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 twelve month period ending December 31, 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 audited 2013 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 metres 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 682 rigs consisting of 255 onshore drilling and sidetracking rigs and 427 workover rigs. Our offshore fleet consists of three jack-up rigs with an additional one under construction.

For the year ended December 31, 2013, we had total revenue of US$3,488 million, Adjusted EBITDA of US$940 million and net income of US$432 million, compared to total revenue of US$3,237 million, EBITDA of US$790 million and net income of US$382 million for the year ended December 31, 2012.

Our business is currently organized into two main divisions: onshore and offshore drilling services. For the year ended December 31, 2013, we had total revenue of US$3,300 million from our onshore division and total revenue of US$188 million from our offshore division.

For the year ended December 31, 2013, we had an estimated market share of approximately 29% of the onshore drilling services market in Russia, as measured by the number of metres drilled, unchanged from the year ended December 31, 2012, according to REnergyCo. Our onshore fleet of 251 land drilling and sidetracking rigs is located in all major Russian oil and gas producing regions, including Western Siberia, Volga-Urals 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 metres. In addition, we provide a wide range of onshore workover and sidetracking services. As of December 31, 2013 our total workover fleet consisted of 427 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 as of December 31, 2013 include a number of major Russian and international oil and gas companies operating in Russia, such as LUKOIL, ROSNEFT, GAZPROMNEFT, REPSOL, RUSVIETPETRO, TOMSKNEFT and others.

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 were contracted to international oil and gas companies Afren, Gulf Keystone, HKN and Marathon Oil during 2013.

For the year ended December 31, 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 four jack-up rigs currently operating and we own three of them, the *ASTRA, SATURN* and *NEPTUNE* 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 metres. Our third jack-up rig, new-build *NEPTUNE* was commissioned in November 2013 and was mobilized for drilling. In addition, we have one new-build jack-up rig that is in the process of being constructed by Lamprell plc, the *MERCURY* rig, with delivery scheduled for the fourth quarter of 2014.

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 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 continued to grow in 2013; in 2013 average oil and condensate output grew to 10.5 mln bpd, an increase of approximately 1.3%, and drilling volumes expanded to 21.7 million metres, an increase of 5.4% as compared to the full year 2012, according to CDU TEK.

Russia's oil production is mostly comprised of output from mature fields, which in 2013 produced approximately 80% of total oil output in Russia. Since 2008 the output from these fields has been slowly 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 2013 our business continued to benefit from favorable market conditions resulting primarily from fairly stable commodity prices and a resulting increase in demand for our services.

Onshore business

Our 2013 onshore operating results include:

- Drilling output of 6.264 million metres, 3.5% above the output achieved in the corresponding period of 2012 (6.051 million metres);
- Horizontal metres drilled during 2013 were up 50.3% compared to the corresponding period of 2012 and amounted to 1.296 million metres;
- Exploration drilling volumes decreased by 10.2% during 2013 compared to the corresponding period of 2012;
- Sidetracking activity remained at strong levels with 255 well sidetracks performed during 2013, 13.3% above the corresponding period of 2012;
- The shares of total drilling volumes of our customers, LUKOIL and ROSNEFT, remained flat at 57% and 24%, respectively, during 2013, while share of GAZPROMNEFT increased to 12% in 2013 from 10% in 2012;
- Our market share remained at the level of approximately 29% based on metres drilled onshore in Russia during 2013.

Total drilling volumes in Russia increased by 5.4% or 1.1 million metres in 2013 compared to 2012 and amounted to 21.6 million metres. The growth was slower than that in 2012 vs 2011, as the industry is moving towards more complex and horizontal drilling which is inherently more time consuming. The results of our operations reflect this change as we help our customers to achieve their production targets. Among E&P companies, GAZPROMNEFT (+19%), SLAVNEFT (+50%) and SURGUTNEFTEGAS (+5%) accounted for a major increases in total metres drilled in 2013 vs 2012 based on CDU TEK data. Horizontal drilling in Russia increased by approximately 46% (normalized, CDU TEK) 2013 vs 2012 with ROSNEFT, SLAVNEFT, LUKOIL and SURGUTNEFTEGAZ being major contributors to this growth.

Our Russian onshore drilling volumes increased by 3.5% compared to the volumes achieved in 2012 mitigated by 50.3% increase in horizontal drilling. Growth in metres drilled in our operations was slightly lower than the overall Russian market growth as it was driven to a larger extent by our non-customers (SLAVNEFT and SURGUTNEFTEGAS). The share of horizontal drilling volumes in our portfolio increased significantly to 21% in 2013 from 14% in 2012. Growth in horizontal metres drilled was significant and among our largest customers universe (LUKOIL, ROSNEFT, GAZPROMNEFT) we accounted for approximately 48% of their horizontal metres drilled estimated on the basis of CDU TEK data. In the total Russian drilling market we were able to maintain our market share at approximately 29% during 2013.

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. The most recent Framework Agreement expired at the end of 2012 and we have concluded a new Framework Agreement for the three years to 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 3.539 million metres for LUKOIL during 2013, a 2.4% increase over the corresponding period of 2012. While the majority of our drilling activity, approximately 81% of total metres drilled, is done in Western Siberia for LUKOIL, the growth in 2013 was driven by higher activity in Timan-Pechora. The moderate increase in total drilling volumes with LUKOIL was mitigated by 21.9% increase in horizontal drilling year-over-year. LUKOIL's share in total metres drilled remained flat year-over-year and amounted to 57%.

It's our strategic priority to diversify our customer base in Russia while building long-term relationships with our clients. ROSNEFT in 2013 continued to be our second largest customer, and post-acquisition of TNK-BP, accounts for 24% of our total drilling volumes during 2013. In EDC's portfolio ROSNEFT's drilling volumes went up by approximately 7% caused mostly by consolidation of TNK-BP late March 2013, while ROSNEFT's legacy volumes with EDC increased only by 0.5% year-over-year. Despite such a moderate increase in ROSNEFT's legacy volumes, during 2013 we drilled 170% more horizontal metres in 2013 for this customer. Most of these volumes were drilled in Western Siberia, which accounts for bulk of ROSNEFT's total oil production. Such a significant increase in horizontals, was made possible by our ability to provide capable crews and rigs. In 2013, based on REnergy estimates, we were the largest independent drilling contractor for ROSNEFT.

One of the notable events of 2013 is the increase in the drilling volumes of GAZPROMNEFT in our portfolio by 28% in 2013 vs. 2012. In addition, there was an increase in drilling activity of 180% year-over-year in horizontal drilling. Most of the growth comes from intensified drilling activity in Western Siberia region. In 2012 we were awarded a drilling contract on the Novoportovskoe field in the Yamalo-Nenetsk Region, one of GAZPROMNEFT's greenfield projects, where we continued to drill in 2013. Overall the share of GAZPROMNEFT in our drilling volumes increased to 12% during 2013, compared to 10% in 2012. EDC provided a sizable 26% of GAZPROMNEFT's total drilling volumes in Russia, according to REnergyCo in 2013. We are expanding collaboration in geographies of strategic importance to this customer.

In 2013 our largest customers (LUKOIL, ROSNEFT and GAZPROMNEFT) accounted for approximately 58% of Russia's total drilling volumes, 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 December 31, 2013 totaled 255 onshore drilling and sidetracking rigs. The rig count was slightly less than that as of December 31, 2012 in the amount of 257 rigs as we retired more rigs than we put into operation. During 2013 we put into operation 4 onshore drilling rigs and retired 6 stationary drilling rigs aged 22-24 years. The rig additions during 2013 were slightly less than we initially expected as we altered the rig specifications which extended the delivery times of 14 rigs forward to 2014. While the prepayments for these rigs were made in the 2013 capital expenditures programme, we expect the delivery of these 14 new drilling rigs to occur in 2014. In addition, as we continue to deliver on our rig modernization plan, during 2014 we expect to order a further 14 new drilling rigs with delivery times in 2014/2016.

Our rigs are located in most 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. As per management estimations, the average age of our rig fleet as of December 31, 2013 was 13 years old with 50% of our rigs being less than 10 years old compared to 48% as of the end of 2012. Besides new rig additions, our rig modernization program involves upgrade of the existing rigs that improves the average age of our fleet. In 2013 we performed four rig upgrades and started another eight. In 2014 we are planning to upgrade 6 existing rigs in total.

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 continue to 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 28 new rigs are expected for 2014/2016 delivery. The drilling rigs that we are ordering are produced by Russian and Chinese manufacturers at prices significantly lower than the peak prices suffered 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 December 31, 2013 totaled to 427 workover rigs, as compared to 413 rigs the previous year. The increase is due to the purchase of new workover rigs which are intended to replace older workover rigs due for retirement later this year. Growth in our total workover and sidetracking jobs performed in 2013 has been quite steady with sidetracking and workover jobs count increasing 13.3% and 2.3%, respectively.

We commenced drilling operations in Iraq in June 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. 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 2013 offshore operating results include:

- During 2013 our *ASTRA* jack-up rig was employed in Russian and Kazakh waters of the Caspian Sea drilling for LUKOIL and CMOC, three wells were drilled during the period;
- Our *SATURN* jack-up rig continued its operations for PETRONAS Carigali (Turkmenistan) Sdn Bhd (Petronas) in Turkmen waters of the Caspian Sea; during 2013 two wells with two geological sidetracks in each were completed and commenced drilling of a third well;
- We drilled and completed five wells on LUKOIL's Yuri Korchagin field platform in the Caspian Sea including three extended-reach horizontal development wells;
- Our *NEPTUNE* jack-up underwent final commissioning during the 3Q 2013, moved to the drilling site in the Cheleken Contract Area, Turkmenistan in the Caspian Sea and in 4Q 2013 mobilized for drilling for Dragon Oil plc;
- Fabrication of our fourth new-build jack-up, *MERCURY*, continued on schedule during 2013. The assembly of its first blocks commenced in a shipyard in the Caspian Sea.

Our offshore operations remained strong in 2013. Our crews remained active on LUKOIL's Yuri Korchagin field platform, drilling five wells including three 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 8.3 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 the second half of 2013. In November 2013, the rig moved to the Russian waters of the Caspian Sea to work for Lukoil during 2014.

Our *SATURN* jack-up continues operations for Petronas in Turkmenistan, and at the end of 2012 we signed a multiyear contract extension with Petronas for drilling offshore Turkmenistan. 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 2013 the *SATURN* continued to operate without any LTIs.

Our *NEPTUNE* jack-up underwent final commissioning during the 3Q 2013 and in 4Q 2013 moved to the drilling site in the Cheleken Contract Area, Turkmenistan in the Caspian Sea and began mobilization for drilling. The LeTourneau designed Super 116E hull and related components were pre-fabricated by Lamprell in its Sharjah facility, while the remaining component fabrication, final assembly, and commissioning were performed at a shipyard in the Caspian Sea. The new build jack-up is designed to operate in water depths of up to 350 feet, and has a rated drilling depth of 30,000 feet. *NEPTUNE* will provide well drilling services for nine months to Dragon Oil plc within the framework of the three year contract awarded at the end of 2013 for the provision and management of new-build jack-up rigs *NEPTUNE* and *MERCURY*. *NEPTUNE* is contracted for a five-year period by LUKOIL-led consortium for drilling in Russian waters of the Caspian Sea once the contract with Dragon Oil plc is complete.

In April 2012 we ordered a 4th jack-up rig *MERCURY* for our Caspian Sea operations from Lamprell; this rig will be another LeTourneau Super 116E like *NEPTUNE*, which we believe is the most versatile and efficient design in its class. The rig is designed to operate in water depths of up to 350 feet, and will have a rated drilling depth of 30,000 feet. Assembly of *MERCURY's* new-build jack-up first blocks commenced in a shipyard in the Caspian Sea during 2013. Assembly of auxiliary equipment and residential quarters and welding of spud cans are being performed. This rig is planned for late 2014 delivery. *MERCURY* will provide well drilling services to Dragon Oil plc in the Cheleken Contract Area, Turkmenistan in the Caspian Sea according to the three year contract after *NEPTUNE* for the remainder of the term.

Non-US GAAP Measure

Reconciliation of Net Income to Adjusted EBITDA

Adjusted Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), a non-GAAP financial measure, is computed with reference to the Company's net income for year ending December 31, 2013 and the year ending December 31, 2012 as follows (in thousands of US dollars, unaudited):

	2013*	**2012**
Net Income	**432,082**	**382,009**
Income tax expense	150,381	121,840
Gain on disposal of PP&E	(1,608)	(4,786)
Currency transaction loss (gain)	705	(631)
Litigation settlement	50,996	-
Interest income	(17,189)	(12,094)
Interest expense	58,254	53,661
Depreciation	265,929	249,987
EBITDA	**939,550**	**789,986**

**- 2013 EBITDA is adjusted for litigation settlement in the amount of US$51.0 million*

Our Adjusted EBITDA in dollar terms increased by US$ 150 million during 2013 as compared to 2012. At the same time the Adjusted EBITDA margin increased to 26.9% from 24.4% achieved during 2012 due to an increase in high-value complex drilling supported by an increased in core drilling efficiency as well as sustained and effective cost control efforts by our management among other factors. Results of offshore business also positively contributed to the adjusted EBITDA margin for 2013.

Outlook

The fundamentals of the Russian OFS markets remain strong as most E&P companies have continued to deliver on their capital expenditures budgets. Demand is growing for more complex drilling solutions with new technology and heavy rigs and we expect the share of horizontal drilling in our portfolio to grow by 15% in 2014. We continue to invest in our rig fleet and replace our rigs over 20 years in age and to take advantage of the growing demand for heavier rigs and complex drilling services. During 2014-2016 we are expecting to add 28 new drilling rigs.

Our customer mix onshore will continue to evolve, and we expect to increase significantly our activity with LUKOIL and GAZPROMNEFT, while activity with ROSNEFT is expected to decline. During 2014 we expect 80% of the onshore drilling rigs deployed by ROSNEFT to be reallocated to other customers at what should be satisfactory terms, while remaining 20% will continue to work for ROSNEFT for the full year. Such a change in customer mix involves a significant increase in rig moves with up to 16% over long-distances which in turn affect our ability to maintain the growth in total metres drilled for the year, mitigated by continued increase in horizontal drilling.

Our offshore business continues to perform well as we operate on a basis of multi-year contracts. All of our jack-up rigs, *ASTRA*, *SATURN* and new-build *NEPTUNE*, are fully booked in 2014 at attractive day rate. The construction on our second new-build jack-up *MERCURY* is on schedule and once completed the jack-up will be employed by Dragon Oil in Turkmen Sector of the Caspian Sea. Our offshore backlog stands at US$ 1.2 billion.

Starting early in the year we saw a significant devaluation of Russian ruble, which if continues, will have a negative impact on our 2014 results. The impact from devaluation is mostly limited to translation effects as opposed to contraction in operational activity.

For the full year 2014, because of the issues discussed above, we expect a decrease in our revenues compared to 2013 and flat EBITDA margin in 2014 with growth returning in 2015 and beyond.

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 2013 we drilled 1,296,143 metres utilizing horizontal drilling techniques, representing 21% of our total drilling volumes, while in 2012 our horizontal drilling operations were 862,309 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 usually 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 2013, we experienced a decrease in pass-through services with our largest customer, LUKOIL-West Siberia, as they began to contract for telemetry services directly with third party providers starting in 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.

Over the medium-term to long-term we expect our productivity 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 improves penetration rates 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. Our productivity as measured in metres drilled per crew per day decreased by 6% during 2013 as compared to 2012 on the back of a 50.3% increase in horizontal drilling. 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 quarters 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 22 new drilling rigs in 2012 and 2013 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 28 new onshore rigs as part of our rig fleet upgrade and modernization plan. As of December 31, 2013, approximately 24% of our drilling rigs were in the heavy class.

At the end of 2013 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, 2013, approximately 37% 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 (as of December 31, 2012).

Foreign Currency Fluctuations

Our audited consolidated financial statements are presented in US dollars, which is the Group's reporting 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 occurs at each balance sheet date.

The Group has currency exposure on the carrying amount of the rig fleet, which is reflected as a Russian ruble asset in the accounting records of the Group's Russian subsidiaries and then translated into US dollars in the Group's audited consolidated financial statements. A strengthening of the Russian ruble against the US dollar means a higher US dollar carrying amount of the Group's rig fleet and vice versa. At the same time, as of December 31, 2013, 77% of our long and short-term debt was denominated in US dollars. Accordingly, the translation effect of the assets is not balanced by a similar translation effect of the liabilities.

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.

	Year ended December 31,			
	2013		**2012**	
	(in thousands of US$, except percentages)			
Drilling and related services	3,460,047	99.2%	3,222,830	99.6%
Other sales and services	27,883	0.8%	14,503	0.4%
Total Revenue	**3,487,930**	**100%**	**3,237,333**	**100%**

Our revenue from drilling and related services represented approximately 99.2% and 99.6% of our total revenue for the years ended December 31, 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 year ended December 31, 2013, accounted for approximately 66.0% of our total revenue. We provide our onshore drilling services to LUKOIL on the basis of a 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 the 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.

	Year ended December 31,			
	2013		2012	
	(in thousands of US$, except percentages)			
Cost of services, excluding depreciation and taxes,	**2,221,207**	**100%**	**2,151,336**	**100%**
Services of subcontractors	939,496	42.3%	936,797	43.5%
Wages and salaries	529,648	23.8%	488,407	22.7%
Materials	397,801	17.9%	414,288	19.3%
Fuel and energy	184,671	8.3%	152,785	7.1%
Transportation of employees to drilling fields	50,665	2.3%	40,003	1.9%
Leasing and rent	16,097	0.7%	20,781	1.0%
Other	102,829	4.6%	98,275	4.6%

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 years ended December 31, 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 operating results set forth below were affected by the 2.4% depreciation of the Russian ruble against the US dollar during the year ended December 31, 2013 as compared to 2012.

	Year ended December 31,			
	2013		**2012**	
	(in thousands of US$, except percentages)			
Total revenue	**3,487,930**	**100.0%**	**3,237,333**	**100%**
Cost of services, excluding depreciation and taxes	(2,221,207)	(63.7%)	(2,151,336)	(66.5%)
General and administrative expenses, excluding depreciation and taxes	(168,878)	(4.8%)	(161,270)	(5.0%)
Taxes other than income taxes	(157,680)	(4.5%)	(134,733)	(4.2%)
Depreciation	(265,929)	(7.6%)	(249,987)	(7.7%)
Gain on disposal of property,	1,608	0.0%	4,786	0.1%

plant and equipment				
Litigation settlement	(50,996)	(1.5%)	-	-
Income from operating activities	**624,848**	**17.9%**	**544,793**	**16.8%**
Interest expense	(58,254)	(1.7%)	(53,661)	(1.7%)
Interest income	17,189	0.5%	12,094	0.4%
Currency transaction (loss) gain	(705)	(0.0%)	631	0.0%
Other expenses	(615)	(0.0%)	(8)	(0.0%)
Income before income taxes	**582,463**	**16.7%**	**503,849**	**15.6%**
Income tax expense	(150,381)	(4.3%)	(121,840)	(3.8%)
Net income	**432,082**	**12.4%**	**382,009**	**11.8%**

Revenue

Revenue increased by US$250.6 million, or 7.7%, to US$3,487.9 million for 2013 from US$3,237.3 million in 2012. The increase was primarily due to an increase in services provided to our customers in most of our business lines. Overall, in US dollar terms the revenue increase is in line with the increase in drilling volumes, considering higher levels of high-value horizontal drilling, workover and sidetracking work, even despite the negative impact of a 2.4% depreciation of the Russian ruble against the US dollar in 2013 and decrease in reimbursable pass-through materials and technology services.

Cost of Services, Excluding Depreciation and Taxes

Cost of services, excluding depreciation and taxes, increased by US$69.9 million, or 3.2%, to US$2,221.2 million for 2013 from US$2,151.3 million for 2012. Cost of services, excluding depreciation and taxes, as a percentage of total revenue decreased from 66.5% for 2012 to 63.7% for 2013. The decrease as a percentage of total revenue was primarily attributable to efforts by the Group’s management to control costs and a decrease in reimbursable pass-through materials and services (such as, for example, telemetry and technology services). The increase in absolute terms was primarily due to the overall growth of our operations.

For 2013, services of subcontractors were US$939.5 million, or 42.3% of total cost of services, excluding depreciation and taxes, as compared to US$936.8 million, or 43.5% of total cost of services, excluding depreciation and taxes, for 2012. The decrease 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 in absolute dollar terms was offset by growth in volumes.

Wages and salaries for 2013 were US$529.6 million, or 23.8% of total cost of services, excluding depreciation and taxes, as compared to US$488.4 million, or 22.7% of total cost of services, excluding depreciation and taxes, for 2012. The increase in absolute terms was primarily driven by the formation of new crews in light of increased drilling volumes in 2013 over 2012 and growth in workover volumes where wages and salaries are a comparatively larger component of cost of services, excluding depreciation and taxes. The increase in wages and salaries as a percentage of total cost of services, excluding depreciation and taxes, also resulted from a decrease in the share of pass-through materials and 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, cost of materials was US$397.8 million, or 17.9% of total cost of services, excluding depreciation and taxes, as compared to US$414.3 million, or 19.3% of total cost of services, excluding depreciation and taxes, for the year ended December 31, 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 casing pipe. In absolute terms this decrease in pricing of pass-through casing pipe is offset by an increase in materials due to volume growth in our onshore business.

Fuel and energy costs for 2013 were US$184.7 million, or 8.3% of total cost of services, excluding depreciation and taxes, compared to US$152.8 million, or 7.1% of total cost of services, excluding depreciation and taxes, for 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 higher local prices.

Expenses relating to the transportation of employees to field locations for 2013 were US$50.7 million, or 2.3% of total cost of services, excluding depreciation and taxes, compared to US$40.0 million, or 1.9% of total cost of services, excluding depreciation and taxes, for 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 activity.

Leasing and rent costs for 2013 were US$16.1 million, or 0.7% of total cost of services, excluding depreciation and taxes, compared to US$20.8 million, or 1.0% of total cost of services, excluding depreciation and taxes, for 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$102.9 million and US$98.3 million of our total cost of services, excluding depreciation and taxes, for 2013 and 2012, respectively. The increase in absolute terms was primarily driven by growth in drilling volumes. As a percentage of total cost of services, excluding depreciation and taxes, other expenses were on the same level of 4.6% for both 2013 and 2012.

General and Administrative Expenses, Excluding Depreciation and Taxes

General and administrative expenses, excluding depreciation and taxes, increased by US$7.6 million, or 4.7%, to US$168.9 million for 2013, as compared to US$161.3 million for 2012. The increase in absolute dollar terms was primarily attributable to growth in volumes and indexation. As a percentage of total revenue, General and administrative expenses, excluding depreciation and taxes, decreased from 5.0% for 2012 to 4.8% for 2013 due to the fixed nature of such expenses.

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$23.0 million, or 17.0%, to US$157.7 million for 2013, as compared to US$134.7 million for 2012. Taxes other than income taxes as a percentage of total revenue increased from 4.2% for 2012 to 4.5% for 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 the 30% contribution bracket in 2013), formation of new drilling crews and growth in workover volumes where wages and salaries and consequently social taxes are a comparatively larger components of cost of services, excluding depreciation and taxes.

Depreciation

Depreciation increased by US$15.9 million, or 6.4%, to US$265.9 million for 2013 as compared to US$250.0 million for 2012. As a percentage of total revenue, depreciation slightly decreased from 7.7% for 2012 to 7.6% for 2013. The increase in absolute dollar terms was primarily the result of our on-going modernization program with consequent significant capital expenditures in property, plant and equipment for all of our business lines.

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

Gain on the disposal of property, plant and equipment amounted to US$1.6 million for 2013, as compared to US$4.8 million for 2012. This difference was primarily due to the timing of opportunistic sales of unneeded or obsolete equipment.

Litigation Settlement

Litigation settlement amounted to US$51.0 million for 2013, as compared to nil for 2012. In 2013 we recognized a claim provision as a result of a decision rendered in March 7, 2014 by the arbitration tribunal before the Stockholm Chamber of Commerce between China Petrochemical International Company Limited (CPIC) and a Group company. The Group is considering a challenge to this decision. For more details please refer to the commitments disclosure in the notes to our 2013 consolidated financial statements.

Income from Operating Activities

Income from operating activities increased by US$80.1 million, or 14.7%, to US$624.8 million for 2013, as compared to US$544.8 million for 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 16.8% for 2012 to 17.9% for 2013 (or 19.4% when excluding the above described litigation settlement claim provision). This was primarily due to the overall positive impact of our cost control efforts.

Interest Expense

Interest expense increased by US$4.6 million, or 8.6%, to US$58.3 million for 2013, compared to US$53.7 million for 2012. The increase in interest expense was primarily attributable to the impact of additional borrowings raised during 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 and US$24 million OAO Sberbank of Russia facility for our workover division. 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 (changed to 3 month Libor plus 3.3% effective 2014) and issued Eurobonds in the amount of USD$600 million bearing interest at 4.875% per annum.

Interest Income

Interest income increased by US$5.1 million, or 42.1%, to US$17.2 million for 2013 from US$12.1 million for 2012. The increase was primarily due to higher average cash balances during 2013 as compared to 2012 due to newly raised funds, as described above.

Currency Transaction Gain/(Loss)

Currency transaction loss amounted to US$0.7 million for 2013, as compared to a gain of US$0.6 million in 2012. The difference is considered immaterial.

Other Expenses

Amounts in this category represent unusual income or expense not resulting from our ordinary course of business activities. In 2013 we recognized expense in the amount of US$0.6 million as compared to nil during 2012. The difference is considered immaterial.

Income Before Income Taxes

Income before income taxes increased by US$78.6 million, or 15.6%, to US$582.5 million for 2013, compared to US$503.8 million for 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$28.5 million, or 23.4%, to US$150.4 million for 2013, compared to US$121.8 million for 2012. The increase was due primarily to a higher tax base. Our effective tax rate increased to 25.8% in 2013 from 24.2% in 2012. The increase in effective tax rate is attributable to a currently non-deductible litigation settlement claim provision in the amount of US$ 51.0 million, as described above.

Net Income

As a result of the foregoing factors, net income increased by US$50.1 million, or 13.1%, to US$432.1 million for 2013, compared to US$382.0 million for 2012.

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 years ended December 31, 2013 and 2012.

	Year ended December 31,	
	2013	**2012**
	(in thousands of US$)	
Net cash provided by operating activities	751,053	592,455
Net cash used in investing activities	(496,236)	(617,922)
Net cash provided by (used in) financing activities	248,667	(197,140)

Operating Activities

Net cash provided by operating activities amounted to US$751.1 million for 2013, as compared to US$592.5 million for 2012. This increase is primarily attributable 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$496.2 million for 2013, as compared to US$617.9 million for 2012. Investing activities in 2013 were impacted by the return of restricted cash in the amount of US$45.4 million which was posted as collateral for the issuance of a commercial letter of credit to Lamprell was replaced by an irrevocable renewable bank guarantee of the same amount from UniCredit Bank. Capital expenditures, including changes in restricted cash, during 2013 amounted to US$507.7 million (including US$120.4 million offshore capital expenditures out of which US$6.2 million is capitalized interest) as compared to US$620.0 million (including US$150 million offshore capital expenditures) in 2012. There were no strategic acquisitions during 2013 and 2012.

Financing Activities

Net cash provided by financing activities amounted to US$248.7 million for 2013, compared to net cash of US$197.1 million used by financing activities for 2012. During both periods, dividends were paid and certain debt was redeemed in accordance with its terms. During 2013, we raised US$600 million through a Eurobond offering and US$210.8 million through a new credit line facility with UniCredit Bank, and made an early repayment of our Raiffeisenbank facility in the amount of US$220 million and OAO Sberbank of Russia facility for our workover division in the amount of US$24 million, while during 2012 there were no new credit facilities nor early repayments.

Liquidity

As of December 31, 2013 we had cash and cash equivalents of US$777.8 million compared to US$305.3 million at December 31, 2012.

	At December 31, 2013	**At December 31, 2012**
	(in thousands of US$)	
Short term deposit – Russian rubles	285,770	128,295
Cash held in banks – mostly US dollars	249,630	19,118
Cash held in banks – Russian rubles	231,178	154,992
Short term deposit - US dollars	11,113	2,805
Other	101	123
Total cash and cash equivalents	**777,792**	**305,333**

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 years ended December 31, 2013 and 2012 advances given for property, plant and equipment amounted to the following:

	At December 31, 2013	At December 31, 2012
	(in thousands of US$)	
Advances given for property, plant and equipment	90,493	275,641

The amounts represent cash advances for property, plant and equipment purchased but for which we have not yet taken delivery. The decrease in advances given for property, plant, and equipment in 2013 is explained by the reclassification of advances for our new-build jack-up rigs *NEPTUNE* and *MERCURY* from Advances given for property, plant and equipment to Construction in progress in the amount of US$227.7 million. This decrease was partially offset by the increase in advances paid for the construction of new onshore drilling rigs and equipment in the amount of US$42.6 million.

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

	At December 31, 2013	At December 31, 2012
	(in thousands of US$)	
Construction in progress	494,735	51,568

The increase in construction in progress in 2013 is mostly due to reclassification of advances for new-build jack-up rigs, as described above. In addition, during 2013 we made instalment payments to Lamprell in the amount of US$90.8 million for the construction of our second new-build jack-up rig, *MERCURY*, and US$42 million final payment for the construction of *NEPTUNE*.

Capital Resources

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

	At December 31, 2013	At December 31, 2012
	(in thousands of US$)	
Current portion of long-term debt	104,394	257,860
Non-current long-term debt	1,010,086	442,013

As of December 31, 2013, our loans and borrowings were comprised of the following:

Long-term debt	Final maturity date	Currency	Interest Rate	Outstanding debt *(in thousands of US$)*	Security
Debt of the Company					
ZAO UniCredit Bank	2017	USD	LIBOR + 3.3%	210,800	Property, plant and equipment
Loans from stockholders	2014	USD	5.8%	50,000	None
Debt of our subsidiaries					
Bank loans					
OAO Sberbank of Russia	2014	RUB	7.7%	20,369	None
Eurobonds	2020	USD	4.875%	600,000	None
Russian ruble bonds	2018	RUB	8.4%	152,769	None
OOO Rushong-Hua	2016	RUB	5%-6.3%	80,542	None
Total long-term debt				**1,114,480**	

Total non-current long-term debt	**1,010,086**

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 December 31, 2013. 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	**2014**	**2015**	**2016**	**2017**	**2018**	**2019 and thereafter**
	(in thousands of US$)						
Contractual Obligations							
Long-term debt	1,114,480	104,394	31,049	15,468	210,800	152,769	600,000

Our long-term debt and overdraft lines are secured by certain property, plant and equipment with a carrying amount of US$165.9 million as of December 31, 2013. At the same time, our secured debt represented approximately 19% of our total long and short-term debt.

As of December 31, 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 2013 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, 2013 a dividend was declared by the Board of Directors on December 10, 2013 in the amount of 92 cents per share, or US$135 million, which was included in "Accounts payable and accrued liabilities" and paid on January 17, 2014. For 2012 a dividend of 70 cents per share, or US$103 million, was declared in December 2012 and paid early in 2013.

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. Also during the reporting period 25,092 shares were transferred to Directors in lieu of cash for their service. As of December 31, 2013 there were 53,875 shares held in treasury.

In February 2014, we announced that we may buy back up to US $200 million of our GDRs commencing April 2, 2014 for a period of six months.

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 periods indicated was as follows:

	Year ended December 31,	
	2013	**2012**
Net income available for common stockholders ('000 US dollars)	432,082	382,009
Weighted average number of outstanding shares	146,778,795	146,782,754
Basic earnings per share of common stock (US dollars)	2.94	2.60
Contingent shares of the Plan	-	875,260
Weighted average number of outstanding shares, after dilution	146,778,795	147,658,014
Diluted earnings per share of common stock (US dollars)	2.94	2.59

In 2013, earnings per share calculated on a fully diluted basis are equal to basic earnings per share. Earnings per share amounted to US$2.94 in 2013, compared to diluted earnings per share of US$2.59 or basic earnings per share of US$2.60 in 2012. The improvement in earnings per share was attributable to the increase in net income by 13.1% in 2013 compared to 2012.

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$2.9 million yearly interest was recognised and paid on these loans during both 2013 and 2012. 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 years ended December 31, 2013 and 2012 the Firm billed EDC for costs and expenses of US$3.9 million and US$2.0 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 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 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. During the reporting period the loan was collected. Additionally during the reporting period the Group acquired services and equipment from OOO Kliver. In relation to these services the Group recognized expenses in amount of USD 2.6 million during year ended December 31, 2013 (2012: nil). The total amount of purchased equipment during the reporting period was USD 6.3 million (2012: nil). As of December 31, 2013 advances paid to OOO Kliver amounted to USD 2 million (as of December 31, 2012: USD 5.4 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:

	2013	2012
	(in thousands of US$)	
LUKOIL revenue for the years ended December 31	2,302,686	2,054,724
LUKOIL accounts receivable as of December 31, 2013 and 2012	221,354	260,781
Rosneft revenue for the years ended December 31	659,004	691,829
Rosneft accounts receivable as of December 31, 2013 and 2012	74,426	84,813

The LUKOIL Group made up approximately 66.0% and 63.5% of our sales for the years ended December 31, 2013 and 2012, respectively. The Rosneft Group made up approximately 18.9% and 21.4% of our sales for the years ended December 31, 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 years ended December 31, 2013 and 2012. Our allowance for doubtful accounts stood at US$11.8 million at December 31, 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 December 31 relating to debt obligations as of December 31, 2013:

	Scheduled Maturity (in millions of US$, except percentages)							Fair Value
	2014	2015	2016	2017	2018	2019 and Thereafter	Total	December 31, 2013
Total long term debt	104.4	31.0	15.5	210.8	152.8	600.0	1,114.5	1,097.8
Fixed rate	104.4	31.0	15.5		152.8	600.0	903.7	887.0
Average interest rate	5.6%	5.6%	5.6%	5.6%	5.6%	4.9%		
Variable rate*				210.8			210.8	210.8
Average interest rate	3.7%	3.7%	3.7%	3.7%				

* Based on the LIBOR rate at the end of 2013, 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 December 31, 2013 we had US$253.7 million of a total of US$1,114.5 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 revenues 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.