and gas companies in the Russian, Kazakh and Turkmen sectors of the Caspian Sea. In addition, we provide onshore drilling services in Iraq. Our total land fleet consists of 676 rigs consists of 257 onshore drilling and sidetracking rigs and 419 workover rigs. Our offshore fleet consists of two jack-up rigs with an additional two under construction.

For the six-month period ended June 30, 2013, we had total revenue of US\$1,695 million, EBITDA of US\$441 million and net income of US\$217 million, compared to total revenue of US\$1,575 million, EBITDA of US\$377 million and net income of US\$189 million for the six-month period ended June 30, 2012.

Our business is currently organized into two main divisions: onshore and offshore drilling services. For the six-month period ended June 30, 2013, we had total revenue of US\$1,614 million from our onshore division and total revenue of US\$81 million from our offshore division.

For the six-month period ended June 30, 2013, we had an estimated market share of approximately 29% of the onshore drilling services market in Russia, as measured by the number of meters drilled, unchanged from the corresponding period of 2012, according to REnergyCo. Our onshore fleet of 253 land drilling and sidetracking rigs is located in all major Russian oil and gas producing regions, including Western Siberia, Volga-Urals, Eastern Siberia and Timan-Pechora. In all these regions we have well-established land support bases. We have expanded our Russian onshore drilling business organically since acquiring substantially all of LUKOIL's onshore drilling assets in 2004. Since our entry into the onshore drilling services, we have transformed the business from an in-house cost center to a major independent oilfield service provider with

sound finances and materially improved operating efficiency. Our onshore drilling services include the construction of production, exploration and appraisal oil and gas and certain other types of wells, including vertical, deviated and horizontal wells, ranging from a depth of approximately 1,200 to more than 6,400 meters. In addition, we provide a wide range of onshore workover and sidetracking services. As of June 30, 2013 our total workover fleet consisted of 419 workover rigs.

In April 2011, we entered into a strategic alliance in Russia and the CIS with Schlumberger, pursuant to which Schlumberger became our preferred supplier for certain drilling services for a five-year period. The transaction also involved an asset swap where we acquired Schlumberger's drilling, sidetracking and workover assets in Russia and sold them certain of our non-core drilling services businesses and assets to our services portfolio. The transaction positively contributed to our operational and financial results.

Our customers include a number of major Russian and international oil and gas companies operating in Russia, such as LUKOIL, Rosneft, Gazprom Neft, TNK-BP, Rusvietpetro, Pechoranefit, Russneft and Tomskneft.

We entered the international drilling market outside the CIS for the first time in the second half of 2012. We acquired three land drilling rigs from an existing drilling contractor and late in 2012 added a fourth rig in Iraq. All four rigs are contracted to international oil and gas companies Afren, Gulf Keystone, HKN and Marathon Oil.

For the six-month period ended June 30, 2013, we were the largest offshore drilling contractor operating in the jack-up market of the Russian, Kazakh and Turkmen sectors of the Caspian Sea. In these sectors there are three jack-up rigs currently operating and we own two of them, the *ASTRA* and *SATURN* jack-up rigs, according to Wood Mackenzie. We entered the offshore drilling business in 2006 by acquiring the *ASTRA* jack-up rig from LUKOIL. Since 2009, we have provided our drilling services on LUKOIL's marine ice-resistant fixed platform LSP-1 on the Yuri Korchagin field in the Russian sector of the Caspian Sea. In 2011, we acquired our second jack-up rig, the *SATURN*, from Transocean. Our offshore drilling services division constructs oil and gas exploration and production wells in waters with depths of up to 107 meters. In addition, we have two new-build jack-up rigs that are in the process of being constructed by Lamprell plc, the *NEPTUNE* and the *MERCURY* rigs, with delivery scheduled for the third quarter of 2013 and the fourth quarter of 2014, respectively.

Our offshore customers in the Caspian Sea have included LUKOIL, Petronas, Dragon Oil, CMOC (a joint venture between Shell, KazMunayTeniz and the Oman Pearls Company Ltd) and the N Operating Company (a joint venture between KazMunayGas, ConocoPhillips and Mubadala).

### General overview

Demand for drilling services depends on a variety of factors, including worldwide demand for oil and gas, the ability of OPEC to set and maintain production levels and pricing, the level of production of non-OPEC countries, and the policies of various governments regarding exploration and development of their oil and gas reserves. Our results of operations depend on the levels of activity in Russia and the countries of the Caspian Sea, and the prices of crude oil and natural gas in Russia. To date most of our drilling activities have been in oil provinces rather than gas provinces. This business mix may slowly change over time if we obtain new clients whose activities are more heavily weighted to drilling natural gas wells.

The oilfield services market in Russia is robust and it is arguably the most stable land market of any size in the world. Onshore drilling activity (as measured by wells or metres drilled) fell in 2009 as compared to 2008 by only around 6%, which was substantially less than the reductions in drilling activity experienced in the world's other large markets. Following the global recession, oil prices stabilised in 2010 and have remained stable at historically high levels in 2011 and 2012, giving oil and gas companies confidence to increase their CAPEX budgets. Russia's oil production and drilling volumes have continued to grow in the first half of 2013;

in 1H 2013 average oil and condensate output grew to 10.4 mln bpd, an increase of approximately 1.3% compared to the first half of 2012, and drilling volumes expanded to a record 10.5 million metres, according to REnergyCO.

Russia's oil production is mostly comprised of output from mature fields, which continues to account for approximately 80% of total oil output in Russia during 1H 2013. Since 2008 the output from these fields has been declining; the overall growth in Russian production was achieved by the contribution from greenfields coming on stream in Eastern Siberia, Timan-Pechora, the Caspian, and Sakhalin.

### Operations review

During 1H 2013 our business continued to benefit from favorable market conditions resulting primarily from fairly stable commodity prices and continued strong demand for our services. Total drilling volumes in Russia increased by 4.3% during the first half of 2013 compared to the corresponding period of 2012. The growth was slightly slower than that in 1H 2012 vs 1H 2011, as the industry is moving towards more complex drilling which is inherently more time consuming. Horizontal drilling in Russia increased by approximately 22% (adjusted) during the first half of 2013 compared to the corresponding period of 2012. The results of our operations reflect this change as we help our customers to achieve their production targets.

### Onshore business

Our first half of 2013 onshore operating results include:

- Drilling output of 3.039 million metres, 5.9% above the output achieved in the corresponding period of 2012 (2.871 million metres);
- Horizontal metres drilled during the first half of 2013 were up significantly by 19.6% compared to the corresponding period of 2012 and amounted to 492,126 metres;
- Exploration drilling volumes increased by 12.8% during the first half of 2013 compared to the corresponding period of 2012;
- Sidetracking activity remained at strong levels with 119 well sidetracks performed during the first half of 2013, 16.7% above the corresponding period of 2012;
- The share of our largest customer, LUKOIL, amounted to 57% of our total metres drilled during 1H 2013, as compared to 56% during the corresponding period of 2012; however, LUKOIL drilling volumes increased by 7.3% for the same period;
- The share of Rosneft, our second largest customer, was 24% (post TNK-BP acquisition) of our total metres drilled during 1H 2013 as compared to 27% during the corresponding period of 2012;
- Our market share was approximately 29% based on metres drilled onshore in Russia during 1H 2013.

Our Russian onshore drilling volumes increased by 5.5% compared to the volumes achieved in 1H 2012. Growth in EDC's metres drilled outpaced the growth of the Russia's total drilling market. Our Western Siberian operations continue to contribute the majority to our drilling volumes, while the fastest growth is attributable to Volga-Urals and Timan-Pechora regions with the 87% and 53% increase in meters drilled period-over-period, respectively.

EDC's horizontal drilling volumes in 1H 2013 increased by 19.6% compared to the corresponding period of 2012, and amounted to 492 thousand metres, which corresponds to 16% of our total metres drilled. In horizontal drilling the component of high value third party services, such as directional drilling and telemetry services, is usually much more significant compared to conventional vertical or deviated well drilling.

Our cooperation with our main customer, LUKOIL, continues to be strong as we operate under long-term Framework Agreements that govern minimum volume commitments and indicative pricing ranges. Our prior Framework Agreement expired at the end of 2012, at which time we concluded a new three-year Framework Agreement through the end of 2015 that includes greater flexibility regarding fleet deployment and contract structures. Pursuant to the new agreement, depending on the complexity of the drilling, our services are provided either on a general contractor "turn-key" basis or on a day rate basis. Completion services which are a part of the well construction service that we provide, pursuant to the new framework agreement, are contracted separately, given the increased complexity of such services. Pursuant to the Agreement we drilled 1.730 million metres for LUKOIL during the first half of 2013, a 7.3% increase over the first half of 2012. Despite a continued increase in LUKOIL's drilling activity, its share in our total drilling volumes increased only by one percentage points compared to 1H 2012. Most of the growth comes from intensified drilling activity in Western Siberia as well as Volga-Urals and Timan-Pechora regions.

It's our strategic priority to diversify our customer base in Russia while building long-term relationships with our clients. Rosneft continues to be our second largest customer, and post-acquisition of TNK-BP, accounts for 24% of our total drilling volumes during the first half of 2013. Overall, Rosneft's drilling volumes in Russia were down by 12% as per CDU TEK, while in EDC's portfolio only by 3.3%. Despite such a temporary decline, we continue to be the largest independent drilling contractor for Rosneft. Management believes that EDC has a strong proven track record with Rosneft and is eager to build cooperation beyond the existing frontiers.

One of the notable events of the first half of 2013 is the increase in the drilling volumes of Gazpromneft in our portfolio by 41% in 1H 2013 vs. 1H 2012. Most of the growth comes from Western Siberia region. In 2012 we were awarded a drilling contract on the Novopostovskoe field in the Yamalo-Nenetsk Region, one of Gazpromneft's greenfield projects, where we continue to drill in 2013. Overall the share of Gazpromneft in our drilling volumes increased to 11% during 1H 2013, compared to 8% in 1H 2012. EDC still provides a sizable 24% of Gazpromneft's total drilling volumes in Russia, according to REnergyCo in 1H 2013, and we are expanding collaboration in geographies of strategic importance to this customer.

Our client portfolio includes the three largest E&P companies in Russia (Rosneft post-acquisition of TNK BP, LUKOIL and Gazpromneft), which, together, accounted for about 60% of the total drilling volumes in Russia in 1H 2013, based on REnergyCo. We also continue to work for smaller oil and gas companies such as Pechoraneft, Samaranafta, Rusvietpetro, Russneft and others.

The availability of rigs is one of the keys to being a successful drilling company. Our rig fleet as of June 30, 2013 totaled 257 onshore drilling and sidetracking rigs, unchanged since December 31, 2012. Our rigs are located in almost all of the major oil and gas provinces of Russia and we continue to invest in modernisation of our rig fleet. Management believes that the effective age of our rig fleet is less than Russia's average of 16 years, as per Douglas Westwood estimates. 34% of our rigs are less than 5 years old and only 33% of our rigs are over 20 years old compared to Russia's average of 59% as per Douglas Westwood. Our rigs are capable of drilling a wide range of oil and gas wells, including vertical, deviated, horizontal, and extended-reach wellbores up to 6,400 metres (21,000 feet) in total length. More than half of our rigs are configured for pad drilling, the method that we believe will dominate future developments.

In Russia, as in the rest of the world, unexploited oil and gas reserves increasingly occur in more challenging environments, both geographically and geologically. The services market in Russia is evolving toward higher technological content and advanced techniques. As technology applications advance, so do the costs of bringing a barrel of hydrocarbons to market. To justify the higher costs, technologies must deliver greater efficiency and production potential to the oil and gas producers. To satisfy this requirement, and to ensure the stability and further growth of oil production in Russia, we forecast an increasing requirement for new modern rigs. We continue to deliver on our five year rig fleet upgrade and modernisation plan, developed in 2010, according to which 11 rigs were contracted in 2012 for 2013/early 2014 delivery. The drilling rigs that

we are ordering are produced by Russian and Chinese manufacturers at prices significantly lower than the peak in 2008, with considerably shorter lead times.

Our onshore workover and sidetracking operations continue to be an important part of our business. Our workover fleet as of June 30, 2013 totaled to 419 workover rigs, unchanged since the end of last year. Growth in our total workover and sidetracking jobs performed in 1H 2013 vs. 1H 2012 has been moderate with a sidetracking and workover jobs count increasing 16.7% and 5%, respectively.

We commenced drilling operations in Iraq in July 2012 by acquiring three land drilling rigs from an existing drilling contractor and added a fourth rig in Iraq later in 2012. We manage our operations through two offices and a rig yard in Iraq. There is also an administrative office located in Houston. We operate four single well drilling rigs capable of drilling wells of up to 5,000 metres in depth. All four rigs are contracted to international oil and gas companies including Afren, Gulf Keystone, HKN and Marathon Oil.

### *Offshore business*

Our first half of 2013 offshore operating results include:

- During the first half of 2013 our *ASTRA* jack-up rig was employed in Russian waters of the Caspian Sea;
- Our *SATURN* jack-up rig continued its operations for PETRONAS Carigali (Turkmenistan) Sdn Bhd (PETRONAS) in Turkmen waters of the Caspian Sea; during 1H 2013 one geological sidetrack was performed;
- We drilled and completed three wells on LUKOIL's Yuri Korchagin field platform in the Caspian Sea including two extended-reach horizontal development wells;
- Fabrication of our third and fourth new-build jack-ups, *NEPTUNE* and *MERCURY*, continued on schedule during the first half of 2013.

Our offshore operations remained strong in 1H 2013. Our crews remained active on LUKOIL's Yuri Korchagin field platform, drilling two challenging extended reach development (ERD) wells. ERD on Yuri Korchagin is expected to continue. To date the longest ERD well drilled by us offshore on this field was 7.4 km.

Our *ASTRA* jack-up after a paid stand-by was deployed in Russian waters of the Caspian Sea drilling for LUKOIL on their Sarmatskoe field. Once it completed operations for LUKOIL, the *ASTRA* moved to Kazakh waters of the Caspian Sea to work for CMOC during 2H 2013.

Our *SATURN* jack-up continues operations for Petronas in Turkmenistan, and in the end of 2012 we signed a multiyear contract extension with Petronas for drilling offshore Turkmenistan in the Caspian Sea. Effective from January 9, 2013, our jack-up drilling rig *SATURN* is contracted for a three-year period. The award marks a continuation of several previous multi-year contracts, as *SATURN* has been contracted to Petronas since 2003, working almost entirely throughout this period in Turkmenistan. In June 2012 the *SATURN* achieved a major milestone of working continuously for five years without a Lost Time Incident (LTI). During the first half 2013 the *SATURN* continued to operate without LTIs.

Fabrication of *NEPTUNE*, our third Caspian jack-up rig, remains on schedule for deployment in the third quarter of 2013, and during 2012 all the rig modules were shipped via the Volga-Don canal system to the shipyard in the Caspian Sea. Early in July 2013 we held a christening ceremony for our first new-build, *NEPTUNE*, in Astrakhan. The LeTourneau designed Super 116E hull and related components are being pre-fabricated by Lamprell in its Sharjah facility, while the remaining component fabrication, final assembly, and commissioning are being performed at a shipyard in the Caspian Sea.

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

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

## Non-US GAAP Measure

### Reconciliation of Net Income to EBITDA

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA), a non-GAAP financial measure, is computed with reference to the Company's net income for the six-month periods ended June 30, 2013 and 2012 as follows (in thousands of US dollars):

	<b>Six-month period ended June 30,</b>	
	<b>2013 (unaudited)</b>	<b>2012 (unaudited)</b>
	<b>(in thousands of US\$)</b>	
<b>Net Income</b>	<b>216,741</b>	<b>189,068</b>
Income tax expense	64,507	59,344
(Gain) Loss on disposal of PP&E	(295)	157
Currency transaction gain	(1,987)	(2,206)
Interest income	(6,206)	(6,543)
Interest expense	31,252	27,403
Depreciation	136,496	109,693
<b>EBITDA</b>	<b>440,508</b>	<b>376,916</b>

Our EBITDA in dollar terms increased by US\$ 64 million during the 2013 Interim Period as compared to the corresponding period of 2012. At the same time the EBITDA margin increased to 26.0% from 23.9% achieved during 1H 2013 due to increase in more complex drilling onshore, sustained and effective cost control efforts by our management among other factors described below in more details.

## Outlook

Global oil prices remained strong during the first half 2013 with Urals blend crude averaging slightly over \$109 per barrel for the first half of 2013, a little under that of \$112 per barrel average in the first half of 2012.

In the Russian market, most commentators forecast the growth in drilling volumes to continue further in 2013 as most E&P companies have continued to expand their capital budgets. Russian crude oil production in 1H 2013 increased by approximately 1.3% compared to 1H 2012 while drilling volumes in Russia increased by approximately 4.3% in 1H 2013 versus the previous year as per REnergyCo.

We continue to see more and more emphasis being placed on strategies to enhance upstream efficiency, including increases in new-well flow rates and improvements in the recovery factor on existing reserves using horizontal drilling techniques. The trend toward greater horizontal drilling and more complex wells that rapidly took off in 2011 continued throughout 2012 and 1H 2013. We expect the shift to more horizontal drilling to re-accelerate through the remainder of 2013.

We continue to make significant capital expenditures for the purpose of taking advantage of the growing demand for drilling services in our market. During 2013 our utilization remains and is expected to remain at

higher levels than in prior years. Pricing for drilling services in 2013 is more favourable than in 2012 as our customers started to observe some tightness in the rig supply, especially in heavier rig classes, which prompted certain clients' interest in establishing multi-year contracts to insure rig availability for their future drilling plans.

For 2013 we expect our onshore drilling volumes to moderately exceed 2012 volumes, however this estimate assumes an increase in horizontal drilling of up to 30% as we continue to see increased demand from our customers for more horizontal drilling and complex drilling in general. Given the strong growth in more complex drilling services, we expect our total revenues and EBITDA margin to continue to increase in 2013 as we continue to improve utilisation, achieve further operating efficiencies and benefit from the strong market environment in the offshore Caspian Sea.

The Company's relationship with its customers continues to be strong. Most of our customers increased their drilling volumes during 2012 compared to the corresponding period of 2011 and we expect this trend to continue into 2013. We expect Rosneft to account for approximately a quarter of our total drilling volumes with the gains coming from both our legacy business and the drilling assets acquired from Schlumberger. The share of our major customer, LUKOIL, is projected to be at the range of 55-57% of total EDC drilling volumes. We expect our drilling volumes with Gazpromneft to be significantly higher than they were in 2012 as we deploy more rigs in Western Siberia.

In 2013 the well intervention market in Russia is projected to expand as high oil prices encourage efforts to prolong and enhance existing well production. Workover and sidetracking drilling activity are expected to be strong contributors to the Company's revenue in 2013. We continue to provide workover services to Rosneft in the Vankor field in East Siberia, which we commenced in the second quarter of 2011. The workover assets acquired from Schlumberger are well utilised and primarily contracted to TNK-BP in their Samotlor field, representing a newer area of activity for EDC.

EDC has established a significant offshore presence, beginning our first platform drilling services contract in 2009 and adding a second jack-up rig (the *SATURN*) to our fleet in early 2011. The *ASTRA* jack-up drilling rig is committed to a full 12 month program in 2013 for drilling in the Russian and Kazakh sectors of the Caspian Sea at attractive day-rates. The *SATURN* jack-up will continue drilling for Petronas under a new 3-year contract effective January 9, 2013 in Turkmen waters of the Caspian Sea. We will continue to provide our services on LUKOIL's Yuri Korchagin field ice-resistant platform throughout the year, drilling complex extended reach wells. Our third jack-up rig, new-build *NEPTUNE*, is currently being assembled in a shipyard in the Caspian Sea, with the rig expected to begin operations in the third quarter of 2013. Construction of our fourth jack-up drilling rig, new-build *MERCURY*, is proceeding as planned with expected completion near the end of 2014. First rig component shipments are expected to start at the end of 2013. We continue to evaluate opportunities for further expansion in this growing market.

Having made an initial foray into the international drilling market with the acquisition of two rigs in Iraq in July 2012, in late 2012 EDC added a third onshore drilling rig and purchased a new fourth rig from an international vendor in Houston. In 2013 we will have four rigs under contract in Iraq working for large independent oil companies. We continue to evaluate opportunities outside Russia and the CIS.

### **Certain Factors Affecting our Results of Operations**

#### ***Macroeconomic Factors Affecting Oil Companies' Capital Expenditure Programs***

Our results of operations are subject to the business cycles of our customers in the oil and gas sector and, more specifically, on their planned capital expenditure programs and their ability to execute them. Oil and gas companies rely on their cash flows from operating activities to finance significant portions of their capital expenditures. Such cash flows depend heavily on the global prices for crude oil and natural gas, which affect

the prices that our customers receive for sales of their products. Accordingly, oil and gas companies' budgets are normally based on assumptions of expected crude oil and natural gas prices for the relevant periods. Lower prices may reduce the amount of oil and gas that our customers can produce economically or reduce the economic viability of projects, both planned and in development. A substantial or extended decline in crude oil and natural gas prices could result in lower capital expenditures by our customers, and, consequently, lead to a reduction in the number of wells they commission to be drilled. Fluctuations in our customers' capital expenditures have caused the results of our drilling operations to vary from year to year.

World prices for crude oil are characterized by significant fluctuations determined by the global balance of supply and demand, expectations regarding future supply and demand, the condition of the world economy and geopolitical events, prices of, demand for and availability of alternative fuels and many other factors beyond our control. Natural gas prices in Russia are regulated by the Russian government. While Russian natural gas prices have increased in recent years, and are expected to continue to rise to a level closer to parity with export netbacks, they are still significantly below world levels.

### *Change in Mix of Services*

Because margins can vary significantly amongst the services we provide, our results of operations are affected by changes in the mix of onshore and offshore drilling and workover services we provide to our customers. The services we provide in our onshore division have expanded from offering primarily conventional production and exploration drilling services in January 2005 to offering a wider range of drilling and workover services, including sidetracking, horizontal, and underbalanced drilling.

For example, in 1H 2013 we drilled 492,126 metres utilizing horizontal drilling techniques, representing 16% of our total drilling volumes, while in 1H 2012 our horizontal drilling operations were 411,519 metres, or about 14% of total drilling volumes. Unexploited oil and gas reserves in Russia increasingly occur in more challenging environments, both geographically and geologically, and drilling is getting increasingly complex. "Easy to access" reservoirs that were intensively developed during past decades are no longer capable of delivering appropriate flow rates using conventional drilling techniques. As existing brownfield resources deplete, particularly in such mature oil production provinces as Western Siberia and Volga Urals, the period of sustainable production growth from conventional oil is ending and oil companies are being pushed to develop less explored regions where the complexity of drilling and, accordingly, its costs, are currently higher. Additionally, Russia's strategic goal to maintain oil production at least at current levels is driving higher drilling volumes and complexity of drilling as oil becomes harder to extract from maturing brownfields. Looking forward we see an increase in horizontal drilling as our customers report higher flow rates from wells drilled horizontally. In many instances vertical wells are not economically feasible due to low flow rates. The horizontal drilling technique is especially beneficial when used to drill reservoirs with a greater horizontal dimension than vertical thickness. Douglas-Westwood estimates that horizontal drilling could improve initial well flow rates by two to seven times in some reservoirs.

Our margins are also affected by the level of pass-through third party services in our expenses and revenue. Under most of our onshore drilling contracts, we act as a general contractor and are contractually responsible for managing all aspects of the drilling process, including certain services we do not perform ourselves. Therefore, historically, some of the revenue has related to pass-through third party services and products sold to our customers with little or no related mark-up (such as, for example, telemetry and technology services for horizontal drilling). The corresponding payments we make to third party service providers are recorded under services of subcontractors. In 2012 and during 1H 2013, we experienced a decrease in pass-through services due to our customer LUKOIL-West Siberia starting to contract for telemetry services directly with the third party provider from May 2012 as well as due to certain other non-recurring factors.



### *Productivity*

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

Our core productivity as measured in metres drilled per crew per day was slightly lower in 1H 2013 than that achieved in 1H 2012 due to a significant increase in horizontal drilling. Over the medium-term to long-term we expect our productivity to continue to improve due to the ongoing implementation and utilization of more advanced drilling technologies and the application of new standards to our drilling operations. Advanced crew training and application of innovative technologies have allowed us to both improve rates of penetration and reduce non-productive time. Examples of technological advancements include wider usage of polycrystalline diamond compact drill bits, introduction of new generation drilling motors, optimization of bottom-hole assembly and mud programs/properties, and real-time drilling navigation. The use of top-drives and four-step drilling mud cleaning systems on our high specification rigs further improved rates of penetration and efficiency in the increasingly challenging wells we are drilling.

During the last several years we have witnessed a number of factors that could moderate the rate of productivity improvement when measured on a per meter basis. All these factors can be broadly described as changing the mix of services that we provide to our customers. Horizontal wells are inherently more time consuming to drill than comparable deviated wells. Another factor that affects our crew productivity is seasonality described in more detail below.

### *Seasonality and Extreme Weather Conditions*

Our results of operations in both our onshore and offshore segments have experienced in the past, and are expected to continue to experience, seasonal fluctuations in revenue and expenses as a result of weather conditions. Our revenue from onshore and offshore drilling services can be negatively affected by particularly severe winter weather in certain regions of Russia that may make oil and gas operations difficult and potentially non-operational during that season. Our revenue from onshore drilling services may also be negatively affected by spring thawing because drilling rigs, equipment, and materials situated in certain regions can only be transported during winter when the ground is sufficiently frozen to create access roads. As a result, a portion of our business activity in the fourth and first quarter of each year is devoted to transportation of drilling rigs, equipment, and materials and we experience a decrease in revenue while continuing to incur costs. If we fail to complete a drilling contract on time or are unable to move our equipment due to adverse weather conditions our ability to commence drilling on a timely basis at another site may be impeded. However, the effect of severe weather conditions on our operations depends on the specific type of service being provided. For instance, our onshore exploration drilling services are most affected by adverse weather conditions, as our drilling rigs, equipment, material and crews that are required for such services are mobilized to remote locations accessible only by winter roads or helicopters. On the other hand, onshore production drilling services tend to be less affected by adverse weather conditions due to the cluster drilling method we utilize, which involves drilling multiple wells from a single drilling pad. However, also when using this drilling method, our operations may be temporarily disrupted by adverse weather conditions such that we are unable to operate our rigs or mobilize required supplies to rig sites. With respect to our offshore division, we are generally unable to perform drilling services in the Russian sector of the Caspian Sea during winter months due to the presence of ice. However, the Yuri Korchagin platform is ice-resistant, which allows us to drill there year-round.

### *Operating Capacity*

Our revenue growth can be negatively affected by the number of drilling rigs and drilling crews available to us. Our ability to increase our onshore business or maintain its current level depends on our ability to

procure a sufficient number of new drilling rigs and modernize our existing ones. Following the stabilization of the global economy, we witnessed the recovery of demand for drilling services in Russia. Importantly, since the wells we drill are getting deeper we anticipate increased demand for heavier rigs. In 2010, we developed a five-year plan for the delivery of new rigs pursuant to which we ordered 11 new drilling rigs in 2012 with the delivery in 2013/2014. These new purchases were either for heavy rigs, i.e., 320 ton hook load, equivalent to 1,500 horsepower or greater, or medium rigs with 250 ton hook load. In the next three years, we expect to purchase up to 32 new onshore rigs as part of our rig fleet upgrade and modernization plan. As of June 30, 2013, approximately 25% of our drilling rigs were in the heavy class.

At the end of 2012 we believed we had sufficient operating capacity with the addition of the new rigs to our drilling fleet and our increased drilling productivity to drill approximately 7.3 million metres on an annual basis.

Additionally, our results of operations can be affected by the amount of capital expenditures we are required to undertake in order to modernize and renovate our drilling rig fleet periodically and to satisfy applicable equipment certification requirements. As of December 31, 2012, approximately 33% of our drilling rigs were more than 20 years old, compared to the Russian average of 59% of rigs that were over 20 years old, according to Douglas Westwood.

#### *Foreign Currency Fluctuations*

Our audited consolidated financial statements are presented in US dollars, which is the Company's presentation currency. The functional currency of most of our operating entities is the Russian ruble as this is the currency of the primary economic environment in which they operate and in which cash is generated and expended. Foreign exchange gains and losses result from converting monetary assets and liabilities denominated in Russian rubles into US dollar amounts at each balance sheet date.

#### **Revenue**

We generate our revenue primarily from the sale of onshore drilling services, as well as from offshore drilling services and certain other services.

The following table sets forth a breakdown of our revenue by type of services provided and as a percentage of total revenue for the period indicated.

	<b>Six-month period ended June 30,</b>			
	<b>2013 (unaudited)</b>		<b>2012 (unaudited)</b>	
	<b>(in thousands of US\$, except percentages)</b>			
Drilling and related services	1,682,545	99.2%	1,569,045	99.6%
Other sales and services	12,918	0.8%	5,535	0.4%
<b>Total Revenue</b>	<b>1,695,463</b>	<b>100%</b>	<b>1,574,580</b>	<b>100%</b>

Our revenue from drilling and related services represented approximately 99.2% and 99.6% of our total revenue the six-month period ended June 30, 2013 and 2012, respectively. Related services include our workover and sidetracking operations.

A significant portion of our revenue from drilling and related services is derived from LUKOIL, which, for the six-month period ended June 30, 2013, accounted for approximately 66.0% of our total revenue. We provide our onshore drilling services to LUKOIL on the basis of long-term three-year onshore drilling services framework agreement (the "Framework Agreement"), under which we are required to provide a guaranteed scope of drilling and well construction services to LUKOIL through the end of 2015. Pursuant to the Framework Agreement, EDC enters into annual contracts with companies in the LUKOIL group which contain

detailed information on the numbers and locations of the wells to be drilled during the relevant year, as well as the basis on which our services are provided. Depending on the complexity of the drilling, our services are provided either on a general contractor "turn-key" basis or on a day rate basis. Completion services which are a part of the well construction service that we provide are contracted separately, given the increased complexity of such services.

In addition, in 2010 we entered into a five-year workover framework agreement with LUKOIL. This workover framework agreement includes a guaranteed volume of workover services to be provided during the five-year term. LUKOIL also represents a significant part of our offshore drilling business, as we have a multi-year agreement for our services on LSP-1 platform on Yury Korchagin field in the Caspian Sea.

With respect to our other customers and the companies of the LUKOIL group with which we enter into contracts outside of the scope of the Framework Agreement, contracts are typically for a period of one year. We generally contract to provide our onshore drilling services on the basis of agreed procedures and prices, as a general contractor and, to a limited extent, on a day rate basis.

Current contracting practices in the Russian drilling market contribute to fluctuations in revenue. We obtain a significant part of our business through open tenders. Most tenders are conducted annually through a process that begins with requests for proposals in September and ends with signed contractual commitments generally between December and March. As a result, a portion of our business activity in the winter months is generally devoted to rig up and rig down operations and transportation of equipment and personnel required for our onshore drilling services.

#### Cost of Services, Excluding Depreciation and Taxes

Our cost of services, excluding depreciation and taxes, comprises seven primary cost categories: services of subcontractors, wages and salaries, materials, fuel and energy, transportation, leasing and rent and other. The table below sets forth the costs associated with each category in dollars and as a percentage of the cost of services, excluding depreciation and taxes, for the periods indicated.

	Six-month period ended June 30,			
	2013 (unaudited)		2012 (unaudited)	
	(in thousands of US\$, except percentages)			
<b>Cost of services, excluding depreciation and taxes,</b>	<b>1,085,640</b>	<b>100%</b>	<b>1,054,942</b>	<b>100%</b>
Services of subcontractors	448,986	41.4%	471,506	44.7%
Wages and salaries	260,818	24.0%	236,997	22.5%
Materials	198,035	18.2%	198,274	18.8%
Fuel and energy	100,224	9.2%	77,913	7.4%
Transportation of employees to drilling fields	23,405	2.2%	20,396	1.9%
Leasing and rent	8,309	0.8%	11,045	1.0%
Other	45,863	4.2%	38,811	3.7%

#### Services of Subcontractors

Under most of our onshore drilling contracts, we act as a general contractor and are contractually responsible for managing all aspects of the drilling process, including certain services we do not perform ourselves. In our onshore division, services contracted from third parties include subcontracting for technological services, transportation services, preparatory services, well facility services, petrophysical services, well services, drilling motor and drilling navigation services, cementing services, and drilling bit

services. Subcontractor services was the largest component of our cost of services, excluding depreciation and taxes, for the six-month period ended June 30, 2013 and 2012. Services of subcontractors include certain reimbursable services the cost of which is passed through to our customers at little or no mark-up. The reimbursements for such services that we receive from our customers are recorded as revenue.

#### *Wages and Salaries*

Employee wages and salaries include costs of our personnel directly engaged in providing onshore and offshore drilling and other services. Employee costs include amounts we pay in support of our private employee insurance and medical funds. Such expenses do not include contributions to pension funds or social taxes.

#### *Materials*

Expenditures for materials have been driven primarily by our customers' particular drilling programs and projects. Materials for our onshore and offshore drilling divisions primarily include spare parts, tubular goods, mud chemicals, cement, and drilling tools.

#### *Fuel and Energy*

Fuel and energy costs consist primarily of oil, lubricants, and electricity.

#### *Transportation of Employees to Drilling Fields*

Costs relating to the transportation of employees to field locations primarily include transportation services related to the mobilization and rotation of rig crews.

#### *Leasing and Rent*

Leasing and rent costs consist primarily of the cost of renting drilling equipment.

#### *Other*

The remaining portion of our cost of services, excluding depreciation and taxes, which we categorize as "other", includes current repair expenses for fixed assets license fees, insurance expenses, safety and environmental expenses, and maintenance expenses.

### **Results of Operations**

The table below sets forth a summary of our operating results in dollars and as a percentage of total revenue for the periods indicated. In absolute terms, all of our 2013 Interim operating results set forth below were affected by the 1.2% depreciation of the Russian ruble against the US dollar during the six-month period ended June 30, 2013 as compared to 1H 2012.

	<b>Six-month period ended June 30,</b>			
	<b>2013 (unaudited)</b>		<b>2012 (unaudited)</b>	
	<b>(in thousands of US\$, except percentages)</b>			
<b>Total revenue</b>	<b>1,695,463</b>	<b>100%</b>	<b>1,574,580</b>	<b>100%</b>
Cost of services, excluding depreciation and taxes	(1,085,640)	(64.0%)	(1,054,942)	(67.0%)
General and administrative	(82,095)	(4.8%)	(70,475)	(4.5%)

expenses, excluding depreciation and taxes				
Taxes other than income taxes	(88,574)	(5.2%)	(70,139)	(4.5%)
Depreciation	(136,496)	(8.1%)	(109,693)	(7.0%)
Gain/(loss) on disposal of property, plant and equipment	295	0.0%	(157)	(0.0%)
<b>Income from operating activities</b>	<b>302,953</b>	<b>17.9%</b>	<b>269,174</b>	<b>17.1%</b>
Interest expense	(31,252)	(1.8%)	(27,403)	(1.7%)
Interest income	6,206	0.4%	6,543	0.4%
Currency transaction gain	1,987	0.1%	2,206	0.1%
Other income/(expenses)	1,354	0.1%	(2,108)	(0.1%)
<b>Income before income taxes</b>	<b>281,248</b>	<b>16.6%</b>	<b>248,412</b>	<b>15.8%</b>
Income tax expense	(64,507)	(3.8%)	(59,344)	(3.8%)
<b>Net income</b>	<b>216,741</b>	<b>12.8%</b>	<b>189,068</b>	<b>12.0%</b>

### Revenue

Revenue increased by US\$120.9 million, or 7.7%, to US\$1,695.5 million for the six-month period ended June 30, 2013 from US\$1,574.6 million in the comparable 2012 period. The increase was primarily due to an increase in services provided to our customers in most of our business lines and commencing operations in Northern Iraq in second half of 2012. Overall, in US dollar terms the revenue increase is in line with the increase in drilling volumes, considering higher levels of horizontal drilling, workover and sidetracking work, even despite the negative impact of a) 1.2% depreciation of the Russian ruble against the US dollar as of 1H 2013 as compared to 1H 2012 and b) decrease in reimbursable pass-through telemetry services (our customer LUKOIL-West Siberia have started to contract for such services directly with the third party provider from May 2012) and materials.

### Cost of Services, Excluding Depreciation and Taxes

Cost of services, excluding depreciation and taxes, increased by US\$30.7 million, or 2.9%, to US\$1,085.6 million for the 2013 Interim Period from US\$1,054.9 million for the comparable 2012 period. Cost of services, excluding depreciation and taxes, as a percentage of total revenue decreased from 67.0% for 1H 2012 to 64.0% for 1H 2013. The decrease as a percentage of total revenue was primarily attributable to efforts by the Company's management to control costs and a decrease in reimbursable pass-through services (such as, for example, telemetry and technology services) as described in more detail above. The increase in absolute terms was primarily due to the overall growth of our operations.

For the six-month period ended June 30, 2013, services of subcontractors were US\$449.0 million, or 41.4% of total cost of services, excluding depreciation and taxes, as compared to US\$471.5 million, or 44.7% of total cost of services, excluding depreciation and taxes, for 1H 2012. The decrease in both absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was primarily due to a decrease in reimbursable services that were largely pass-through, as described above, in the EDC onshore business, which was partially offset by growth in volumes.

Wages and salaries for 1H 2013 were US\$260.8 million, or 24.0% of total cost of services, excluding depreciation and taxes, as compared to US\$237.0 million, or 22.5% of total cost of services, excluding depreciation and taxes, for comparable period in 2012. The increase in absolute terms was primarily driven by the formation of new crews in the light of increased drilling volumes in 1H 2013 over 1H 2012 and significant growth in workover volumes where wages and salaries are a comparatively larger component of cost of services, excluding depreciation and taxes and start of operations in Northern Iraq. The increase in

wages and salaries as a percentage of total cost of services, excluding depreciation and taxes, resulted from a decrease in the share of pass-through services of subcontractors in total cost of services, excluding depreciation and taxes, as described above, causing the relative share of other constituents of our cost of services, excluding depreciation and taxes, to increase.

For 2013 Interim period, cost of materials was US\$198.0 million, or 18.2% of total cost of services, excluding depreciation and taxes, as compared to US\$198.3 million, or 18.8% of total cost of services, excluding depreciation and taxes, for the six-month period ended June 30, 2012. The decrease in a percentage of total cost of services, excluding depreciation and taxes, was primarily caused by decrease in reimbursable pass-through materials in Nefteyugansk due to change in pricing terms with Rosneft for the casing pipe. In absolute terms this decrease in pricing of the pass-through casing pipe is offset by increase in materials due to volume growth in our onshore business.

Fuel and energy costs for the six-month period ended June 30, 2013 were US\$100.2 million, or 9.2% of total cost of services, excluding depreciation and taxes, compared to US\$77.9 million, or 7.4% of total cost of services, excluding depreciation and taxes, for the six-month period ended June 30, 2012. The increase in both absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was primarily driven by growth in volumes of our drilling, workover and sidetracking operations as well as indexation of the fuel and energy.

Expenses relating to the transportation of employees to field locations for 1H 2013 were US\$23.4 million, or 2.2% of total cost of services, excluding depreciation and taxes, compared to US\$20.4 million, or 1.9% of total cost of services, excluding depreciation and taxes, for 1H 2012. The increase both in absolute terms and as a percentage of the total cost of services, excluding depreciation and taxes, was primarily caused by growth in drilling volumes.

Leasing and rent costs for 2013 Interim period were US\$8.3 million, or 0.8% of total cost of services, excluding depreciation and taxes, compared to US\$11.0 million, or 1.0% of total cost of services, excluding depreciation and taxes, for the six-month period ended June 30, 2012. The decrease in both absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was due to the discontinuance of certain leases and rent in respect of drilling equipment.

Other expenses amounted to US\$45.9 million, or 4.2%, of our total cost of services, excluding depreciation and taxes, for 1H 2013, as compared to US\$38.8 million, or 3.7% of our total cost of services, excluding depreciation and taxes, for 1H 2012. The increase both in absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was primarily driven by start of operations in Northern Iraq as well as growth in legacy drilling volumes.

#### *General and Administrative Expenses, Excluding Depreciation and Taxes*

General and administrative expenses, excluding depreciation and taxes, increased by US\$11.6 million, or 16.5%, to US\$82.1 million for the six-month period ended June 30, 2013, as compared to US\$70.5 million for 1H 2012. As a percentage of total revenue, General and administrative expenses, excluding depreciation and taxes, increased to 4.8% for 1H 2013 from 4.5% for 1H 2012. The increase was primarily attributable to a bad debt provision in our Perm operation, indexation and growth in volumes.

#### *Taxes Other Than Income Taxes*

Taxes other than income taxes include various local taxes, such as social, property, road, and other small regional taxes. Taxes other than income taxes increased by US\$18.5 million, or 26.4%, to US\$88.6 million for 2013 Interim period, as compared to US\$70.1 million for 1H 2012. Taxes other than income taxes as a percentage of total revenue increased from 4.5% in 1H 2012 to 5.2% in the comparable period in 2013. The

increase in both absolute terms and as a percentage of revenue was primarily driven by the change in Russian tax law (adjustments in the formula for social contributions raising the salary base for 30% contribution in 2013), formation of new drilling crews and growth in workover volumes where wages and salaries and consequently social taxes are comparatively larger components of cost of services, excluding depreciation and taxes.

#### *Depreciation*

Depreciation increased by US\$26.8 million, or 24.4%, to US\$136.5 million for the six-month period ended June 30, 2013 as compared to US\$109.7 million for 2012 Interim period. As a percentage of total revenue, depreciation increased from 7.0% in 1H 2012 to 8.1% in 1H 2013. The increase was primarily the result of our on-going modernization program with consequent significant capital expenditures in property, plant and equipment for both onshore drilling and workover businesses.

#### *Gain/(Loss) on Disposal of Property, Plant and Equipment*

Gain on the disposal of property, plant and equipment amounted to US\$0.3 million for 2013 Interim period, as compared to a US\$0.2 million loss on the disposal of property, plant and equipment for 1H 2012. This difference was primarily due to the timing of opportunistic sales of unneeded or obsolete equipment.

#### *Income from Operating Activities*

Income from operating activities increased by US\$33.8 million, or 12.6%, to US\$303.0 million for 1H 2013, as compared to US\$269.2 million for 1H 2012. The increase in absolute terms was primarily due to the increase in drilling, sidetracking and workover volumes as well as sustained cost control efforts. As a percentage of total revenue, income from operating activities increased from 17.1% for 1H 2012 to 17.9% in 1H 2013. This was primarily due to the overall positive impact of our cost control efforts.

#### *Interest Expense*

Interest expense increased by US\$3.9 million, or 14.2%, to US\$31.3 million for the six-month period ended June 30, 2013, compared to US\$27.4 million for 2012 Interim period. The increase in interest expense was primarily attributable to the impact of additional borrowings raised during second half of 2012 and first half 2013 to support the growth of both our onshore and offshore businesses including modernization of our drilling fleet. This was partially offset by the scheduled repayment of our other outstanding loans as well as early repayment of our US\$220 million Raiffeisenbank facility. In particular, in 2013 we drew down US\$210.8 million from a dollar-denominated credit facility from UniCredit Bank in the amount of US\$227 million bearing interest at 3 month Libor plus 3.65% per annum and issued eurobonds in the amount of USD\$600 million bearing interest at 4.875% per annum.

#### *Interest Income*

Interest income decreased by US\$0.3 million, or 4.6%, to US\$6.2 million for 1H 2013 from US\$6.5 million in 1H 2012. The decrease was primarily due to lower average cash balances in 2013 Interim period as compared to 2012 Interim period.

#### *Currency Transaction Gain/(Loss)*

Currency transaction gain amounted to US\$2.0 million for the six-month period ended June 30, 2013, as compared to US\$2.2 million in 1H 2012. The difference is considered immaterial.

*Other Income/(Expenses)*

Amounts in this category represent unusual income or expense not resulting from our ordinary course of business activities. In 1H 2013 we recognized income in the amount of US\$1.4 compared to expense of \$US2.1 million during 1H 2012.

*Income Before Income Taxes*

Income before income taxes increased by US\$32.8 million, or 13.2%, to US\$281.2 million for the six-month period ended June 30, 2013, compared to US\$248.4 million for 1H 2012. The increase in income before income taxes was attributable to the factors described in more detail above.

*Income Tax Expense*

Income tax expenses increased by US\$5.2 million, or 8.8%, to US\$64.5 million for 2013 Interim period, compared to US\$59.3 million for 1H 2012. The increase was due primarily to a higher tax base. Our effective tax rate decreased to 22.9% in 1H 2013 from 23.9% in 1H 2012. The decrease in effective tax rate is attributable to fewer non-deductible expenses in 1H 2013 compared to 1H 2012 as well as lower income tax in our offshore operations (in the first six months 2012 *ASTRA* was working in Kazakh waters where income tax rate is significantly higher while in 1H 2013 it was working in Russian waters for LUKOIL).

*Net Income*

As a result of the foregoing factors, net income increased by US\$27.6 million, or 14.6%, to US\$216.7 million for 2013 Interim period, compared to US\$189.1 million for 2012 Interim period.

**Liquidity and Capital Resources**

The Company's primary sources of liquidity are cash generated from operating activities and debt financing. The Company's plan going forward is to finance its capital expenditures, interest payments and dividends primarily out of operating cash flows, as well as to finance a portion of its capital expenditures through existing and prospective credit facilities.

*Cash flows*

The table below shows our net cash flows from operating, investing and financing activities for the six-month periods ended June 30, 2013 and 2012.

	<b>Six-month period ended June 30,</b>	
	<b>2013 (unaudited)</b>	<b>2012 (unaudited)</b>
	<b>(in thousands of US\$)</b>	
Net cash provided by operating activities	215,587	231,703
Net cash used in investing activities	(173,385)	(279,855)
Net cash provided by (used in) financing activities	365,560	(140,139)

*Operating Activities*

Net cash provided by operating activities amounted to US\$215.6 million for the six-month period ended June 30, 2013, as compared to US\$231.7 million for 2012 Interim period. This decrease in cash flows provided by operating activities was caused by US\$95 million bank deposits with original maturity exceeding 3 month



opened during 1H 2013. Otherwise there is a positive impact on cash provided by operating activities due to higher drilling and workover volumes and sustained cost control efforts by our management.

### *Investing Activities*

Net cash used in investing activities amounted to US\$173.4 million for 1H 2013, as compared to US\$279.9 million for 1H 2012. Investing activities during 2013 Interim period are impacted by return of restricted cash in the amount of US\$45.4 million as collateral for issuance of commercial letter of credit to Lamprell was replaced by irrevocable renewable bank guarantee of the same amount from UniCredit Bank. Capital expenditures during the six-month period ended June 30, 2013 amounted to US\$224.5 (including US\$54.2 million offshore capital expenditures out of which US\$8 million is capitalized interest) as compared to US\$281.8 (including US\$46.5 million offshore capital expenditures) in 2012 Interim period. There were no strategic acquisitions in six-month periods ending June 30, 2013 and 2012.

### *Financing Activities*

Net cash provided by financing activities amounted to US\$365.6 million for the six-month period ended June 30, 2013, compared to net cash of US\$140.1 million used by financing activities for 2012 Interim period. During both periods, dividends were paid and certain debt was redeemed in accordance with its terms. During 1H 2013, we raised US\$600 million through Eurobonds offering and US\$210.8 million through a new credit line facility with UniCredit Bank, and made an early repayment of Raiffeisenbank facility in the amount of US\$220 million, while during 1H 2012 there were no new credit facilities nor early repayments.

### *Liquidity*

As of June 30, 2013 we had cash and cash equivalents of US\$692.0 million compared to US\$305.3 million at December 31, 2012.

	<b>At June 30, 2013</b> <b>(unaudited)</b>	<b>At December 31,</b> <b>2012</b>
	<b>(in thousands of US\$)</b>	
Cash held in banks – Russian rubles	285,597	154,992
Short term deposit – US dollars	263,544	2,805
Cash held in banks – mostly US dollars	86,269	19,118
Short term deposit – Russian rubles	56,180	128,295
Other	361	123
<b>Total cash and cash equivalents</b>	<b>691,951</b>	<b>305,333</b>

We also had bank deposits with original maturities that exceeded 3 months in amount of US\$95.0 million and US\$5.3 million included in other current assets as of June 30, 2013 and December 31, 2012, respectively.

Our cash flow in the short term can be negatively affected by the level of expenditures we are required to make in the fourth and first quarters of each year to mobilize our rigs, crews and equipment to drilling sites.

### *Capital Expenditures*

Our business is capital intensive and expenditures are primarily required to (i) purchase new drilling rigs and other equipment and (ii) upgrade and modernize the technical characteristics of our existing drilling rigs and equipment.

For the period ended June 30, 2013 and for the year ended December 31, 2012 advances given for property, plant and equipment amounted to the following:

	<b>At June 30, 2013 (unaudited)</b>	<b>At December 31, 2012</b>
	<b>(in thousands of US\$)</b>	
Advances given for property, plant and equipment	333,978	275,641

The amounts represent cash advances for property, plant and equipment purchased but for which we have not yet taken delivery. The increase in advances given for property, plant, and equipment in the six-month period ended June 30, 2013 was mainly attributable to a US\$45.4 million payment made to Lamprell for the construction of our second new-build jack-up rig, *MERCURY*, with delivery scheduled for late 2014.

The table below presents the amounts invested in construction still in progress for the periods indicate:

	<b>At June 30, 2013 (unaudited)</b>	<b>At December 31, 2012</b>
	<b>(in thousands of US\$)</b>	
Construction in progress	124,596	51,568

The increase in construction in progress in the six-month period ended June 30, 2013 was due to the arrival of new drilling rigs that had not yet been put into service.

Additionally, as of June 30, 2013, the Company had on deposit restricted cash in the amount of US\$4.0 million to collateralize the Company's issuance of guarantee for a customer.

### Capital Resources

For the six-month period ended June 30, 2013 and for the year ended December 31, 2012 our short-term and long-term debt amounted to the following:

	<b>At June 30, 2013 (unaudited)</b>	<b>At December 31, 2012</b>
	<b>(in thousands of US\$)</b>	
Current portion of long-term debt	145,200	257,860
Non-current long-term debt	1,074,032	442,013

As of June 30, 2013 (unaudited), our loans and borrowings were comprised of the following:

<b>Long-term debt</b>	<b>Final maturity date</b>	<b>Currency</b>	<b>Interest Rate</b>	<b>Outstanding debt (in thousands of US\$)</b>	<b>Security</b>
<b>Debt of the Company</b>					
ZAO UniCredit Bank	2017	USD	LIBOR+3.65%	210,800	Property, plant and equipment
Loans from stockholders	2014	USD	5.8%	50,000	None
<b>Debt of our subsidiaries</b>					
<i>Bank loans</i>					
Alfa-Bank	2013	RUB	8.4%	56,865	None
OA O Sberbank of Russia	2014	RUB	7.7%	30,573	None
OA O Sberbank of Russia	2015	RUB	10.15%	24,458	None
OA O Sberbank of Russia	2013	RUB	LIBOR + 4.1%	9,385	Property, plant and equipment
Eurobonds	2020	USD	4.875%	600,000	None
Russian ruble bonds	2018	RUB	8.4%	152,863	None

OOO Rushong-hua	2016	RUB	5%-6.3%	84,288	None
<b>Total long-term debt</b>				<b>1,219,232</b>	
<b>Total non-current long-term debt</b>				<b>1,074,032</b>	

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

The following table summarizes the principal maturities of our long-term debt, including its current portion, as of June 30, 2013 (unaudited). Long-term debt also includes remaining instalment payments for onshore rigs. We expect to meet our debt payment requirements with cash flows from our operations and other financing arrangements.

	Payments due by period						
	Total	July 1, 2013 to June 30, 2014	July 1, 2014 to December 31, 2014	2015	2016	2017	2018 and thereafter
	(in thousands of US\$)						
<b>Contractual Obligations</b>							
Long-term debt	1,219,232	145,200	63,102	41,164	6,102	210,800	752,864

Our long-term debt and overdraft lines are secured by certain property, plant and equipment with a carrying amount of US\$249.4 million as of June 30, 2013. At the same time, our secured debt represented approximately 18% of our total long and short-term debt.

As of June 30, 2013, our short-term and long-term capital lease obligations were nil.

### Off-Balance Sheet Arrangements

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

### Overview of Other Matters

#### *Dividend Policy and Year-End 2012 Dividend Declaration*

Our ability to pay dividends depends primarily on the amount of cash we have on-hand and on the receipt of dividends and distributions from our subsidiaries. The payment of dividends by our subsidiaries is contingent upon the sufficiency of their earnings, cash flows, and distributable reserves and the ability of our subsidiaries to make, in accordance with relevant legislation, Company law, exchange controls and contractual restrictions, dividend payments and other types of distributions to us.

In August 2007, we adopted a dividend policy according to which we expect to declare and pay dividends each year based on the Company's earnings and the cash needs of the business.

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

For the year ended December 31, 2012 a dividend was declared by the Board of Directors on December 12, 2012 in the amount of 70 cents per share, or US\$103 million, which was included in “Accounts payable and accrued liabilities” and paid on January 17, 2013. For 2011 a dividend of 47 cents per share, or US\$69 million, was declared in December 2011 and paid early in 2012.

### *Treasury Shares*

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

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

In August 2011, we announced that we may buy back up to US\$60 million of our Global Depositary Receipts due to exogenous market conditions. The repurchase programme lasted for 180 days and expired on February 26, 2012. During the time of the share buy-back programme 105,781 GDRs were purchased. In 2012 27,924 shares were transferred to Directors in lieu of cash for their service in 2011. As of December 31, 2012 there were 77,857 shares in treasury.

In accordance with the Company’s Incentive Compensation Plan our officers were awarded 875,260 GDRs for their performance in 2012. During the reporting period 876,370 GDRs were purchased and 875,260 shares were distributed to participants in the Plan. As of June 30, 2013 there were 78,967 shares held in treasury.

### *Earnings per Share*

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

The calculation of earnings per share for the first six months of 2013 and 2012 was as follows:

	<b>Six-month period ended June 30,</b>	
	<b>2013 (unaudited)</b>	<b>2012 (unaudited)</b>
Net income available for common stockholders	216,741	189,068
Weighted average number of outstanding shares	146,792,115	146,778,071
Basic earnings per share of common stock (US dollars)	1.48	1.29

Basic earnings per share were US\$1.48 in the first six months of 2013, compared to US\$1.29 in 1H 2012. The improvement in earnings per share was attributable to the increase in net income by 14.7% in 1H 2013 compared to 1H 2012. For the above mentioned periods, earnings per share calculated on a fully diluted basis are equal to basic earnings per share.

## ***Related Party Transactions***

### ***Shareholder Loans***

In the period from November 2006 through March 2007 the Company entered into loan agreements with its shareholders to partially fund the investment programme of our onshore drilling services division and the purchase of our offshore drilling services business. The aggregate principal amount of such loans was US\$50 million as of June 30, 2013 and December 31, 2012. These loans are denominated in US dollars and bear interest at 5.8% per annum with the maturity date on or before December 31, 2014.

US\$1.4 million interest was recognised on these loans during the six-month period ended on June 30, 2013 and 2012. Interest payable to stockholders was US\$1.5 million and nil as June 30, 2013 and December 31, 2012, respectively. Management believes the terms of these loans are no more onerous than those that would have been negotiated in an arms-length negotiation.

### ***Legal Services***

The Company's General Counsel, Douglas Stinemetz, is a partner with The Stinemetz Law Firm (the Firm). During the six-month period ended June 30, 2013 and 2012 the Firm billed EDC for costs and expenses of US\$1.9 million and US\$0.8 million, respectively. All services were billed at a discount to the Firm's normal billing rates, while expenses were billed at their actual cost. In addition the amounts paid to The Stinemetz Law Firm include considerable third party expenses and charges for the services of other lawyers. Mr. Stinemetz is not otherwise paid for his services as the Company's General Counsel. Management believes the amounts paid for these legal services are no more onerous than those that would have been negotiated in an arms-length negotiation for a similar level of service and expertise.

### ***Transactions with the Associate Company***

During 2012 the Company 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 Company issued short-term loans of USD 20.6 million to OOO Kliver, the associate company. The loans were denominated in Russian rubles, bore interest at 10% and matured on July 1, 2013. As of December 31, 2012, the outstanding balance was US \$3.6 million which was collected during the reporting period. Additionally during the six-month period ended June 30, 2013 the Company acquired services and equipment from OOO Kliver and in relation to these services recognized expenses in amount of US\$2.6 million.

## **Quantitative and Qualitative Disclosures about Market Risk**

We are exposed to market risk from adverse movements in foreign currency exchange rates and changes in interest rates on our obligations. Our overall risk management objective is to reduce the potential adverse effects of these risks on our financial performance; however, we do not maintain any formal hedging programs beyond management of credit risk.

### ***Credit Risks***

Financial assets which potentially subject our entities to credit risk consist principally of trade receivables. We have policies in place to ensure that sales of products and services are made to customers with an appropriate credit history. Credit risks related to accounts receivable are systematically monitored and are considered when impairment provisions are created. The carrying amount of accounts receivable, net of provision for impairment of receivables, represents the maximum amount exposed to credit risk.

A significant proportion of our operations are with LUKOIL Group companies and Rosneft Group companies and as such the Company has significant concentrations of credit risk with these clients.

Included in our sales and accounts receivables are the following transactions and balances with these major customers:

	<b>2013</b>	<b>2012</b>
	<b>(unaudited)</b>	
	<b>(in thousands of US\$)</b>	
LUKOIL revenue for the six-month period ended June 30	1,118,943	967,650
LUKOIL accounts receivable as of June 30, 2013 and December 31, 2012	291,379	260,781
Rosneft revenue for the six-month period ended June 30	295,973	378,316
Rosneft accounts receivable as of June 30, 2013 and December 31, 2012	71,710	84,813

The LUKOIL Group made up approximately 66.0% and 61.5% of our sales for the periods ended June 30, 2013 and 2012, respectively. The Rosneft Group made up approximately 17.5% and 24.0% of our sales for the periods ended June 30, 2013 and 2012, respectively. In order to reduce exposure to this credit risk we have been increasing our business with other, unrelated, customers and continue to monitor our account receivable balances closely. We perform periodic credit checks on our customers and, as a result, did not have any material bad debt expense from our operations during the six-month periods ended June 30, 2013 and 2012. Our allowance for doubtful accounts stood at US\$13.0 million at June 30, 2013, which amount was considered adequate. Our cash and cash equivalents are placed with major banks of Russia, Switzerland, Austria and the United Kingdom.

### *Interest Rate Risk*

Our exposure to market risk for changes in interest rates relates primarily to our long-term and short-term debt. The table below presents scheduled long-term debt maturities in US dollars and related weighted-average interest rates for each of the 12-month periods ending June 30 relating to debt obligations as of June 30, 2013:

	<b>Scheduled Maturity (in millions of US\$, except percentages)</b>						<b>Fair Value</b>	
	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019 and Thereafter</b>	<b>Total</b>	<b>June 30, 2013</b>
<b>Total long term debt</b>	145.2	81.1	29.3	105.4	258.3	600.0	1,219.2	1,183.2
Fixed rate	135.8	81.1	29.3		152.9	600.0	999.0	963.0
Average interest rate	5.9%	5.7%	5.7%	5.6%	5.6%	4.9%		
Variable rate*	9.4			105.4	105.4		220.2	220.2
Average interest rate	4.0%	4.0%	4.0%	4.0%	4.0%			

\* Based on the LIBOR rate at the end of 2013 Interim Period, which rate may fluctuate in later periods.

### *Currency Risk*

We are exposed to foreign currency exchange rate risks. The currency giving rise to these risks is primarily the Russian ruble. We use the Russian ruble for the majority of our operations, while the US dollar is our reporting currency. Foreign exchange gains and losses result from converting monetary and certain non-monetary assets and liabilities denominated in the Russian ruble into US dollar amounts at each balance sheet date. This includes any borrowings in a foreign currency. As of June 30, 2013 we had US\$358.4 million of a total of US\$1,219.2 million of our long and short-term debt denominated in the Russian ruble. As of December 31, 2012 we had US\$429.9 million of a total of US\$699.9 million of our long and short-term debt denominated in the Russian ruble. In addition, the results of our operations are impacted by transactions entered into in currencies other than the Russian ruble, and a fluctuation in the Russian ruble versus US

dollar exchange rates will result in a change in the recognized revenue and expenses associated with such transactions. Furthermore, while the majority of our revenue are denominated in the Russian ruble, some of our costs, including some of those associated with purchases of foreign manufactured land and offshore drilling rigs, are denominated in the US dollar and other currencies. Any significant foreign currency exchange rate fluctuations (both short- and long-term) could have a material adverse effect on our business, financial condition and results of operations.